

**PROTECTING EMPLOYEES AND RETIREES IN  
BUSINESS BANKRUPTCIES ACT OF 2010**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
COMMERCIAL AND ADMINISTRATIVE LAW  
OF THE  
COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED ELEVENTH CONGRESS  
SECOND SESSION

ON

**H.R. 4677**

MAY 25, 2010

**Serial No. 111-123**

Printed for the use of the Committee on the Judiciary



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## **PROTECTING EMPLOYEES AND RETIREES IN BUSINESS BANKRUPTCIES ACT OF 2010**

**TUESDAY, MAY 25, 2010**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COMMERCIAL  
AND ADMINISTRATIVE LAW,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 11:05 a.m., in Room 2142, Rayburn House Office Building, the Honorable Steve Cohen (Chairman of the Subcommittee) presiding.

Present: Representatives Cohen, Delahunt, Watt, Lofgren, Scott, Chu, Franks, Jordan, Coble, and Issa.

Staff Present: (Majority) James Park, Counsel; Andrés Jimenez, Staff Assistant; and (Minority) Daniel Flores, Counsel.

Mr. COHEN. This hearing of the Committee on the Judiciary, Subcommittee on Commercial and Administrative Law will come to order. Without objection, I shall be authorized to declare a recess to the hearing.

I now recognize myself for a brief statement. Congress enacted Chapter 11 of the Bankruptcy Code to give all interested parties a say in how a struggling business should be reorganized. In theory, financial returns and sacrifices should be shared in an equitable manner.

In the 110th Congress, this Subcommittee conducted three hearings on how American workers and retirees are treated in cases under Chapter 11. These hearings revealed that Chapter 11 may not be working as we intended, with some businesses using the bankruptcy process to bust unions and deprive retirees of hard-won wages and benefits, while at the same time paying their executives outrageous amounts of money; millions and millions and millions of dollars.

Even prior to the country's recent economy troubles, workers and retirees had been hit very hard by the growing number of corporate bankruptcies. Working families have been asked, and in many cases forced to make substantial sacrifices including cuts in pay and benefits and wholesale default by their bankrupt employers on their pension obligations.

To pick just one example, United Airlines successfully convinced a bankruptcy court to terminate its collective bargaining agreements with new, harsher terms implemented in their place. United pilots had to take a 30-percent pay cut, less job security, harsher work rules, and a terminated pension plan. They were also forced

to call the company's telephones and be put on hold for a long time, like customers are too, and be intermittently told which button to push.

United employees faced the threat of personal bankruptcy, a loss of retiree medical benefits and other significant financial hardship, after having devoted years of their lives to their company. Sadly, this story seems to repeat itself through many cases in many different industries.

The sting of these sacrifices may have been slightly easier for workers and retirees to stomach were it not for the fact that these same bankrupt employers would be paying their CEOs and other senior management executives almost what could conservatively be called obscene amounts of compensation.

These are the reasons why I am an original cosponsor of the House Judiciary Committee Chairman John Conyers' bill, H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act" which makes urgently needed changes to the Bankruptcy Code to ensure that the interests of workers and retirees are protected in corporate bankruptcies and to ensure that executive compensation is reasonable and fair.

[The bill, H.R. 4677, follows:]



111TH CONGRESS  
2D SESSION

# H. R. 4677

To amend title 11, United States Code, to improve protections for employees and retirees in business bankruptcies.

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## IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 24, 2010

Mr. CONYERS (for himself, Mr. COHEN, Mr. NADLER of New York, Mr. HARE, Mr. FILNER, Mr. DELAHUNT, Ms. BALDWIN, Mr. KENNEDY, Mr. THOMPSON of Mississippi, Ms. SUTTON, Mr. KILDEE, Ms. CHU, Mr. MICHAUD, Mr. JOHNSON of Georgia, Mr. GEORGE MILLER of California, Mr. HALL of New York, Mr. SERES, and Mr. RYAN of Ohio) introduced the following bill; which was referred to the Committee on the Judiciary

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## A BILL

To amend title 11, United States Code, to improve protections for employees and retirees in business bankruptcies.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

### 3 SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

4 (a) SHORT TITLE.—This Act may be cited as the  
5 “Protecting Employees and Retirees in Business Bank-  
6 ruptcies Act of 2010”.

7 (b) TABLE OF CONTENTS.—The table of contents of  
8 this Act is as follows:

Sec. 1. Short title; table of contents.

Sec. 2. Findings.

#### TITLE I—IMPROVING RECOVERIES FOR EMPLOYEES AND RETIREES

Sec. 101. Increased wage priority.

Sec. 102. Claim for stock value losses in defined contribution plans.

Sec. 103. Priority for severance pay.

Sec. 104. Financial returns for employees and retirees.

Sec. 105. Priority for WARN Act damages.

#### TITLE II—REDUCING EMPLOYEES' AND RETIREES' LOSSES

Sec. 201. Rejection of collective bargaining agreements.

Sec. 202. Payment of insurance benefits to retired employees.

Sec. 203. Protection of employee benefits in a sale of assets.

Sec. 204. Claim for pension losses.

Sec. 205. Payments by secured lender.

Sec. 206. Preservation of jobs and benefits.

Sec. 207. Termination of exclusivity.

#### TITLE III—RESTRICTING EXECUTIVE COMPENSATION PROGRAMS

Sec. 301. Executive compensation upon exit from bankruptcy.

Sec. 302. Limitations on executive compensation enhancements.

Sec. 303. Assumption of executive benefit plans.

Sec. 304. Recovery of executive compensation.

Sec. 305. Preferential compensation transfer.

#### TITLE IV—OTHER PROVISIONS

Sec. 401. Union proof of claim.

Sec. 402. Exception from automatic stay.

### 1 SEC. 2. FINDINGS.

2 The Congress finds the following:

3 (1) Business bankruptcies have increased  
 4 sharply over the past year and remain at high levels.  
 5 These bankruptcies include several of the largest  
 6 business bankruptcy filings in history. As the use of  
 7 bankruptcy has expanded, job preservation and re-  
 8 tirement security are placed at greater risk.

9 (2) Laws enacted to improve recoveries for em-  
 10 ployees and retirees and limit their losses in bank-

1       ruptcy cases have not kept pace with the increasing  
2       and broader use of bankruptcy by businesses in all  
3       sectors of the economy. However, while protections  
4       for employees and retirees in bankruptcy cases have  
5       eroded, management compensation plans devised for  
6       those in charge of troubled businesses have become  
7       more prevalent and are escaping adequate scrutiny.

8       (3) Changes in the law regarding these matters  
9       are urgently needed as bankruptcy is used to ad-  
10      dress increasingly more complex and diverse condi-  
11      tions affecting troubled businesses and industries.

12 **TITLE I—IMPROVING RECOV-**  
13 **ERIES FOR EMPLOYEES AND**  
14 **RETIREEES**

15 **SEC. 101. INCREASED WAGE PRIORITY.**

16       Section 507(a) of title 11, United States Code, is  
17 amended—

18       (1) in paragraph (4)—

19               (A) by striking “\$10,000” and inserting  
20               “\$20,000”;

21               (B) by striking “within 180 days”; and

22               (C) by striking “or the date of the ces-  
23       sation of the debtor’s business, whichever oc-  
24       curs first,”;

25       (2) in paragraph (5)(A), by striking—

1 (A) “within 180 days”; and  
2 (B) “or the date of the cessation of the  
3 debtor’s business, whichever occurs first”; and  
4 (3) in paragraph (5), by striking subparagraph  
5 (B) and inserting the following:  
6 “(B) for each such plan, to the extent of  
7 the number of employees covered by each such  
8 plan, multiplied by \$20,000.”.

9 **SEC. 102. CLAIM FOR STOCK VALUE LOSSES IN DEFINED**  
10 **CONTRIBUTION PLANS.**

11 Section 101(5) of title 11, United States Code, is  
12 amended—

13 (1) in subparagraph (A), by striking “or” at  
14 the end;

15 (2) in subparagraph (B), by inserting “or”  
16 after the semicolon; and

17 (3) by adding at the end the following:

18 “(C) right or interest in equity securities  
19 of the debtor, or an affiliate of the debtor, held  
20 in a defined contribution plan (within the mean-  
21 ing of section 3(34) of the Employee Retirement  
22 Income Security Act of 1974 (29 U.S.C.  
23 1002(34))) for the benefit of an individual who  
24 is not an insider, a senior executive officer, or  
25 any of the 20 next most highly compensated

1 employees of the debtor (if 1 or more are not  
2 insiders), if such securities were attributable to  
3 either employer contributions by the debtor or  
4 an affiliate of the debtor, or elective deferrals  
5 (within the meaning of section 402(g) of the In-  
6 ternal Revenue Code of 1986), and any earn-  
7 ings thereon, if an employer or plan sponsor  
8 who has commenced a case under this title has  
9 committed fraud with respect to such plan or  
10 has otherwise breached a duty to the partici-  
11 pant that has proximately caused the loss of  
12 value.”.

13 **SEC. 103. PRIORITY FOR SEVERANCE PAY.**

14 Section 503(b) of title 11, United States Code, is  
15 amended—

16 (1) in paragraph (8), by striking “and” at the  
17 end;

18 (2) in paragraph (9), by striking the period and  
19 inserting “; and”; and

20 (3) by adding at the end the following:

21 “(10) severance pay owed to employees of the  
22 debtor (other than to an insider, other senior man-  
23 agement, or a consultant retained to provide services  
24 to the debtor), under a plan, program, or policy gen-  
25 erally applicable to employees of the debtor (but not

1 under an individual contract of employment), or  
2 owed pursuant to a collective bargaining agreement,  
3 for layoff or termination on or after the date of the  
4 filing of the petition, which pay shall be deemed  
5 earned in full upon such layoff or termination of em-  
6 ployment.”.

7 **SEC. 104. FINANCIAL RETURNS FOR EMPLOYEES AND RE-**  
8 **TIREES.**

9 Section 1129(a) of title 11, United States Code is  
10 amended—

11 (1) by adding at the end the following:

12 “(17) The plan provides for recovery of dam-  
13 ages payable for the rejection of a collective bar-  
14 gaining agreement, or for other financial returns as  
15 negotiated by the debtor and the authorized rep-  
16 resentative under section 1113 (to the extent that  
17 such returns are paid under, rather than outside of,  
18 a plan).”; and

19 (2) by striking paragraph (13) and inserting  
20 the following:

21 “(13) With respect to retiree benefits, as that  
22 term is defined in section 1114(a), the plan—

23 “(A) provides for the continuation after its  
24 effective date of payment of all retiree benefits  
25 at the level established pursuant to subsection

(e)(1)(B) or (g) of section 1114 at any time before the date of confirmation of the plan, for the duration of the period for which the debtor has obligated itself to provide such benefits, or if no modifications are made before confirmation of the plan, the continuation of all such retiree benefits maintained or established in whole or in part by the debtor before the date of the filing of the petition; and

“(B) provides for recovery of claims arising from the modification of retiree benefits or for other financial returns, as negotiated by the debtor and the authorized representative (to the extent that such returns are paid under, rather than outside of, a plan).”.

**SEC. 105. PRIORITY FOR WARN ACT DAMAGES.**

Section 503(b)(1)(A)(ii) of title 11, United States Code is amended to read as follows:

“(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay or damages attributable to any period of time occurring after the date of commencement of the case under this title, as a result of a violation of Fed-

1           eral or State law by the debtor, without re-  
2           gard to the time of the occurrence of un-  
3           lawful conduct on which the award is  
4           based or to whether any services were ren-  
5           dered on or after the commencement of the  
6           case, including an award by a court under  
7           section 2901 of title 29, United States  
8           Code, of up to 60 days' pay and benefits  
9           following a layoff that occurred or com-  
10          menced at a time when such award period  
11          includes a period on or after the com-  
12          mencement of the case, if the court deter-  
13          mines that payment of wages and benefits  
14          by reason of the operation of this clause  
15          will not substantially increase the prob-  
16          ability of layoff or termination of current  
17          employees or of nonpayment of domestic  
18          support obligations during the case under  
19          this title.”.



1 **TITLE II—REDUCING EMPLOY-**  
2 **EES’ AND RETIREES’ LOSSES**

3 **SEC. 201. REJECTION OF COLLECTIVE BARGAINING AGREE-**  
4 **MENTS.**

5 Section 1113 of title 11, United States Code, is  
6 amended by striking subsections (a) through (f) and in-  
7 serting the following:

8 “(a) The debtor in possession, or the trustee if one  
9 has been appointed under this chapter, other than a trust-  
10 ee in a case covered by subchapter IV of this chapter and  
11 by title I of the Railway Labor Act, may reject a collective  
12 bargaining agreement only in accordance with this section.  
13 Hereinafter in this section, a reference to the trustee in-  
14 cludes a reference to the debtor in possession.

15 “(b) No provision of this title shall be construed to  
16 permit the trustee to unilaterally terminate or alter any  
17 provision of a collective bargaining agreement before com-  
18 plying with this section. The trustee shall timely pay all  
19 monetary obligations arising under the terms of the collec-  
20 tive bargaining agreement. Any such payment required to  
21 be made before a plan confirmed under section 1129 is  
22 effective has the status of an allowed administrative ex-  
23 pense under section 503.

24 “(c)(1) If the trustee seeks modification of a collec-  
25 tive bargaining agreement, then the trustee shall provide

1 notice to the labor organization representing the employ-  
2 ees covered by the agreement that modifications are being  
3 proposed under this section, and shall promptly provide  
4 an initial proposal for modifications to the agreement.  
5 Thereafter, the trustee shall confer in good faith with the  
6 labor organization, at reasonable times and for a reason-  
7 able period in light of the complexity of the case, in at-  
8 tempting to reach mutually acceptable modifications of  
9 such agreement.

10 “(2) The initial proposal and subsequent proposals  
11 by the trustee for modification of a collective bargaining  
12 agreement shall be based upon a business plan for the re-  
13 organization of the debtor, and shall reflect the most com-  
14 plete and reliable information available. The trustee shall  
15 provide to the labor organization all information that is  
16 relevant for negotiations. The court may enter a protective  
17 order to prevent the disclosure of information if disclosure  
18 could compromise the debtor’s position with respect to its  
19 competitors in the industry, subject to the needs of the  
20 labor organization to evaluate the trustee’s proposals and  
21 any application for rejection of the agreement or for in-  
22 terim relief pursuant to this section.

23 “(3) In consideration of Federal policy encouraging  
24 the practice and process of collective bargaining and in  
25 recognition of the bargained-for expectations of the em-

1 ployees covered by the agreement, modifications proposed  
2 by the trustee—

3 “(A) shall be proposed only as part of a pro-  
4 gram of workforce and nonworkforce cost savings  
5 devised for the reorganization of the debtor, includ-  
6 ing savings in management personnel costs;

7 “(B) shall be limited to modifications designed  
8 to achieve a specified aggregate financial contribu-  
9 tion for the employees covered by the agreement  
10 (taking into consideration any labor cost savings ne-  
11 gotiated within the 12-month period before the filing  
12 of the petition), and shall be not more than the min-  
13 imum savings essential to permit the debtor to exit  
14 bankruptcy, such that confirmation of a plan of re-  
15 organization is not likely to be followed by the liq-  
16 uidation, or the need for further financial reorga-  
17 nization, of the debtor (or any successor to the debt-  
18 or) in the short-term; and

19 “(C) shall not be disproportionate or overly bur-  
20 den the employees covered by the agreement, either  
21 in the amount of the cost savings sought from such  
22 employees or the nature of the modifications.

23 “(d)(1) If, after a period of negotiations, the trustee  
24 and the labor organization have not reached an agreement  
25 over mutually satisfactory modifications, and further ne-

1 negotiations are not likely to produce mutually satisfactory  
2 modifications, the trustee may file a motion seeking rejection  
3 of the collective bargaining agreement after notice  
4 and a hearing. Absent agreement of the parties, no such  
5 hearing shall be held before the expiration of the 21-day  
6 period beginning on the date on which notice of the hearing  
7 is provided to the labor organization representing the  
8 employees covered by the agreement. Only the debtor and  
9 the labor organization may appear and be heard at such  
10 hearing. An application for rejection shall seek rejection  
11 effective upon the entry of an order granting the relief.

12 “(2) In consideration of Federal policy encouraging  
13 the practice and process of collective bargaining and in  
14 recognition of the bargained-for expectations of the employees  
15 covered by the agreement, the court may grant a  
16 motion seeking rejection of a collective bargaining agreement  
17 only if, based on clear and convincing evidence—

18 “(A) the court finds that the trustee has complied  
19 with the requirements of subsection (c);

20 “(B) the court has considered alternative proposals  
21 by the labor organization and has concluded  
22 that such proposals do not meet the requirements of  
23 paragraph (3)(B) of subsection (c);

24 “(C) the court finds that further negotiations  
25 regarding the trustee’s proposal or an alternative

1       proposal by the labor organization are not likely to  
2       produce an agreement;

3               “(D) the court finds that implementation of the  
4       trustee’s proposal shall not—

5               “(i) cause a material diminution in the  
6               purchasing power of the employees covered by  
7               the agreement;

8               “(ii) adversely affect the ability of the  
9               debtor to retain an experienced and qualified  
10              workforce; or

11              “(iii) impair the debtor’s labor relations  
12              such that the ability to achieve a feasible reor-  
13              ganization would be compromised; and

14              “(E) the court concludes that rejection of the  
15              agreement and immediate implementation of the  
16              trustee’s proposal is essential to permit the debtor to  
17              exit bankruptcy, such that confirmation of a plan of  
18              reorganization is not likely to be followed by liquida-  
19              tion, or the need for further financial reorganization,  
20              of the debtor (or any successor to the debtor) in the  
21              short term.

22              “(3) If the trustee has implemented a program of in-  
23              centive pay, bonuses, or other financial returns for insid-  
24              ers, senior executive officers, or the 20 next most highly  
25              compensated employees or consultants providing services

1 to the debtor during the bankruptcy, or such a program  
2 was implemented within 180 days before the date of the  
3 filing of the petition, the court shall presume that the  
4 trustee has failed to satisfy the requirements of subsection  
5 (c)(3)(C).

6 “(4) In no case shall the court enter an order reject-  
7 ing a collective bargaining agreement that would result in  
8 modifications to a level lower than the level proposed by  
9 the trustee in the proposal found by the court to have com-  
10 plied with the requirements of this section.

11 “(5) At any time after the date on which an order  
12 rejecting a collective bargaining agreement is entered, or  
13 in the case of an agreement entered into between the  
14 trustee and the labor organization providing mutually sat-  
15 isfactory modifications, at any time after such agreement  
16 has been entered into, the labor organization may apply  
17 to the court for an order seeking an increase in the level  
18 of wages or benefits, or relief from working conditions,  
19 based upon changed circumstances. The court shall grant  
20 the request only if the increase or other relief is not incon-  
21 sistent with the standard set forth in paragraph (2)(E).

22 “(e) During a period in which a collective bargaining  
23 agreement at issue under this section continues in effect,  
24 and if essential to the continuation of the debtor’s busi-  
25 ness or in order to avoid irreparable damage to the estate,

1 the court, after notice and a hearing, may authorize the  
2 trustee to implement interim changes in the terms, condi-  
3 tions, wages, benefits, or work rules provided by the collec-  
4 tive bargaining agreement. Any hearing under this sub-  
5 section shall be scheduled in accordance with the needs  
6 of the trustee. The implementation of such interim  
7 changes shall not render the application for rejection  
8 moot.

9 “(f) Rejection of a collective bargaining agreement  
10 constitutes a breach of the agreement, and shall be effec-  
11 tive no earlier than the entry of an order granting such  
12 relief. Notwithstanding the foregoing, solely for purposes  
13 of determining and allowing a claim arising from the rejec-  
14 tion of a collective bargaining agreement, rejection shall  
15 be treated as rejection of an executory contract under sec-  
16 tion 365(g) and shall be allowed or disallowed in accord-  
17 ance with section 502(g)(1). No claim for rejection dam-  
18 ages shall be limited by section 502(b)(7). Economic self-  
19 help by a labor organization shall be permitted upon a  
20 court order granting a motion to reject a collective bar-  
21 gaining agreement under subsection (d) or pursuant to  
22 subsection (e), and no provision of this title or of any other  
23 provision of Federal or State law may be construed to the  
24 contrary.

1 “(g) The trustee shall provide for the reasonable fees  
2 and costs incurred by a labor organization under this sec-  
3 tion, upon request and after notice and a hearing.

4 “(h) A collective bargaining agreement that is as-  
5 sumed shall be assumed in accordance with section 365.”.

6 **SEC. 202. PAYMENT OF INSURANCE BENEFITS TO RETIRED**  
7 **EMPLOYEES.**

8 Section 1114 of title 11, United States Code, is  
9 amended—

10 (1) in subsection (a), by inserting “, whether or  
11 not the debtor asserts a right to unilaterally modify  
12 such payments under such plan, fund, or program”  
13 before the period at the end;

14 (2) in subsection (b)(2), by inserting after “sec-  
15 tion” the following: “, and a labor organization serv-  
16 ing as the authorized representative under sub-  
17 section (c)(1),”;

18 (3) in subsection (f), by striking “(f)” and all  
19 that follows through paragraph (2) and inserting the  
20 following:

21 “(f)(1) If a trustee seeks modification of retiree bene-  
22 fits, then the trustee shall provide a notice to the author-  
23 ized representative that modifications are being proposed  
24 pursuant to this section, and shall promptly provide an  
25 initial proposal. Thereafter, the trustee shall confer in



1 good faith with the authorized representative at reason-  
2 able times and for a reasonable period in light of the com-  
3 plexity of the case in attempting to reach mutually satis-  
4 factory modifications.

5 “(2) The initial proposal and subsequent proposals  
6 by the trustee shall be based upon a business plan for the  
7 reorganization of the debtor and shall reflect the most  
8 complete and reliable information available. The trustee  
9 shall provide to the authorized representative all informa-  
10 tion that is relevant for the negotiations. The court may  
11 enter a protective order to prevent the disclosure of infor-  
12 mation if disclosure could compromise the debtor’s posi-  
13 tion with respect to its competitors in the industry, subject  
14 to the needs of the authorized representative to evaluate  
15 the trustee’s proposals and an application pursuant to  
16 subsection (g) or (h).

17 “(3) Modifications proposed by the trustee—

18 “(A) shall be proposed only as part of a pro-  
19 gram of workforce and nonworkforce cost savings  
20 devised for the reorganization of the debtor, includ-  
21 ing savings in management personnel costs;

22 “(B) shall be limited to modifications that are  
23 designed to achieve a specified aggregate financial  
24 contribution for the retiree group represented by the  
25 authorized representative (taking into consideration

1 any cost savings implemented within the 12-month  
2 period before the date of filing of the petition with  
3 respect to the retiree group), and shall be no more  
4 than the minimum savings essential to permit the  
5 debtor to exit bankruptcy, such that confirmation of  
6 a plan of reorganization is not likely to be followed  
7 by the liquidation, or the need for further financial  
8 reorganization, of the debtor (or any successor to  
9 the debtor) in the short term; and

10 “(C) shall not be disproportionate or overly bur-  
11 den the retiree group, either in the amount of the  
12 cost savings sought from such group or the nature  
13 of the modifications.”;

14 (4) in subsection (g)—

15 (A) by striking “(g)” and all that follows  
16 through the semicolon at the end of paragraph  
17 (3) and inserting the following:

18 “(g)(1) If, after a period of negotiations, the trustee  
19 and the authorized representative have not reached agree-  
20 ment over mutually satisfactory modifications and further  
21 negotiations are not likely to produce mutually satisfac-  
22 tory modifications, then the trustee may file a motion  
23 seeking modifications in the payment of retiree benefits  
24 after notice and a hearing. Absent agreement of the par-  
25 ties, no such hearing shall be held before the expiration

1 of the 21-day period beginning on the date on which notice  
2 of the hearing is provided to the authorized representative.  
3 Only the debtor and the authorized representative may ap-  
4 pear and be heard at such hearing.

5 “(2) The court may grant a motion to modify the  
6 payment of retiree benefits only if, based on clear and con-  
7 vincing evidence—

8 “(A) the court finds that the trustee has com-  
9 plied with the requirements of subsection (f);

10 “(B) the court has considered alternative pro-  
11 posals by the authorized representative and has de-  
12 termined that such proposals do not meet the re-  
13 quirements of subsection (f)(3)(B);

14 “(C) the court finds that further negotiations  
15 regarding the trustee’s proposal or an alternative  
16 proposal by the authorized representative are not  
17 likely to produce a mutually satisfactory agreement;

18 “(D) the court finds that implementation of the  
19 proposal shall not cause irreparable harm to the af-  
20 fected retirees; and

21 “(E) the court concludes that an order granting  
22 the motion and immediate implementation of the  
23 trustee’s proposal is essential to permit the debtor to  
24 exit bankruptcy, such that confirmation of a plan of  
25 reorganization is not likely to be followed by liquida-

1       tion, or the need for further financial reorganization,  
2       of the debtor (or a successor to the debtor) in the  
3       short term.

4       “(3) If a trustee has implemented a program of in-  
5       centive pay, bonuses, or other financial returns for insid-  
6       ers, senior executive officers, or the 20 next most highly-  
7       compensated employees or consultants providing services  
8       to the debtor during the bankruptcy, or such a program  
9       was implemented within 180 days before the date of the  
10      filing of the petition, the court shall presume that the  
11      trustee has failed to satisfy the requirements of subpara-  
12      graph (f)(3)(C).”; and

13               (B) by striking “except that in no case”  
14              and inserting the following:

15      “(4) In no case”; and

16              (5) by striking subsection (k) and redesignating  
17      subsections (l) and (m) as subsections (k) and (l),  
18      respectively.

19   **SEC. 203. PROTECTION OF EMPLOYEE BENEFITS IN A SALE**  
20                   **OF ASSETS.**

21      Section 363(b) of title 11, United States Code, is  
22      amended by adding at the end the following:

23      “(3) In approving a sale under this subsection, the  
24      court shall consider the extent to which a bidder has of-  
25      fered to maintain existing jobs, preserve terms and condi-

1 tions of employment, and assume or match pension and  
2 retiree health benefit obligations in determining whether  
3 an offer constitutes the highest or best offer for such prop-  
4 erty.”.

5 **SEC. 204. CLAIM FOR PENSION LOSSES.**

6 Section 502 of title 11, United States Code, is  
7 amended by adding at the end the following:

8 “(l) The court shall allow a claim asserted by an ac-  
9 tive or retired participant, or by a labor organization rep-  
10 resenting such participants, in a defined benefit plan ter-  
11 minated under section 4041 or 4042 of the Employee Re-  
12 tirement Income Security Act of 1974, for any shortfall  
13 in pension benefits accrued as of the effective date of the  
14 termination of such pension plan as a result of the termi-  
15 nation of the plan and limitations upon the payment of  
16 benefits imposed pursuant to section 4022 of such Act,  
17 notwithstanding any claim asserted and collected by the  
18 Pension Benefit Guaranty Corporation with respect to  
19 such termination.

20 “(m) The court shall allow a claim of a kind described  
21 in section 101(5)(C) by an active or retired participant  
22 in a defined contribution plan (within the meaning of sec-  
23 tion 3(34) of the Employee Retirement Income Security  
24 Act of 1974 (29 U.S.C. 1002(34))), or by a labor organi-  
25 zation representing such participants. The amount of such

1 claim shall be measured by the market value of the stock  
 2 at the time of contribution to, or purchase by, the plan  
 3 and the value as of the commencement of the case.”.

4 **SEC. 205. PAYMENTS BY SECURED LENDER.**

5 Section 506(c) of title 11, United States Code, is  
 6 amended by adding at the end the following: “If employees  
 7 have not received wages, accrued vacation, severance, or  
 8 other benefits owed under the policies and practices of the  
 9 debtor, or pursuant to the terms of a collective bargaining  
 10 agreement, for services rendered on and after the date of  
 11 the commencement of the case, then such unpaid obliga-  
 12 tions shall be deemed necessary costs and expenses of pre-  
 13 serving, or disposing of, property securing an allowed se-  
 14 cured claim and shall be recovered even if the trustee has  
 15 otherwise waived the provisions of this subsection under  
 16 an agreement with the holder of the allowed secured claim  
 17 or a successor or predecessor in interest.”.

18 **SEC. 206. PRESERVATION OF JOBS AND BENEFITS.**

19 Title 11, United States Code, is amended—

20 (1) by inserting before section 1101 the fol-  
 21 lowing:

22 **“SEC. 1100. STATEMENT OF PURPOSE.**

23 “A debtor commencing a case under this chapter  
 24 shall have as its principal purpose the reorganization of  
 25 its business to preserve going concern value to the max-

1 imum extent possible through the productive use of its as-  
2 sets and the preservation of jobs that will sustain produc-  
3 tive economic activity.”;

4 (2) in section 1129(a), as amended by section  
5 104, by adding at the end the following:

6 “(18) The debtor has demonstrated that the re-  
7 organization preserves going concern value to the  
8 maximum extent possible through the productive use  
9 of the debtor’s assets and preserves jobs that sustain  
10 productive economic activity.”;

11 (3) in section 1129(c), by striking the last sen-  
12 tence and inserting the following: “If the require-  
13 ments of subsections (a) and (b) are met with re-  
14 spect to more than 1 plan, the court shall, in deter-  
15 mining which plan to confirm—

16 “(1) consider the extent to which each plan  
17 would preserve going concern value through the pro-  
18 ductive use of the debtor’s assets and the preserva-  
19 tion of jobs that sustain productive economic activ-  
20 ity; and

21 “(2) confirm the plan that better serves such  
22 interests.

23 A plan that incorporates the terms of a settlement with  
24 a labor organization representing employees of the debtor

1 shall presumptively constitute the plan that satisfies this  
2 subsection.”; and

3 (4) in the table of sections for chapter 11, by  
4 inserting the following before the item relating to  
5 section 1101:

“1100. Statement of purpose.”.

6 **SEC. 207. TERMINATION OF EXCLUSIVITY.**

7 Section 1121(d) of title 11, United States Code, is  
8 amended by adding at the end the following:

9 “(3) For purposes of this subsection, cause for reduc-  
10 ing the 120-day period or the 180-day period includes the  
11 following:

12 “(A) The filing of a motion pursuant to section  
13 1113 seeking rejection of a collective bargaining  
14 agreement if a plan based upon an alternative pro-  
15 posal by the labor organization is reasonably likely  
16 to be confirmed within a reasonable time.

17 “(B) The proposed filing of a plan by a pro-  
18 ponent other than the debtor, which incorporates the  
19 terms of a settlement with a labor organization if  
20 such plan is reasonably likely to be confirmed within  
21 a reasonable time.”.



1 **TITLE III—RESTRICTING EXECU-**  
2 **TIVE COMPENSATION PRO-**  
3 **GRAMS**

4 **SEC. 301. EXECUTIVE COMPENSATION UPON EXIT FROM**  
5 **BANKRUPTCY.**

6 Section 1129(a) of title 11, United States Code, is  
7 amended—

8 (1) in paragraph (4), by adding at the end the  
9 following: “Except for compensation subject to re-  
10 view under paragraph (5), payments or other dis-  
11 tributions under the plan to or for the benefit of in-  
12 siders, senior executive officers, and any of the 20  
13 next most highly compensated employees or consult-  
14 ants providing services to the debtor, shall not be  
15 approved except as part of a program of payments  
16 or distributions generally applicable to employees of  
17 the debtor, and only to the extent that the court de-  
18 termines that such payments are not excessive or  
19 disproportionate compared to distributions to the  
20 debtor’s nonmanagement workforce.”; and

21 (2) in paragraph (5)—

22 (A) in subparagraph (A)(ii), by striking  
23 “and” at the end; and

(B) in subparagraph (B), by striking the period at the end and inserting the following: “; and

“(C) the compensation disclosed pursuant to subparagraph (B) has been approved by, or is subject to the approval of, the court as reasonable when compared to individuals holding comparable positions at comparable companies in the same industry and not disproportionate in light of economic concessions by the debtor’s nonmanagement workforce during the case.”.

**SEC. 302. LIMITATIONS ON EXECUTIVE COMPENSATION ENHANCEMENTS.**

Section 503(e) of title 11, United States Code, is amended—

(1) in paragraph (1)—

(A) by inserting “, a senior executive officer, or any of the 20 next most highly compensated employees or consultants” after “an insider”;

(B) by inserting “or for the payment of performance or incentive compensation, or a bonus of any kind, or other financial returns designed to replace or enhance incentive, stock, or other compensation in effect before the date

1 of the commencement of the case,” after “re-  
2 main with the debtor’s business,”; and

3 (C) by inserting “clear and convincing” be-  
4 fore “evidence in the record”; and

5 (2) by amending paragraph (3) to read as fol-  
6 lows:

7 “(3) other transfers or obligations, to or for the  
8 benefit of insiders, senior executive officers, man-  
9 agers, or consultants providing services to the debt-  
10 or, in the absence of a finding by the court, based  
11 upon clear and convincing evidence, and without def-  
12 erence to the debtor’s request for such payments,  
13 that such transfers or obligations are essential to the  
14 survival of the debtor’s business or (in the case of  
15 a liquidation of some or all of the debtor’s assets)  
16 essential to the orderly liquidation and maximization  
17 of value of the assets of the debtor, in either case,  
18 because of the essential nature of the services pro-  
19 vided, and then only to the extent that the court  
20 finds such transfers or obligations are reasonable  
21 compared to individuals holding comparable posi-  
22 tions at comparable companies in the same industry  
23 and not disproportionate in light of economic conces-  
24 sions by the debtor’s nonmanagement workforce dur-  
25 ing the case.”.

1 **SEC. 303. ASSUMPTION OF EXECUTIVE BENEFIT PLANS.**

2 Section 365 of title 11, United States Code, is  
3 amended—

4 (1) in subsection (a), by striking “and (d)” and  
5 inserting “(d), (q), and (r)”; and

6 (2) by adding at the end the following:

7 “(q) No deferred compensation arrangement for the  
8 benefit of insiders, senior executive officers, or any of the  
9 20 next most highly compensated employees of the debtor  
10 shall be assumed if a defined benefit plan for employees  
11 of the debtor has been terminated pursuant to section  
12 4041 or 4042 of the Employee Retirement Income Secu-  
13 rity Act of 1974, on or after the date of the commence-  
14 ment of the case or within 180 days before the date of  
15 the commencement of the case.

16 “(r) No plan, fund, program, or contract to provide  
17 retiree benefits for insiders, senior executive officers, or  
18 any of the 20 next most highly compensated employees  
19 of the debtor shall be assumed if the debtor has obtained  
20 relief under subsection (g) or (h) of section 1114 to impose  
21 reductions in retiree benefits or under subsection (d) or  
22 (e) of section 1113 to impose reductions in the health ben-  
23 efits of active employees of the debtor, or reduced or elimi-  
24 nated health benefits for active or retired employees within  
25 180 days before the date of the commencement of the  
26 case.”.

1 **SEC. 304. RECOVERY OF EXECUTIVE COMPENSATION.**

2 Title 11, United States Code, is amended by inserting  
3 after section 562 the following:

4 **“SEC. 563. RECOVERY OF EXECUTIVE COMPENSATION.**

5 “(a) If a debtor has obtained relief under subsection  
6 (d) of section 1113, or subsection (g) of section 1114, by  
7 which the debtor reduces the cost of its obligations under  
8 a collective bargaining agreement or a plan, fund, or pro-  
9 gram for retiree benefits as defined in section 1114(a),  
10 the court, in granting relief, shall determine the percent-  
11 age diminution in the value of the obligations when com-  
12 pared to the debtor’s obligations under the collective bar-  
13 gaining agreement, or with respect to retiree benefits, as  
14 of the date of the commencement of the case under this  
15 title before granting such relief. In making its determina-  
16 tion, the court shall include reductions in benefits, if any,  
17 as a result of the termination pursuant to section 4041  
18 or 4042 of the Employee Retirement Income Security Act  
19 of 1974, of a defined benefit plan administered by the  
20 debtor, or for which the debtor is a contributing employer,  
21 effective at any time on or after 180 days before the date  
22 of the commencement of a case under this title. The court  
23 shall not take into account pension benefits paid or pay-  
24 able under of such Act as a result of any such termination.

25 “(b) If a defined benefit pension plan administered  
26 by the debtor, or for which the debtor is a contributing

1 employer, has been terminated pursuant to section 4041  
2 or 4042 of the Employee Retirement Income Security Act  
3 of 1974, effective at any time on or after 180 days before  
4 the date of the commencement of a case under this title,  
5 but a debtor has not obtained relief under subsection (d)  
6 of section 1113, or subsection (g) of section 1114, then  
7 the court, upon motion of a party in interest, shall deter-  
8 mine the percentage diminution in the value of benefit ob-  
9 ligations when compared to the total benefit liabilities be-  
10 fore such termination. The court shall not take into ac-  
11 count pension benefits paid or payable under title IV of  
12 the Employee Retirement Income Security Act of 1974 as  
13 a result of any such termination.

14 “(c) Upon the determination of the percentage dimi-  
15 nution in value under subsection (a) or (b), the estate shall  
16 have a claim for the return of the same percentage of the  
17 compensation paid, directly or indirectly (including any  
18 transfer to a self-settled trust or similar device, or to a  
19 nonqualified deferred compensation plan under section  
20 409A(d)(1) of the Internal Revenue Code of 1986) to any  
21 officer of the debtor serving as member of the board of  
22 directors of the debtor within the year before the date of  
23 the commencement of the case, and any individual serving  
24 as chairman or lead director of the board of directors at  
25 the time of the granting of relief under section 1113 or

1 1114 or, if no such relief has been granted, the termi-  
2 nation of the defined benefit plan.

3 “(d) The trustee or a committee appointed pursuant  
4 to section 1102 may commence an action to recover such  
5 claims, except that if neither the trustee nor such com-  
6 mittee commences an action to recover such claim by the  
7 first date set for the hearing on the confirmation of plan  
8 under section 1129, any party in interest may apply to  
9 the court for authority to recover such claim for the ben-  
10 efit of the estate. The costs of recovery shall be borne by  
11 the estate.

12 “(e) The court shall not award postpetition com-  
13 pensation under section 503(e) or otherwise to any person  
14 subject to subsection (c) if there is a reasonable likelihood  
15 that such compensation is intended to reimburse or re-  
16 place compensation recovered by the estate under this sec-  
17 tion.”.

18 **SEC. 305. PREFERENTIAL COMPENSATION TRANSFER.**

19 Section 547 of title 11, United States Code, is  
20 amended by adding at the end the following:

21 “(j) The trustee may avoid a transfer to or for the  
22 benefit of an insider (including an obligation incurred for  
23 the benefit of an insider under an employment contract)  
24 made in anticipation of bankruptcy, or a transfer made  
25 in anticipation of bankruptcy to a consultant who is for-

1 merly an insider and who is retained to provide services  
2 to an entity that becomes a debtor (including an obligation  
3 under a contract to provide services to such entity or to  
4 a debtor) made or incurred on or within 1 year before the  
5 filing of the petition. No provision of subsection (c) shall  
6 constitute a defense against the recovery of such transfer.  
7 The trustee or a committee appointed pursuant to section  
8 1102 may commence an action to recover such transfer,  
9 except that, if neither the trustee nor such committee com-  
10 mences an action to recover such transfer by the time of  
11 the commencement of a hearing on the confirmation of  
12 a plan under section 1129, any party in interest may apply  
13 to the court for authority to recover the claims for the  
14 benefit of the estate. The costs of recovery shall be borne  
15 by the estate.”.

## 16 **TITLE IV—OTHER PROVISIONS**

### 17 **SEC. 401. UNION PROOF OF CLAIM.**

18 Section 501(a) of title 11, United States Code, is  
19 amended by inserting “, including a labor organization,”  
20 after “A creditor”.

### 21 **SEC. 402. EXCEPTION FROM AUTOMATIC STAY.**

22 Section 362(b) of title 11, United States Code, is  
23 amended—

24 (1) in paragraph (27), by striking “and” at the  
25 end;



1           (2) in paragraph (28), by striking the period at  
2           the end and inserting “; and”; and

3           (3) by adding at the end the following:

4           “(29) of the commencement or continuation of  
5           a grievance, arbitration, or similar dispute resolution  
6           proceeding established by a collective bargaining  
7           agreement that was or could have been commenced  
8           against the debtor before the filing of a case under  
9           this title, or the payment or enforcement of an  
10          award or settlement under such proceeding.”.

○

Mr. COHEN. The American public is tired of seeing executives come away with tremendous moneys and workers lose their jobs and/or their pension benefits and/or their job security.

I commend Chairman Conyers for his leadership in attempting to address what is an obscenely unfair treatment of workers and retirees in business bankruptcies. And I thank our witnesses for being here today to share their perspectives on this important legislation as well. I think the American public is fed up with bankruptcies being a bonanza for executives and desperation for employees. Accordingly, I look forward to the testimony of the witnesses.

I now recognize my colleague Mr. Franks, the Ranking Member of the Subcommittee, for his opening remarks.

And, Mr. Franks, you are recognized.

Mr. FRANKS. Well, thank you, Mr. Chairman.

Mr. Chairman, as the Second Circuit Court of Appeals has noted, "section 1113 of the Bankruptcy Code requires unions to face those changed circumstances that occur when a company becomes insolvent, and it requires all affected parties to compromise in the face of financial hardship. At the same time, section 1113 also imposes requirements on the debtor to prevent it from using bankruptcy as a judicial hammer to break the union."

In other words, section 1113 strikes a careful balance between competing interests in businesses and in their reorganizations.

The legislation we are examining today will destroy that balance, Mr. Chairman. In fact, Harvey Miller, a bankruptcy expert the majority has called to testify before this Committee on multiple occasions, wrote that this legislation is comprised of "ill-considered proposed amendments that are antithetical to the policy of rehabilitation and reorganization of distressed businesses. The proposed amendments may preordain the failure of a reorganization to the real prejudice and detriment of all employees and all other stakeholders."

Mr. Chairman, this bill puts the interests of labor unions above all others. However, labor issues do not exist in a vacuum. They are surrounded by many other interests and constituencies, all of which must be dealt with fairly and equitably in order for reorganization to be successful.

Additionally, this legislation increases substantially the costs of Chapter 11. It impedes debtors from restructuring labor costs to market levels. It makes it much more difficult for debtors to attract and retain the management necessary to turn a company around. It impairs debtors' ability to find affordable bankruptcy financing. It gives unions the right to strike after a court has determined that they have unreasonably rejected modification of a collective bargaining agreement. And by moving organized labor to the front of the line, the new priority claims in this legislation may stymie otherwise workable reorganizations.

These changes will make it more difficult for a company to successfully reorganize. But Mr. Chairman, reorganization is the goal of Chapter 11. As Congress observed in enacting Chapter 11, "It is more economically efficient to reorganize than to liquidate because it preserves jobs and assets."

Simply naming this legislation the "Protecting Employees and Retirees in Business Bankruptcies Act" does not mean that either group will be protected. Yes, this bill will allow unions a few Pyrrhic victories in court, but at the end of the day all parties will lose if this legislation is enacted.

We have recently seen unions get handed the keys to Chrysler and General Motors during their bankruptcies. And we are currently seeing public employee unions push many cities and towns to the brink of insolvency. And I have to question whether we shouldn't be considering legislation to weaken the inordinate union influence in bankruptcies rather than legislation aimed at strengthening it.

So Mr. Chairman, with that, I look forward to the witnesses' testimony and yield the balance of my time.

Mr. COHEN. Thank you, Mr. Franks. I appreciate your statement.

Mr. Watt, would you like to make an opening statement or would you like to yield to the Ranking Member if he would like to make a statement?

Mr. Watt yields. Mr. Smith, the distinguished gentleman from Texas, close to Continental Airlines, you are recognized for a statement.

Mr. SMITH. Thank you Mr. Chairman. Thank you, Mr. Watt, as well. I will be happy to follow him, too.

Mr. Chairman, American businesses no longer operate in the same economic climate of the 1950's and sixties. Today they must compete in a global marketplace. And in this marketplace, unionized businesses that thrived decades ago now face stiff competition from domestic and international competitors. In labor-intensive industries from manufacturing to the airlines, unionized businesses have been burdened by high wages, stringent work rules and crippling pension liabilities. This has allowed competitors not burdened by similar constraints to overtake their unionized counterparts. As a result, for many unionized businesses, their only path to survival is reorganization through Chapter 11 of the Bankruptcy Code.

Unfortunately, H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act" cuts off that path of survival. H.R. 4677 makes it nearly impossible for unionized businesses operating in labor-intensive industries to reorganize successfully. This undermines the purpose of Chapter 11 and threatens our economic recovery.

Chapter 11 is designed to enable financially troubled companies to restructure their operations and obligations so they can remain in business. If financially troubled companies are forced to liquidate, employees lose jobs, retirees' pensions are slashed, and creditors, customers, suppliers and communities suffer. Chapter 11's labor provisions work, and there is no need for the major overhaul this bill represents.

Certainly employees and retirees face hardships when jobs, salaries, and benefits are cut in Chapter 11 reorganizations, but these hardships will be even greater if, as a result of this legislation, reorganization is no longer a viable option.

American workers, retirees, and their families are living through difficult times. We do not need to make these times more difficult

by forcing businesses, which could otherwise be restructured, into liquidation through misguided legislation like H.R. 4677.

What employees and retirees really need are economic policies that help American workers and small businesses rebuild our economy and create jobs. They do not need more pro-union special interest legislation that is aimed at only 7 percent of the private sector workforce.

Despite its name, this legislation protects neither employees nor retirees. Instead, it puts companies at greater risk of liquidation, and employees and retirees in danger of losing not just some of their income, but all of it.

Mr. Chairman, I look forward to the testimony today and yield back the balance of my time.

Mr. COHEN. Thank you Mr. Smith.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDI-  
CIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

**Statement of the Honorable John Conyers, Jr.  
for the Hearing on  
H.R. 4677, the "Protecting Employees and Retirees in Business  
Bankruptcies Act of 2010"**

**Before the Subcommittee on Commercial and Administrative Law**

**Tuesday, May 25, 2010, at 11:00 a.m.  
2141 Rayburn House Office Building**

Today's hearing continues this Subcommittee's efforts over the last two Congresses to shed light on the collateral damage that a corporation's reorganization in bankruptcy can inflict on its workers and retirees.

All too often, it is these hardworking Americans who end up bearing the brunt of their employer's financial reorganization. Their wages are cut, or they lose their jobs outright. And if they have already retired, they lose health benefits they bargained for and worked hard for over the course of a lifetime.

Meanwhile, the top executives are often unjustly rewarded with huge bonuses and retention pay incentives – the very individuals who drove their businesses into bankruptcy.

Based on the growing number of businesses filing for bankruptcy, the economic security of American workers and retirees is steadily worsening.

I think most of my colleagues would agree that the inherent goal of bankruptcy law is to provide a level playing field, so that all those affected are treated fairly under the circumstances.

But unfortunately, the Bankruptcy Code has been interpreted and applied in ways that yield *unbalanced* results – often at the expense of workers and others who need its protections the most.

It has become painfully clear that, over the last quarter-century, the rights of workers and retirees have been whittled away by corporate-friendly interpretations of the bankruptcy laws.

That's what led me to introduce H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010," earlier this year.

This bill, which currently has 45 cosponsors, is substantially similar to legislation that Senator Durbin and I introduced in the last Congress.

This legislation takes three important steps toward fairness for workers and retirees.

**First**, it gives them stronger procedural safeguards where their employer seeks to jettison a collective bargaining agreement or alter the retiree health benefits it agreed to.

The Bankruptcy Code sections that allow corporations to take these steps – sections 1113 and 1114 – were intended to ensure balanced protections for workers and retirees.

But some courts have applied these provisions in ways that favor the corporation to such a degree that the needs of workers and retirees are disregarded.

As a result, corporations have repeatedly – under cover of bankruptcy law – been able to reject hard-won collective bargaining agreements and retirement benefits in the airline, steel, and other industries.

H.R. 4677 would help restore a proper balance to the process under which collective bargaining agreements and retiree benefits can be altered in corporate bankruptcy.

The corporation would have to prove – by clear and convincing evidence – that any proposed alteration of a collective bargaining agreement or retiree benefits is essential to its survival. And that it is the least that will effectively enable the corporation’s reorganization and survival. And that it will not overly burden workers or retirees.

Where a collective bargaining agreement has been rejected, the bill would permit a union representative to apply to the bankruptcy court for an order increasing wages or benefits based on later changed circumstances.

These changes to the Bankruptcy Code will help ensure that workers and retirees are treated more fairly in corporate bankruptcy reorganizations.

**Second**, the bill would make a corporation’s senior management share some of the economic pain that its workers and retirees suffer in bankruptcy.

Executive compensation would be subject to court approval. Continued bonuses, and other forms of special performance or incentive compensation, would be prohibited.

If the corporation was seeking to use bankruptcy reorganization to reduce wages it committed to under a collective bargaining agreement, or terminate retiree health benefits, executives would be subject to having their own compensation reduced by the same percent.

These steps will help protect the rights of workers and retirees against being cast overboard in a corporate bankruptcy reorganization.

**Third**, the bill would improve recoveries for employees and retirees when their company files for bankruptcy.

For example, it increases the amount of unpaid wages, salaries, and commissions given priority protection from \$10,000 to \$20,000, and makes calculation of these amounts more straightforward.

And for workers being laid off, the bill moves their severance pay to the highest priority level for unsecured claims – the administrative expense priority.

Corporate reorganization plans will also have to preserve for workers and retirees the right to seek recovery of damages when their collective bargaining agreement or retiree benefits are altered, a right now denied them.

In the last decade, Congress went out of its way to skew the bankruptcy system to favor big business interests over ordinary Americans.

It is time that we restore balance to bankruptcy law, to give basic respect to the interests of working families. We must add a measure of fairness to a playing field that is overwhelmingly tilted against workers.

H.R. 4677 restores procedural and substantive balance with respect to how employees and retirees are treated in Chapter 11.

I thank our witnesses for their testimony today, and I urge my colleagues to support H.R. 4677.



[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF THE HONORABLE HENRY C. "HANK" JOHNSON, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND MEMBER, SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

**Congressman Henry C. "Hank" Johnson, Jr.  
Statement for the Hearing on  
H.R. 4677, the "Protecting Employees and Retirees in  
Business Bankruptcies Act of 2010"**

**May 25, 2010**

Thank you, Mr. Chairman, for holding this very important hearing on the Protecting Employees and Retirees in Business Bankruptcies Act of 2010.

According to the Air Transport Association, since the beginning of 2008, airlines have lost at least 27 billion dollars. Roughly one out of every three jobs in the airline industry has been lost since 2001.

Unfortunately, the airline industry is not alone. According to the Automatic Access to Court Electronic Records system, a provider of bankruptcy data, last year an average of 345 businesses filed for bankruptcy each day.

Because of the economic forecast, the need to preserve jobs, benefits, and protections for workers and retirees must be a top priority.

Chapter 11 of the bankruptcy code was intended to give all participants an equal say in how a business, struggling to overcome financial difficulties, should reorganize. Unfortunately, this intent has not always been realized for hard-working American workers.

Many companies have used Chapter 11 bankruptcy to cut pay and benefits for workers and retirees. In too many instances, hard working Americans are losing jobs while the executives walk away with multi-million dollar bonuses and stock options.

Workers and retirees have been hit the hardest by the high number of business bankruptcies. I am deeply concerned about how we can protect the jobs and livelihood of American workers, while preserving the economic stability of American companies.

This is why I am an original cosponsor of H.R. 4677, which will make changes to the Bankruptcy Code to ensure that the interests of workers and retirees are protected in business bankruptcies. It is a bill that works for American workers and businesses.

Thank you, Mr. Chairman, for scheduling this hearing. I look forward to hearing from our witnesses today, and yield back the balance of my time.

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Mr. COHEN. The other Members' opening statements, without objection, they will be included in the record if they are not desirous of making a statement.

I am now pleased to introduce the witnesses on the panel for today's hearing. I want to thank each of you for your willingness to

participate in today's hearing. Without objection, your written statements will be placed in the record.

I would ask that you limit your remarks to 5 minutes. We have a lighting system. Green means you are within the first 4 minutes, yellow means you are in the last minute, and red means you should be finished. There is also a little button to push to turn on the microphone. Make sure you can be heard.

After each witness has presented his or her testimony, the Subcommittee Members will be asked to ask questions subject to the same 5-minute rule.

Our first witness is Babette Ceccotti. Ms. Ceccotti is a partner at Cohen, Weiss and Simon LLP, in New York City, a law firm specializing in the representation of labor organizations, employee benefit plans and individual employees. Ms. Ceccotti divides her time between the firm's bankruptcy practice and employee benefits practice. She represents labor organizations, numerous bankruptcy cases and a wide range of industries, and serves as outside counsel for the AFL-CIO in bankruptcy matters since 1998.

Ms. Ceccotti, will you proceed with your testimony

**TESTIMONY OF BABETTE CECCOTTI,  
COHEN, WEISS AND SIMON LLP**

Ms. CECCOTTI. Good morning, Mr. Chairman, Ranking Member Franks, and Members of the Subcommittee.

I would like to thank you and Chairman Conyers for convening this hearing on H.R. 4677.

I am appearing today on behalf of the AFL-CIO, a labor federation with affiliates representing 10.5 million workers. H.R. 4677 is a vitally important bill that would amend the Bankruptcy Code to provide greater protection to employees and retirees in business bankruptcy cases.

As envisioned by Congress when the bankruptcy laws were modernized in 1978, the fundamental purpose of bankruptcy organization is 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. But as the bankruptcy system has grown over the past 30 years, it has become clear that bankruptcy has been working well for powerful, moneyed constituencies, but is disastrous for workers and retirees.

Rather than a vehicle for the preservation of jobs, bankruptcy has come to mean the loss of good jobs, decent wages, pensions and health care.

And at the same time that workers are seeing their own financial security deteriorate through their employer's bankruptcy cases, they also see company executives being rewarded with bonuses and other pay schemes that reflect executive compensation practices at their worst. Corrective action by Congress is long overdue and is urgently needed.

The bill provides a comprehensive set of reforms to the Bankruptcy Code that would increase workers' recoveries, reset the rules when labor costs are addressed in bankruptcy, restore job preservation as a true principal goal of business reorganization, and halt the use of bankruptcy as a safe haven for executive pay schemes.

Bankruptcy is intended to provide a debtor with legal remedies in aid of restructuring its business. But the law was never intended to allow a debtor absolute control or unfettered discretion to impair the interests of other stakeholders. By design, creditors retain important rights in their dealings with the debtor. The law is, in fact, designed to develop negotiated solutions, and this can only work when stakeholders are able to effectively counterbalance the advantages that the law gives to the debtor.

In crafting the bankruptcy laws, Congress has historically provided special protections for employees and retirees.

Sections 113 and 114 reflect Congress' recognition that bankruptcy policy must be balanced by important nonbankruptcy policies, those favoring the resolution of disputes through collective bargaining, and the protection of retiree health benefits. However, protections that were built into the law have been severely weakened over time. Some statutory provisions simply have not kept pace with the growth of the bankruptcy system. Others have been undermined by court rulings.

Court rulings have restricted the collection of the wage priority, severance pay, and WARN Act damages. Other rulings have hollowed out the protections under sections 1113 and 1114 by reading out of those sections the nonbankruptcy policies Congress intended to apply.

Some employees have been left literally defenseless by court rulings prohibiting them from engaging in self-help and suggesting that they may not even have a damages claim for contract rejection. As a result, workers are collecting less and losing more in business bankruptcies. The erosion of protections under section 1113 and 1114 have made workers and retirees particularly vulnerable because these protections go to the very heart of their financial security.

The bankruptcy system's capacity to absorb ever larger and more complex business situations and the broad advantages given to a debtor under the law have proved to be a toxic combination for workers and retirees. Labor costs have become irresistible targets for the debtors and the restructuring professional that advise them, to a large degree, because systemic industry and economic conditions that may adversely be affecting the business cannot be controlled, even by a debtor in bankruptcy. In effect, workers and retirees are paying for problems because their wages and benefits can be controlled by bankruptcy but other forces cannot.

In my written testimony, I have described a recent study that was conducted of cases filed in two popular venues, the Southern District of New York, and the District of Delaware, that showed that in 32 instances in which the courts ruled on motions under section 1113, the courts granted rejection in all of them. The author of that study concluded that section 1113 as currently drafted is defectively ambiguous and provides insufficiently clear direction to the court regarding the protection of labor agreements.

The bill would amend section 1113, to interject more specific direction to the debtor and to the courts to promote collective bargaining and prevent workers from disproportionately bearing losses, and adopt similar changes for section 1114.

In addition, the preservation of jobs would become an express statutory purpose of Chapter 11. Although this fundamental goal has been at the heart of the business bankruptcy system, it is often lost among competing stakeholder concerns, as bankruptcy increasingly becomes the vehicle of choice for significant transactions.

The bill would also improve the application of the wage priority, clarify that WARN Act damages are entitled to priority, and enhance recoveries for lost pension benefits. In addition, the bill would increase court oversight of executive compensation programs.

Amendments enacted in 2005 to rein in these programs have led their proponents to devise strategies to circumvent the new rules, and with considerable success. Workers continue to lose money, but executives are doing well. Congress correctly took action to halt these practices in 2005, and more expansive rules are now needed to effectively curtail these programs.

Mr. COHEN. Can you wrap it up?

Ms. CECCOTTI. Yes. Mr. Chairman, I will be happy to answer any questions any of the Members of the Committee have concerning the legislation.

I would simply like to close by saying that labor groups worked very hard under difficult circumstances to achieve pragmatic outcomes in bankruptcy cases. H.R. 4677 would correct the seriously imbalanced bankruptcy process that has eroded the financial security—

Mr. COHEN. Thank you ma'am. We need to keep with our times. We appreciate everybody else doing so as well.

[The prepared statement of Ms. Ceccotti follows:]

PREPARED STATEMENT OF BABETTE CECOTTI

Hearing on H.R. 4677  
the “Protecting Employees and Retirees in  
Business Bankruptcies Act of 2010”

Before the Subcommittee on Commercial and  
Administrative Law of the  
Committee on the Judiciary

U.S. House of Representatives

Statement of:

Babette Ceccotti  
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On behalf of the AFL-CIO

May 25, 2010

**Statement of Babette Ceccotti****Introduction**

Good morning, Mr. Chairman, Ranking Member, and members of the Subcommittee. I would like to express our appreciation to you, to the members of the Subcommittee and to Chairman Conyers for convening this hearing on H.R. 4677, the “Protecting Employees and Retirees in Business Bankruptcies Act of 2010.” I am appearing today on behalf of the AFL-CIO, a labor federation with affiliates representing over 10.5 million workers. H.R. 4677 (like its predecessor, H.R. 3652, introduced in the 110<sup>th</sup> Congress)<sup>1</sup> represents the most significant effort to address the interests of employees and retirees in business bankruptcies in over 20 years and would provide vital and long-overdue protections for employees and retirees. This is a comprehensive bill that would increase workers’ recoveries in bankruptcy, reset the rules for using bankruptcy to address labor and benefit obligations, restore job preservation as a principal goal of reorganization, and stop the unseemly growth of executive pay schemes in bankruptcy cases.

Congress comprehensively revamped the bankruptcy laws in 1978, and designed the business reorganization system with the goal of preventing the liquidation of viable businesses. As envisioned by Congress, the fundamental purpose of reorganization is “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.”<sup>2</sup> Since that time, business bankruptcy, and chapter 11 in particular, has grown into a sophisticated arena for addressing financial distress and bringing about business change. Businesses, the banks that lend to them, and prospective investors and buyers very often make a strategic choice to use the bankruptcy system to bring about a transaction or address particular debts through a restructuring. The credit market freeze

and the current recession have led to sharp increases in business bankruptcy filings, a trend which shows no signs of reversal in the near future.<sup>3</sup>

As the reach and uses of the bankruptcy system have grown, it has become clear that the system functions very well for powerful, moneyed constituencies, but has been disastrous for workers and retirees. Despite Congress's deliberate emphasis on the preservation of jobs as a fundamental goal of reorganization, business bankruptcy has become a threat to workers' living standards and retirement security. For workers, their employer's bankruptcy has come to mean the loss of good jobs, decent wages, pensions and healthcare.<sup>4</sup> The bankruptcy system has also embraced a wholly indefensible double-standard: while workers and retirees are sustaining huge losses, company executives are being rewarded with bonuses and other pay schemes that reflect executive compensation practices at their worst.

Bankruptcy Law Is Intended to Strike a Balance Between Debtors and Their Stakeholders

While the bankruptcy system offers a debtor enormous advantages in aid of its restructuring, the law does not allow a debtor unfettered discretion to conduct its affairs, nor are its stakeholders without significant rights and protections. The bankruptcy process requires a debtor to deal with many different creditors and stakeholders – its lenders, property lessors, key suppliers and other vendors, equipment financiers, the Pension Benefit Guaranty Corporation, state and local governments, as well as labor groups. General unsecured creditors have official representatives that actively participate in all aspects of the case and negotiate on their behalf.<sup>5</sup> By design, creditors and other stakeholders retain important rights – both under bankruptcy law and under non-bankruptcy law—to balance the rights of the debtor.

Congress has incorporated a number of provisions intended to protect employees, in particular, from the effects of an employer's bankruptcy and to counter-balance the rights given to the debtor. Early business bankruptcy laws established a payment priority for wages. The



wage priority has been increased and expanded over the years to take into account different forms of payroll and deferred compensation and the employee benefit plans that pay workers' health, pension and other benefits.<sup>6</sup> Most recently, in 2005, Congress increased the wage priority<sup>7</sup> and added other amendments to safeguard employee payroll deductions for health and pension plan contributions and improve recovery for back-pay awards where companies violated federal and state laws.<sup>8</sup>

Congress has also acted to balance the basic tenets of federal labor policy with bankruptcy policy. Taking aim at companies that were using bankruptcy as a strategic weapon in collective bargaining, Congress passed Section 1113 of the Bankruptcy Code in 1984.<sup>9</sup> Through Section 1113, Congress sought to protect collective bargaining agreements and the collective bargaining process by devising a new section of the Bankruptcy Code that set out the rules that would apply when a debtor sought changes to a labor agreement in bankruptcy. This new section was intended to recognize, and give effect to both labor policy and bankruptcy policy. Congress stepped in again in 1986 as a matter of health care policy, when one of the Big Steel companies filed a bankruptcy case and stopped paying health benefits for 70,000 retired steelworkers. That action led Congress to pass Section 1114, which protects retiree health and life insurance benefits.<sup>10</sup>

In spite of these efforts, protections for employees and retirees have not kept pace with the growth and reach of the business bankruptcy system and have been severely weakened by the courts. Court rulings have limited workers' recoveries under the wage priority.<sup>11</sup> Other rulings have rewritten the rules for severance pay and WARN Act damages in bankruptcy, depriving workers of pay they are entitled to – and need – when businesses shut down.<sup>12</sup> Courts have approved settlements that have allowed debtors to box up their pension plans and ship them

off to the Pension Benefit Guaranty Corporation, while other rulings deny employees and retirees bankruptcy claims when their pension plans have been terminated in bankruptcy.<sup>13</sup> Many court rulings have hollowed out the safeguards Congress built into Sections 1113 and 1114.<sup>14</sup> Court rulings also have gone so far as to prohibit airline workers from exercising their fundamental right to engage in self-help when their labor contracts were rejected and suggest that, even though the Bankruptcy Code provides for a damages claim for rejected contracts, workers may not assert a damages claim for rejection of a labor agreement.<sup>15</sup>

Inadequate provisions in the bankruptcy law, compounded by adverse court rulings on matters of vital concern to employees and a zealous growth in the use of bankruptcy as a strategic tool brought to bear against workers' interests have heavily tipped the scales against employees and retirees and virtually destroyed any semblance of the balance among stakeholders that bankruptcy law is intended to reflect. Adding insult to injury, debtors opportunistically continue to promote executive pay schemes – little more than thinly veiled efforts to give management more money – oblivious to (or simply unconcerned with) the damage these programs inflict on employee morale, particularly where a debtor expects concessions from its workforce. In short, the bankruptcy system is at a point where “open season” has been declared on workers and retirees in ways that can only be effectively corrected through comprehensive reform.

**H.R. 4677 Would Improve Recoveries for Employees and Retirees, Stem Their Losses, and Rein in Executive Pay Schemes**

**1. H.R. 4677 Would Increase Workers' Recoveries**

Despite recent improvements, the current wage priority, which imposes a per employee dollar limit for wages and fringe benefits earned within 180 days prior to the bankruptcy filing, remains deficient in three ways. *First*, the per-employee dollar limit, which is \$11,725 as of

April 1, 2010, remains inadequate. Employee compensation takes many forms: payroll wages and fringe benefits, many types of deferred compensation, and an increasingly varied array of benefit programs make up total employee compensation. The constraints of the wage priority limits are evident in bankruptcy cases where money for ongoing operations is not particularly scarce, as well as in leaner cases where pitched battles can erupt over payment entitlements.

In larger bankruptcies where debtors expect to conduct the case without operational disruption, debtors routinely ask to continue their employee-related compensation practices and programs unaffected by the bankruptcy filing in order to maintain employee morale and allay the employees' concerns regarding the continuation of their pay. The restrictions in the current wage priority can get in the way of these requests. To address the current limits, some debtors expressly seek authority to exceed them. Others assert that, on average, the requested authority will not likely exceed the per-employee limits.<sup>16</sup>

These ad hoc, but now routine, practices indicate that many practitioners favor the seamless continuation of employee compensation policies and programs in bankruptcy. Given the widespread acceptance of "first day" wage motion practice, the statutory wage priority lags behind current practices and should be updated accordingly. H.R. 4677 would increase the wage priority amount to \$20,000 per employee, an improvement that would permit more forms of compensation to be treated on a priority basis.<sup>17</sup>

*Second*, outdated court decisions have reduced the amount that can be collected under the wage priority by treating some earned compensation – such as vacation, sick leave and severance pay – less favorably than payroll wages.<sup>18</sup> These rulings have created artificial limits that have cost employees hard-earned pay, whether in the form of vacation pay a court deemed to be "earned" too early to qualify for priority treatment, or severance pay, which is recognized in only

one Circuit Court of Appeals as compensation for termination of employment and earned in full at termination.<sup>19</sup> When an employer is in bankruptcy, employees continue to perform their jobs the same way they did before bankruptcy. The company receives the full benefit of their tenure and experience every day and they should earn the full complement of their compensation each day. H.R. 4677 would eliminate the 180-day “earning” period and provide greater certainty regarding the amount that can be paid as a priority.

*Third*, the wage priority pits payroll compensation against pension, health and other benefits employees received through employee benefit plans. Unpaid contributions owed to these plans are entitled to priority only to the extent the per-employee amount hasn’t been exhausted by payroll compensation.<sup>20</sup> As a result, valuable benefits compete with straight payroll compensation for priority dollars that are already inadequate. The current system relegates benefit plans to the wage priority leftovers, even though employee benefits are integral to overall employee compensation and often reflect trade offs from straight pay. H.R. 4677 would remedy this inequity by establishing a separate \$20,000 per-employee priority for unpaid contributions to employee benefit plans, de-linked from the priority for wages and fringe benefits.

Improving recoveries and eliminating wage priority disputes bolster the key purposes of establishing a priority, which is to pay a meaningful sum certain to employees on a priority basis. H.R. 4677 would increase employees’ recoveries and greatly simplify the application of the priority by providing certainty and by eliminating disputes that cost employees valuable compensation, create delay and waste resources expended on disputes over priority claims.

H.R. 4677 also rectifies an ongoing problem regarding the payment of severance pay in bankruptcy. Most courts erroneously classify severance benefits that are calculated with

reference to an employee's length of service as pay that is earned over time, and assign only a small portion to a priority "earning" period.<sup>21</sup> But as the Court of Appeals for the Second Circuit has recognized, severance pay is a form of compensation for the termination of employment. It is triggered upon employment termination and should be paid in full so that workers can pay their bills and living expenses if they should lose their jobs.<sup>22</sup> H.R. 4677 provides that the full amount of severance pay owed to employees who are terminated during the bankruptcy (other than insiders or senior management) qualifies as an administrative expense of the estate.<sup>23</sup> H.R. 4677 also clarifies the treatment of WARN Act damages where a layoff occurs on the eve of bankruptcy. In 2005, Congress amended Section 503(b) to add a provision protecting back pay awards resulting from violations of state or federal law.<sup>24</sup> Even though WARN Act damages fit well within the letter of the new section, four courts have now rejected administrative expense status for any portion of the damages awarded under the WARN Act.<sup>25</sup> Under H.R. 4677, where a WARN Act event occurs just prior to a bankruptcy filing, the damages will be treated as back pay in violation of federal law, in the same way as other back pay violations.<sup>26</sup>

## **2. H.R. 4677 Would Limit Workers' and Retirees' Losses**

As bankruptcy has become a well-established mechanism for business change, the issues that are addressed in bankruptcy have become more diverse and often implicate significant non-bankruptcy policies. The protections enacted by Congress for labor agreements in Section 1113 and for retiree health benefits in Section 1114 reflect two instances in which Congress recognized that bankruptcy policy must be balanced with important, non-bankruptcy policies.<sup>27</sup> The balance struck by Congress between bankruptcy and non-bankruptcy policy in these provisions is now all but gone, and protections intended to reflect important non-bankruptcy

concerns have been written out of the application of these statutes.<sup>28</sup> To restore a true balance, these provisions must be rewritten to more explicitly reflect non-bankruptcy policy.

Through Section 1113, rules were established to protect the collective bargaining process and impose a more stringent legal standard for rejection of labor agreements than the standard applied to other contracts. The events leading to the enactment of Section 1113 have been well-documented by commentators.<sup>29</sup> A review of those accounts should leave no serious doubt that Section 1113 was crafted to reflect both bankruptcy policy and non-bankruptcy policies favoring collective bargaining. But the courts' reaction to Section 1113 was deeply divided from the outset. Notably, the few court opinions that took the statutory history and context into consideration recognized the dual policies reflected in the statute and interpreted the statutory requirements strictly.<sup>30</sup> Over time, however, a legal standard informed by both labor policies and bankruptcy policies has been rejected by most courts in favor of a bankruptcy-centered standard that has disregarded the labor policies Congress undertook to protect.<sup>31</sup> As a result, debtors face few effective limits in seeking to reject a labor agreement.<sup>32</sup> Stripping out labor policies that recognize the process and product of collective bargaining leaves the Section 1113 process completely dominated by bankruptcy goals and the debtor's perspective of its problems. As a result, business bankruptcies have been "disastrous for labor."<sup>33</sup>

A recently published study of large publicly held chapter 11 cases filed in the Southern District of New York and in the District of Delaware between 2001 and 2007 has confirmed what the labor organizations appearing at today's hearing all know from their own experiences: debtors have been virtually assured of favorable court rulings when they bring motions to reject labor contracts under Section 1113 because the current legal standard does not adequately protect collective bargaining interests. In the bankruptcy cases that were studied, thirty debtors brought

a total of 103 motions under Section 1113. In the thirty-two motions that resulted in court rulings, the debtor prevailed in all cases. The study's author concluded that Section 1113 as currently drafted does not serve its intended purpose-- to protect labor agreements--because the current standards do not provide sufficient guidance to the courts. In the absence of clearer statutory guidance regarding the protection of labor agreements, the courts have ruled on these motions simply on the basis of whether rejecting the agreement facilitates the reorganization, applying a standard virtually no different than the courts apply to other administrative matters under the Bankruptcy Code.<sup>34</sup>

Outside of the bankruptcy cases reviewed in this particular study, there have been cases where debtors have not prevailed in rejection motions under Section 1113, although such decisions tend to involve more technical requirements of the statute which the courts find have not been followed.<sup>35</sup> But these decisions have not changed the overwhelmingly bankruptcy-centered approach to the statute.<sup>36</sup> The courts long ago stopped debating whether the statute should be read solely with bankruptcy policy in mind or as a balance between labor policies and bankruptcy policies. Bankruptcy policy has clearly overtaken countervailing concerns.<sup>37</sup> Without a true balance between labor policies and bankruptcy policy, Section 1113 becomes a potent negotiating weapon in the debtor's arsenal – precisely the result Congress sought to avoid – rather than a process guiding both parties to a fair solution that provides relief for a financially strapped debtor without destroying workers' standards of living in the process.

In addition to thwarting Congressional intent, the debtor-centered practices that have gained ground under Section 1113 and Section 1114 are bad policy. First, bankruptcy is meant to function – and can only realistically function – as a “breathing spell” which recognizes that bankruptcy may offer temporary solutions to financial distress but is not a substitute for a long-

term viable business plan, a rational industry model or an economic policy. And it was never meant to define a new framework for labor relations. The complete disregard for labor policies in applying Section 1113 has left labor groups with no effective means to halt the onslaught by debtors who see bankruptcy as a means of “transforming” their businesses through the eliminations of jobs, deep cuts in labor costs, pension funding and retiree health obligations.<sup>38</sup> These obligations become attractive targets to a large degree because systemic industry and economic forces adversely affecting the business are beyond the company’s control.

Bankruptcy cannot lower commodities prices or impose a more rational airfare structure. Bankruptcy cannot reverse trade policies that disadvantage American manufacturers, restore newspaper circulation or boost media ad revenues. But because bankruptcy offers a powerful arsenal of remedies that allows a debtor to shed its obligations, companies have aimed these tools at their employees and retirees to compensate for forces that are battering their business models but are outside their control. As a result, workers and retirees have paid dearly in lost jobs, lower pay and benefits, harsher working conditions and weakened retirement security, but these sacrifices cannot solve systemic problems that continue to confront a particular industry and cannot prevent the adverse effects of a massive economic slowdown.<sup>39</sup>

Recent economic conditions point to another significant consequence of harsh labor cost cutting: employees taking home less pay and losing benefits and retirement security cannot productively participate in the economy. The current recession has exposed the dangers of relying on cheap credit and ignoring the implications of a low wage economy.<sup>40</sup> Bankruptcy should not further aggravate trends which are detrimental to the economy as a whole.

Permitting companies a largely unchecked means of eliminating pension funding and retiree health benefits obligations in bankruptcy also interferes with the development of



comprehensive pension and health care policy. After a spate of bankruptcy-induced pension plan terminations that dramatically increased projected deficits in the government's pension insurance system, Congress took steps to discourage plan terminations in bankruptcy through several provisions of its most recent pension funding legislation, the Pension Protection Act of 2006.<sup>41</sup> As a deterrent to plan terminations in bankruptcy, companies that terminate defined benefit pension plans while in bankruptcy must pay a post-reorganization Termination Premium to the Pension Benefit Guaranty Corporation.<sup>42</sup> However, workers pay a steep price as well, through a provision of the PPA that ties critical pension guarantee calculations to the bankruptcy petition date rather than the plan termination date that would occur later in time, a difference that can significantly affect the benefits employees recover as a result of plan termination.<sup>43</sup> Employer-provided retiree health care coverage has also eroded steadily as companies, motivated by accounting disclosure requirements and cyclical cost spikes have curtailed these benefits or eliminated them altogether.<sup>44</sup> Now that comprehensive healthcare reform has become law, the bankruptcy system should not be the place to conduct health care policy choices one company at a time.<sup>45</sup>

Pension funding, the availability of affordable health care and industry transformations that drastically reduce U.S.-based jobs implicate major policy questions that are more appropriately addressed through legislative choices that take into consideration the range of policy and legislative options.<sup>46</sup> But labor groups have had to contend with these difficult problems in the context of bankruptcy cases, where time and resources are limited and other creditor interests must be accommodated as well. Not surprisingly, the same "solutions" are repeated in case after case: job loss, lower pay and benefits, termination of pension funding obligations, and cuts in retiree health benefits. Bankruptcy cannot function—and should not be

administered – as a substitute for a pension funding system, a national health care policy, or an economic policy.

H.R. 4677 would correct the severe imbalance in the system through amendments that would make clear that bankruptcy policy must be effectively balanced with other policies that protect workers, labor agreements, and retirees.

A. Amendments to Section 1113

H.R. 4677 proposes a number of changes in the operation and application of Sections 1113 intended to reset the balance between bankruptcy and non-bankruptcy policy.<sup>47</sup> Changes proposed for Section 1113 are designed to restore the collective bargaining process as the principal means of addressing an employer's demand for concessions in bankruptcy. The amendments are also designed to insure that workers and retirees do not bear disproportionate burden of a company's – or an industry's – restructurings. In response to recent court decisions, H.R. 4677 clarifies the remedies available upon rejection of a labor contract, including the right to engage in economic self help. Hearing and scheduling rules that have become unduly burdensome for the parties – and for the courts – would also be modified.<sup>48</sup> Other changes would equalize the provisions of Section 1113 and Section 1114, which were intended to operate in a similar manner.<sup>49</sup>

Changes that would stop overbroad cost cutting aimed at workers' pay and benefits

Because courts that have addressed Section 1113 have favored a bankruptcy-centered legal standard that permits a debtor wide latitude in proposing concessions and ignores labor policies, Section 1113 does not provide effective protection against broad cost cutting aimed at jobs, pay and benefits. H.R. 4677 would correct this imbalance in several ways. The bill makes explicit that a debtor proposing modifications, and a court reviewing a request to reject a labor agreement, must take into consideration federal policy encouraging the practice and process of

collective bargaining. Proposals by the debtor for labor cost concessions must be part of a general program of cost cuts that is not limited labor groups, or even to labor costs. In addition, the proposal must define the amount of labor savings sought for each labor group so that labor groups can address and evaluate a specific share of the necessary sacrifice, rather than open-ended “labor transformation” demands.<sup>50</sup>

H.R. 4677 would also prohibit modifications that disproportionately affect the employees, either in the amount or the nature of the modifications and would shift the focus from unrealistic, long-term concessionary agreements to contributions that can be made to aid the reorganization in the short term. These limits recognize that bankruptcy is not a “silver bullet” that can solve all of a business’s problems. The amendments would also insure that employees and retirees are not singled out for sacrifices, nor expected to “make up for” the adverse effects of a bad economy or poor industry conditions by sacrificing their jobs and benefits.

In reviewing a motion for rejection, the court must consider the financial implications of the debtor’s proposal on the employees, whether the proposal adversely affects the debtor’s ability to retain an experienced and qualified workforce and whether it would impair the debtor’s labor relations such that the company’s ability to achieve a feasible reorganization would be compromised.<sup>51</sup> In this way, a debtor would be prevented from making short-term decisions to slash costs that could work against the restructuring in the long run.

#### Changes to promote the bargaining process

H.R. 4677 proposes changes to restore Congressional intent to promote good faith collective bargaining, rather than litigation, where a debtor seeks labor contract modifications. Debtors now routinely embark upon litigation before exhausting the statutory bargaining requirement.<sup>52</sup> A so-called “two-track” system where parties are bargaining at the same time they are engaged in litigation seriously detracts from, and undermines, the bargaining process.

In addition, a process where negotiations and litigation intersect improperly draws the court into the give and take of the parties' bargaining over proposals.<sup>53</sup> H.R. 4677 would require that a debtor demonstrate that further negotiations are not likely to produce an agreement in order to obtain court-authorized rejection. In addition, to ensure that both parties' proposed solutions are given due consideration as part of a process of good faith bargaining, the court would be required to consider whether an alternative proposal by the labor group would meet the statutory requirements, something courts do not have to do now.

#### Contract rejection remedies

H.R. 4677 would correct the ruling of the Court of Appeals for the Second Circuit Court's in the *Norwest Airlines* case that airline workers could be denied their most basic right – to withhold their services – when their contracts were rejected in bankruptcy, an unprecedented and deeply flawed court decision that broke with well-settled labor law and bankruptcy principles never before questioned in bankruptcy cases.<sup>54</sup> The bill would restate what was well understood before *Northwest*, that economic self-help by a labor organization is permitted upon a court order rejecting a labor agreement. The bill also clarifies that a labor union – like all other contract counter-parties – is entitled to assert a bankruptcy claim for contract rejection damages, following the majority view of the courts prior to the *Northwest Airlines* ruling.<sup>55</sup>

#### B. Amendments to Protect Employee Benefits

H.R. 4677 would amend Section 1114, which Congress adopted to protect retiree health benefits,<sup>56</sup> to add new rules similar to those proposed for Section 1113.<sup>57</sup> Strengthened standards would apply to limit a debtor's ability to modify or terminate retiree health benefits and better protect retirees. In addition, H.R. 4677 would halt efforts by debtors to avoid Section 1114 altogether by using "reservation of rights" clauses to claim that unilateral changes can be made

to retiree health benefits under non-bankruptcy law that varies widely by jurisdiction.<sup>58</sup> In addition, the bill would give employees and retirees a general unsecured contract damages claim for benefits lost as a result of the termination of a defined benefit pension plan, in addition to the termination liability claim collected by the Pension Benefit Guaranty Corporation.<sup>59</sup> In recognition of the increasing reliance upon defined contribution plans for employees' retirement security,<sup>60</sup> H.R. 4677 would amend the Bankruptcy Code to recognize a claim for losses in the value of employer stock held in individual account plans, where value is lost due to fraud or other breaches of fiduciary duty.<sup>61</sup> This provision addresses the lessons learned by the bankruptcies of companies such as Enron and Worldcom, which focused attention on the devastating losses in retirement savings that can occur when employees must rely on defined contribution plans holding large amounts of the stock of an employer in bankruptcy.

C. Amendments to Restore the Principal Goal of Job Preservation

While the preservation of jobs is at the heart of the business bankruptcy system,<sup>62</sup> the absence of express statutory guidance has left this fundamental goal without a clear role in key bankruptcy transactions. Under H.R. 4677, the preservation of jobs would be an express purpose of chapter 11 and a finding regarding the debtor's efforts to preserve jobs and the productive use of its assets would be required for approval of a reorganization plan.<sup>63</sup> Where competing plans are presented, the court must take into consideration the extent to which each plan would maintain existing jobs and benefits. In addition, in asset sales, the court would be required to consider the extent to which a bidder will maintain existing jobs, preserve retiree health benefits and assume pension obligations in determining whether an offer constitutes the successful bid.<sup>64</sup>

3. **H.R. 4677 Would Strengthen Restrictions on Executive Pay Schemes**

In 2005, Congress cracked down on “pay to stay” executive compensation plans and oversized severance packages through a new Bankruptcy Code Section 503(c), which was intended to strictly limit the instances in which these programs could be approved.<sup>65</sup> Since that time, debtors have become quite adept in designing pay schemes to bypass the restrictions<sup>66</sup> and courts are generally approving them. Now routinely labeled “incentive plans” of one kind or another, they are often tailored to bankruptcy milestones and reflect little more than court-authorized opportunities to make extra payments to management.<sup>67</sup> These pay schemes unfailingly serve to inflame already difficult circumstances where debtors seek to implement them at the same time they are attempting to cut labor costs and benefit obligations owed to rank and file workers.<sup>68</sup> Notwithstanding the distraction and ill will caused by these programs, restructuring professionals stubbornly insist upon promoting them in case after case.<sup>69</sup>

H.R. 4677 would bolster Congress’s initial effort to halt these practices by expanding executive pay restrictions to programs proposed in anticipation of, or during a bankruptcy case. The bill would expand the strict criteria that now apply to so-called retention payments to other forms of payment that would replace or enhance compensation set prior to bankruptcy.<sup>70</sup> Pay schemes would no longer be reviewed under the lenient, deferential business judgment standard that courts have continued to apply, notwithstanding the rigorous scrutiny required under the 2005 amendment. In addition, the bill would halt the use of inappropriate comparison data and other questionable criteria employed by for- hire compensation consultants.<sup>71</sup>

The bill would also increase court oversight of executive compensation disclosed as part of a plan of reorganization, where debtors have used reorganization plans as opportunities to propose generous grants of stock in the reorganized entity, cash and other “perks”<sup>72</sup> To avoid eve of bankruptcy awards that might otherwise escape the scrutiny of the court or creditors, the

bill also provides that a compensation arrangement made in anticipation of bankruptcy can be recovered as a preferential transfer.<sup>73</sup>

Other provisions of the bill address the lack of shared sacrifice these pay schemes represent. A debtor seeking labor cost relief would have to overcome a presumption that its proposal would overly burden the employees if the debtor had implemented an executive pay scheme.<sup>74</sup> In addition, a debtor would be required to treat pension and retiree health benefit plans for rank and file employees the same as those for senior management in the bankruptcy. If workers' pension plans have been terminated, or retiree health benefits have been modified, then senior management pension plans and retiree health programs cannot ride through the bankruptcy unaffected.<sup>75</sup>

#### Other technical changes

H.R. 4677 also contains amendments of a more technical nature, which would codify two widely accepted practices, the filing of a proof of claim by a labor organization on behalf of its members and an exception to the automatic stay for ordinary course grievances and labor arbitrations pending at the time of the bankruptcy case.<sup>76</sup>

#### Concluding Remarks

Unique among stakeholders in a bankruptcy case, workers experience the bankruptcy process in ways that are very different and far more consequential than financial and commercial stakeholders. Workers cannot limit their exposure to the risk of their employer's bankruptcy by diversifying portfolios. They do not get collateral for providing their services. Among the least able to absorb deep cuts in pay and benefits, workers have become the most vulnerable stakeholders in a bankruptcy process, with much to lose and with far more long-lasting consequences.

You will likely hear that this bill would hamper a debtor's ability to reorganize, and perhaps worse. Unsupportable critiques of this nature are little more than arguments against *any* change in the status quo – fear-mongering in an effort to ward off perceived threats to vigorously guarded bankruptcy prerogatives. Charges of that nature are not at all surprising given the enormous advantages debtors have been able to wield over employees. It is simply unrealistic to suggest that companies would forego the potent remedies afforded by the bankruptcy system rather than adapt to rules that better protect employees and retirees.

Labor groups and the employees who show up to work every day for a company in bankruptcy know that their company's future depends on the success of the reorganization. No group works harder to achieve pragmatic outcomes under the extraordinarily difficult conditions of a bankruptcy case, yet workers are sacrificing too much to too many other interests in bankruptcy. H.R. 4677 is desperately needed to correct a serious imbalance in the bankruptcy process that has taken away the financial security of far too many workers, and will continue to strip away good, middle class jobs and decent standards of living unless Congress acts to put a stop to these practices. We urge Congress to take prompt action on this bill. Thank you once again for the opportunity to appear today in support of this important legislation.



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<sup>1</sup> H.R. 3652, 110<sup>th</sup> Cong. (2007).

<sup>2</sup> H.R. Rep No. 95-595 at 220 (1977) (“The purpose of a business reorganization case, unlike a liquidation case, is 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. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap .... It is more economically efficient to reorganize than to liquidate because it preserves jobs and assets.”).

<sup>3</sup> For the 12-month period ending December 31, 2009, business bankruptcy filings increased 40% compared to filings in calendar year 2008. Chapter 11 filings for the 12-month period ending December 31, 2009 were up 50% compared to chapter 11 filings in calendar year 2008. See [www.uscourts.gov/Press\\_Releases/2010/BankruptcyFilingsDec2009.cfm](http://www.uscourts.gov/Press_Releases/2010/BankruptcyFilingsDec2009.cfm) (visited March 21, 2010). See also Nelson D. Schwartz, “Tight Credit Seen as Corporate Debts Come Due,” *The New York Times* (March 16, 2010) A1 (potential overload in debt markets as many high yield debt issues come due could increase bankruptcy filings as companies seek credit renewals).

<sup>4</sup> See *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc.* (*In re Mesaba Aviation, Inc.*), 350 B.R. 435, 443 (D. Minn. 2006) (describing the impact of airline bankruptcies on employees).

<sup>5</sup> See 11 U.S.C. §§ 1102, 1103 (describing official creditors committees and their duties and powers).

<sup>6</sup> See *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, 547 U.S. 651 (2006) (reviewing the expansion of the wage priority to include contributions to employee benefit plans).

<sup>7</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 212 (2005), codified at 11 U.S.C. §§ 507(a)(4),(5).

<sup>8</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, §§ 323, 329 (2005), codified at 11 U.S.C. § 541(b)(7) and § 503(b)(1)(A).

<sup>9</sup> The Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, § 541 (1984) codified at 11 U.S.C. § 1113.

<sup>10</sup> The Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, §2, (1988), codified at 11 U.S.C. § 1114.

<sup>11</sup> See note 18 *infra*.

<sup>12</sup> See notes 21, 25 *infra*.

<sup>13</sup> *In re UAL Corp.*, 428 F.3d 677 (7<sup>th</sup> Cir. 2005); *In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006)(affirming decisions authorizing multiple pension plan terminations); see *United*

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*Steelworkers of Am. v. United Eng'g, Inc.*, 52 F.3d 1386 (6th Cir. 1995) (rejecting plan termination contract claim by employees).

<sup>14</sup> E.g., *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 848 F.2d 345 (2d Cir. 1988); *Truck Drivers Local 807 v. Carey Transportation, Inc.* (*In re Carey Transportation, Inc.*), 816 F.2d 82 (2d Cir. 1987).

<sup>15</sup> *Northwest Airlines Corp. v. Association of Flight Attendants*, 483 F.3d 160 (2d Cir. 2007).

<sup>16</sup> For a recent representative example of a comprehensive “first day” wage motion, see Debtors’ Motion for Entry of Interim and Final Orders (A) Authorizing, but not Directing, Debtors (I) to Pay Certain Prepetition Wages and Reimbursable Employee Expenses, (II) to Pay and Honor Employee Medical and Other Benefits and (III) to Continue Employee Benefits Programs and (B) Authorizing Financial Institutions to Honor all Related Checks and Electronic Payment Requests [Docket No. 6, Mar. 18, 2009], *In re Chemtura Corp., et al.*, Case No. 09-11233 (REG) (Bankr. S.D.N.Y.). Obtaining authority to maintain pay and benefit programs uninterrupted by the bankruptcy case allows debtor companies to stabilize the business, maintain employee morale, and mitigate economic hardships. See Eisenberg and Gecker, “The Doctrine of Necessity and Its Parameters,” 73 Marq. Law Rev. 1 (Fall, 1989).

<sup>17</sup> H.R. 4677, 111<sup>th</sup> Cong. § 101 (2010).

<sup>18</sup> Vacation pay is typically allocated by the court to earnings periods, even where fully earned as of a specified date. See, e.g., *In the Matter of Northwest Engineering Co.*, 863 F.2d 1313 (7th Cir. 1988); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992). Court decisions that allow priority payment only for an allocated portion of the total amount of earned compensation, limit the collection of the wage priority to less than the full per-employee amount.

<sup>19</sup> See *Straus-Duparquet, Inc. v. Local Union No. 3, Int’l Brotherhood of Electrical Workers*, 386 F.2d 649 (2d Cir. 1967).

<sup>20</sup> 11 U.S.C. § 507(a)(5)(B) (describing calculation of priority for unpaid benefit plan contributions, which subtracts “the aggregate amount paid to such employees under paragraph 4 of this subsection....”).

<sup>21</sup> Most courts distinguish between “length of service” severance pay and “pay in lieu of notice” severance. See *In re Public Ledger*, 161 F.2d 762 (3d Cir. 1947). Where courts make this distinction, severance pay in which the amount is based on length of service is allocated between “earned” periods. Under *Roth*-type cases, employees are left with a small fraction of their contractual severance pay if they lose their jobs during a bankruptcy.

<sup>22</sup> See *Straus-Duparquet, Inc. v. Local Union No. 3, Int’l Brotherhood of Electrical Workers*, 386 F.2d at 650-51. See also *Supplee v. Bethlehem Steel Corp.*, 479 F.3d 167 (2d Cir. 2007) (supplemental retirement plan payment was not severance pay entitled to be paid as an administrative expense).

<sup>23</sup> H.R. 4677, 111<sup>th</sup> Cong. § 103 (2010).

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<sup>24</sup> 11 U.S.C. § 503(a)(1)(A)(ii).

<sup>25</sup> See *In re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. June 20, 2008); *In re Powermate Holding Corp.*, 394 B.R. 765 (Bankr. D. Del. Oct. 10, 2008); *In re Continental AFA Dispensing Company*, 403 B.R. 653 (Bankr. E.D. Mo. 2009); See also *In re Circuit City Stores, Inc.*, 2010 WL 120014 (Bankr. E.D. Va. 2010).

<sup>26</sup> H.R. 4677, 111<sup>th</sup> Cong. § 105 (2010).

<sup>27</sup> See *Adventure Res., Inc. v. Holland*, 137 F.3d 786, 797-98 (4th Cir. 1998) (Congress acted to halt use of “bankruptcy law as an offensive weapon in labor relations”) (quoting *In re Roth American, Inc.*, 975 F.2d 949, 956 (3d Cir. 1992)); see also *Century Brass Prods., Inc. v. Int’l Union (In re Century Brass Prods. Inc.)*, 795 F.2d 265, 272 (2d Cir. 1986) (noting that statute imposed “several safeguards” on a debtor seeking rejection “to insure that employers did not use Chapter 11 as medicine to rid themselves of corporate indigestion”); see also, *Shugrue v. Air Line Pilots Association, Int’l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 990 (2d Cir. 1990); *In re Tower Automotive, Inc.*, No. 06-CV4996(VM), 2006 WL 3751360, at \*4 (S.D.N.Y. 2006) (describing Congress’s intent in enacting Section 1114 to “ensure that the debtors did not seek to effect reorganization ‘on the backs of retirees’ for the benefit of other parties in interest”).

<sup>28</sup> Babette A. Ceccotti, “Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code,” 15 ABI Law Rev. 415 (Winter 2007) (“Lost in Transformation”). A copy is submitted with this hearing statement. See also Andrew B. Dawson, “Collective Bargaining Agreements in Corporate Reorganizations,” 84 Am. Bankr. L.J. 103, 119 (Winter 2010) (concluding that consistently pro-debtor rulings under Section 1113 demonstrate that the statute has provided “very little protection at all” for labor agreements, and recommending statutory modifications to cure the statute’s defective ambiguity).

<sup>29</sup> See, e.g., Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement: A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 AM BANKR. L. J. 293, 306, 316 (1984); Bruce Charnov, *The Uses and Misuses of Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 925, 948–50 (1989).

<sup>30</sup> See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers Of Am. (In re Wheeling-Pittsburgh Steel Corp.)*, 791 F.2d 1074 (3d Cir. 1986) (overruling rejection of labor agreement); *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc. (In re Royal Composing Room, Inc.)*, 848 F.2d 345, 351-8 (2d Cir. 1988) (Feinberg, J., dissenting from majority decision affirming rejection of labor agreement).

<sup>31</sup> “Lost in Transformation,” 15 ABI Law Rev. at 432; see e.g. *Truck Drivers Local 807 v. Carey Transportation, Inc. (In re Carey Transportation, Inc.)*, 816 F.2d 82, 89 (2d Cir. 1987); *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc. (In re Mesaba Aviation, Inc.)*, 350 B.R. 449 (D. Minn. 2006) (approving less stringent interpretation of Section 1113).

<sup>32</sup> See Dawson, “Collective Bargaining Agreements in Corporate Reorganizations,” 84 Am. Bankr. L.J. at 104.

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<sup>33</sup> See *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc. (In re Mesaba Aviation, Inc.)*, 350 B.R. 435, 443 (D. Minn. 2006) (noting “disastrous” results of airline bankruptcies for labor).

<sup>34</sup> Dawson, “Collective Bargaining Agreements,” 84 Am. Bank. L.J. at 104, 119. *see also* *Id.* at 116 (relating that in one decision in which the debtor did not prevail, the debtor ultimately prevailed in a subsequently filed motion).

<sup>35</sup> E.g., *Teamsters Airline Division v. Frontier Airlines, Inc.*, 2009 WL 2168851 (S.D.N.Y. 2009) (overturning the bankruptcy court’s rejection order where the court considered proposals made by the debtor after the commencement of the Section 1113 hearing).

<sup>36</sup> See *Teamsters Airline Division v. Frontier Airlines, Inc.*, 2009 WL 2168851 (S.D.N.Y. 2009); *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc. (In re Mesaba Aviation, Inc.)*, 350 B.R. 435 (D. Minn. 2006).

<sup>37</sup> See, e.g., *In re Delta Air Lines, Inc.*, 359 B.R. 468, 475 (Bankr. S.D.N.Y. 2006) (“It is important to bear in mind the context in which this statute operates. Section 1113 is not a labor law, it is a bankruptcy law.”).

<sup>38</sup> See U.S. Gov’t Accountability Office, GAO 07-1101, “Many Factors Affect the Treatment of Pension and Health Benefits in Chapter 11 Bankruptcy” (2007) (identifying companies that rejected labor agreements and terminated pension and/or non-pension benefits obligations in bankruptcy); *Lost in Transformation*, 15 ABI Law Rev. at 417 and note 10.

<sup>39</sup> “Lost in Transformation,” 15 ABI Law Rev. at 417-18 and notes 11, 12, 13 (collecting cases filed to achieve “transformational” goals in light of fundamental industry change).

<sup>40</sup> See Damon A. Silvers, “How We Got Into This Mess,” *The America Prospect* (April 21, 2008), available at: [www.prospect.org/cs/articles?article=how\\_we\\_got\\_into\\_this\\_mess](http://www.prospect.org/cs/articles?article=how_we_got_into_this_mess) (visited May 19, 2010).

<sup>41</sup> The Pension Protection Act of 2006, Pub. L. No. 109-280 120 Stat. 780 (August 17, 2006) (“PPA”). See Testimony of Ron Gebhardt, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (describing plan terminations in the *Bethlehem Steel* and *UAI Corp.* bankruptcies); Testimony of Richard Jones, Chief Retirement Actuary, *Hewitt Associates LLC, Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (noting that the defined benefit plan “is a common area to look for cost cutting” when companies are in financial distress and describing how pension values are lost by employer bankruptcies).

<sup>42</sup> See *Pension Benefit Guaranty Corporation v. Oneida, Ltd.*, 562 F.3d 154 (2d Cir. 2009) (ruling that the obligation to pay the Termination Premium is not discharged in bankruptcy).

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<sup>43</sup> PPA section 404(a), adding Section 4022(g) to the Employee Retirement Income Security Act. See Testimony of David R. Jury, USW, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (calling for repeal of Section 404).

<sup>44</sup> Paul Fronstin, “The Future of Employment-Based Health Benefits: Have Employers Reached a Tipping Point?” Employee Benefit Research Institute Issue Brief No. 312 (December 2007) (describing trends in employer-provided retiree health benefits).

<sup>45</sup> Among other provisions intended to address the cost of retiree health benefits, Section 1102(a)(1) of the Patient Protection and Affordable Care Act, P.L. 111-148 (March 23, 2010) establishes a temporary reinsurance program designed to reimburse a portion of the claims cost for eligible employment-based plans that provide coverage to early retirees.

<sup>46</sup> See *PBGC v. LTV Corp.*, 496 U.S. 633, 646–47 (1990) (“Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice”) (quoting *Rodriguez v. United States*, 480 U.S. 522, 525–26 (1987)).

<sup>47</sup> H.R. 4677, 111<sup>th</sup> Cong. § 201 (2010).

<sup>48</sup> See “Lost in Transformation,” 15 ABI Law Rev. at 426–7 (describing legislators’ concerns that led to the inclusion of the time limits in the statute). In addition, adopting a ruling from the Seventh Circuit Court of Appeal in the *United Airlines* case, the bill also clarifies that only the debtor and the affected labor organization may appear and be heard at a Section 1113 hearing. See *In re UAL Corp. (Appeals of Independent Fiduciary Services, Inc.)*, 408 F.3d 847 (7th Cir. 2005) (ruling that the parties to a Section 1113 hearing are those legally capable of modifying the agreement).

<sup>49</sup> See, e.g., *In re Ionosphere Clubs, Inc.*, 22 F.3d 403 (2d Cir. 1994); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992); *In re Northwest Airlines Corp.*, 366 B.R. 270 (Bankr. S.D.N.Y. 2007) (noting differences in text between Section 1113 and Section 1114).

<sup>50</sup> H.R. 4677, 111<sup>th</sup> Cong. § 201.

<sup>51</sup> H.R. 4677, 111<sup>th</sup> Cong. § 201 (2010).

<sup>52</sup> Delphi Corporation, for example, requested a litigation schedule for its section 1113 proceedings against five unions on the very first day of its bankruptcy case. See Delphi’s Motion for Scheduling Order to Establish Notice Procedures, Briefing Schedule, and Hearing Date Regarding Debtors’ Conditional Applications for Relief Under 11 U.S.C. § 1113 if Voluntary Modifications to Collective Bargaining Agreements Cannot Be Reached [Docket # 14, Oct. 11, 2005], *In re Delphi Corporation*, No. 05-44481 (RDD) (Bankr. S.D.N.Y.).

Dana Corporation, another automotive supplier, established a litigation schedule for its Section 1113 and Section 1114 motions having tendered its proposals only days earlier. See Motion of Debtors and Debtors in Possession, Pursuant to 11 U.S.C. Section 105(a) for Entry of a Scheduling Order in Connection with Debtors’ Section 1113/1114 Process [Docket No. 4278,

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Dec. 6, 2006] *and* Joint Objection to Motion on behalf of International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), United Steelworkers [Docket No. 4341, Dec. 14, 2006], *In re Dana Corp.*, No. 06-10354 (BRL) (Bankr. S.D.N.Y.).

<sup>53</sup> See *Teamsters Airline Division v. Frontier Airlines, Inc.*, 2009 WL 2168851 (S.D.N.Y. 2009) (describing course of negotiations and information disclosure that continued through a Section 1113 hearing and vacating bankruptcy court's order authorizing rejection of labor agreement because the court considered proposals made after the commencement of the hearing).

See also *In re Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006) *and* Motion to Approve Compromise and For Relief Under 1113(c) Approving Amended Agreements with ALPA, AFA and AMFA, at 5-7, *In re Mesaba Aviation, Inc.*, No. 05-39258 (GFK) (Bankr. D. Minn. Nov. 7, 2006). Mesaba sought a six-year concessionary agreement and a fixed level of savings in its Section 1113 court case and in a later settlement agreed to a lower percentage of cuts, a shorter duration and a form of wage increase snapback it rejected in its court case.

<sup>54</sup> *Northwest Airlines Corp. v. Association of Flight Attendants*, 483 F.3d 160 (2d Cir. 2007). See Richard M. Seltzer and Thomas N. Ciantra, "The Return of Government by Injunction in Airline Bankruptcies," 15 ABI Law Rev. 499 (Winter 2007). A copy is submitted with this hearing statement.

<sup>55</sup> See generally, Michael St. Patrick Baxter, "Is There a Claim for Damages From the Rejection of a Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code?" 15 Bankr. Dev. J. 703 (1996).

<sup>56</sup> See *In re Tower Automotive, Inc.*, No. 06-CV4996(VM), 2006 WL 3751360, at \*4 (S.D.N.Y. 2006) (describing Congress's intent in enacting Section 1114 to "ensure that the debtors did not seek to effect reorganization 'on the backs of retirees' for the benefit of other parties in interest").

<sup>57</sup> H.R. 4677, 111<sup>th</sup> Cong. § 202 (2010).

<sup>58</sup> Compare *In re Delphi Corporation*, 2009 WL 637315 (Bankr. S.D.N.Y. March 9, 2009) and *In re Dorskocil Cos.*, 130 B.R. 810 (Bankr. D. Kansas 1991) (debtor need not follow Section 1114 procedures) with *In re Farmland Industries*, 294 B.R. 903 (Bankr. W.D. Mo. 2003) (Section 1114 procedures apply even where debtor asserted the right to make unilateral changes in retiree health benefits).

<sup>59</sup> H.R. 4677, 111<sup>th</sup> Cong. § 204 (2010).

<sup>60</sup> See Testimony of Richard Jones, Chief Retirement Actuary, Hewitt Associates LLC, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (describing increase in defined contribution plans).

<sup>61</sup> H.R. 4677, 111<sup>th</sup> Cong. § 204 (2010).

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<sup>62</sup> See H.R. Rep No. 95-595 at 220 (1977).

<sup>63</sup> H.R. 4677, 111<sup>th</sup> Cong. § 206 (2010).

<sup>64</sup> H.R. 4677, 111<sup>th</sup> Cong. § 203 (2010).

<sup>65</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501 (2005), codified at 11 U.S.C. § 503(c).

<sup>66</sup> See Maryjo Bellow and Edith K. Altice, “Tackle §503(c) by Structuring a ‘MIP’ – And Other Strategies to Have in Your Playbook,” 27 APR Am. Bankr. Inst. J. 34 (offering strategies for devising compensation packages in light of the Section 503(c) restrictions).

<sup>67</sup> E.g., *In re Global Home Products, LLC*, No. 06-10340, 2007 WL689747 (Bankr. D. Del. March 6, 2007) (approving program as incentive plan and excusing review by an independent consultant); *In re Nelson Neutraceutical Inc.*, 369 B.R. 787 (Bankr. D. Del. 2007).

<sup>68</sup> See *In re Dana Corporation*, No. 06-10354, 2006 WL 3479406 \* note 30 (Bankr. S.D.N.Y. 2006) (approving, as modified, revised executive contracts and noting that the CEO, “with curious timing, issued a letter to employees and former employees in the days after the Executive Compensation Motion was filed” indicating that the debtors, in aid of their reorganization “would have to close plants, terminate employees, modify collective bargaining agreements and potentially terminate retiree [health] benefits.”).

<sup>69</sup> See Peg Brickley, “Banks and Bonuses Still Rule in Delaware Bankruptcy Court,” *The Daily Bankruptcy Review*, October 27, 2008.

<sup>70</sup> H.R. 4677, 111<sup>th</sup> Cong. § 302 (2010).

<sup>71</sup> See “Executive Pay: Conflicts of Interest Among Compensation Consultants,” U.S. House of Representatives, Committee on Oversight and Governmental Reform (Majority Staff) (December, 2007).

<sup>72</sup> H.R. 4677, 111<sup>th</sup> Cong. § 301 (2010). See *In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009)(approving incentive pay program in reorganization plan where bonuses were tied to certain objectives, including a publication “shutdown” objective and emergence from bankruptcy).

<sup>73</sup> H.R. 4677, 111<sup>th</sup> Cong. § 305 (2010).

<sup>74</sup> H.R. 4677, 111<sup>th</sup> Cong. § 201 (2010).

<sup>75</sup> H.R. 4677, 111<sup>th</sup> Cong. § 303 (2010).

<sup>76</sup> H.R. 4677, 111<sup>th</sup> Cong. §§ 401, 402 (2010). See, e.g., *In re Ionosphere Clubs, Inc.*, 922 F.2d 984 (2d Cir. 1990); *In re Fulton Bellows & Components, Inc.*, 307 B.R. 896 (Bankr. E.D. Tenn. 2004) (automatic stay does not bar contractual arbitration proceedings).

## ATTACHMENT 1

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LOST IN TRANSFORMATION: THE DISAPPEARANCE OF LABOR  
POLICIES IN APPLYING SECTION 1113 OF THE BANKRUPTCY CODE

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INTRODUCTION

A resurgence in corporate bankruptcies targeting labor costs, pension funding and retiree health benefits obligations recalls an earlier time when companies saw bankruptcy as a potent instrument in labor-management relations. In the early 1980's, the strategic use of bankruptcy in several high profile labor disputes, fueled by the Supreme Court's 1984 decision in *NLRB v. Bildisco & Bildisco*,<sup>1</sup> unleashed a storm of protest that companies were abusing the bankruptcy process to target collective bargaining agreements.<sup>2</sup> Soon after the *Bildisco* decision, Congress enacted section 1113 of the Bankruptcy Code<sup>3</sup> to impose restrictions on the ability of a company in bankruptcy to reject a labor agreement.<sup>4</sup> Two years later, LTV

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<sup>1</sup> 465 U.S. 513 (1984).

<sup>2</sup> A number of widely publicized cases brought attention to the issue. In 1983, Continental Airlines filed a chapter 11 petition, immediately laid-off its employees, and resumed operations with a reduced workforce at half of their regular pay. Wilson Foods also filed a chapter 11 petition in 1983 and unilaterally slashed wage rates under its collective bargaining agreements. See *In re Wilson Foods Corp.*, 31 B.R. 269 (Bankr. Okl. 1983); Laurel Sorenson, *Chapter 11 Filing By Wilson Foods Roils Workers' Lives, Tests Law*, WALL ST. J., May 23, 1983, at 37 (leading union to file "charges of unfair labor practice [for] misuse of the bankruptcy law with the National Labor Relations Board"). Eastern Air Lines openly threatened its workers with bankruptcy to gain leverage in collective bargaining negotiations. See Katherine Van Wezel Stone, *Labor Relations on the Airlines: The Railway Labor Act in the Era of Deregulation*, 42 STAN. L. REV. 1485, 1491-92 (1990) (indicating mid-1980s airline management "used the threat of bankruptcy, merger or sale in negotiations to procure concessions"); Agis Salpukas, *A Wrenching Week at Airline*, N.Y. TIMES, Oct. 8, 1983, at 1.37 (reporting that "leaders of the pilot, flight attendant and machinist unions . . . charge that Frank A. Lorenzo, the airline chairman, was using bankruptcy laws to repudiate union contracts and break the power of the union"). Congressional hearings were held in which labor organizations reported growing instances of these tactics, including testimony by the president of the Teamsters union that numerous companies were "taking total advantage of the *Bildisco* decision." See Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement—A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 AM BANKR. L. J. 293, 306, 316 (1984) (describing two subcommittees of House of Education and Labor Committee holding "a joint hearing on the subject of the growing use of federal bankruptcy law as a 'new collective bargaining weapon'").

<sup>3</sup> References to the Bankruptcy Code are to 11 U.S.C. §§101-1532 (2006).

<sup>4</sup> See 11 U.S.C. § 1113 (2006). Under section 1113, a collective bargaining agreement remains in effect upon a bankruptcy filing and a debtor may not unilaterally alter any term of a labor agreement without meeting the requirements of the statute. See 11 U.S.C. § 1113(f), see also *Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 992 (2d Cir. 1990) (holding "that § 1113(f) precludes application of the automatic stay to disputes involving a collective bargaining agreement only when its application allows a debtor unilaterally to terminate or alter any provision of a collective bargaining agreement"); *United Steelworkers of Am. v. Unimet Corp. (In re Unimet Corp.)*, 842 F.2d 879, 884 (6th Cir. 1988) ("[P]rohibiting modification of any provision of the collective bargaining agreement without prior court approval."). Before seeking court-approved rejection of a labor agreement, a debtor must engage in



Corporation, then the second largest domestic steel company, filed a chapter 11 bankruptcy case and immediately announced that it was ceasing the payment of retiree health benefits covering some 70,000 retirees.<sup>5</sup> Congress acted again, this time to forestall the elimination of retiree health, life insurance and disability benefits upon a bankruptcy filing through legislation that ultimately became section 1114 of the Bankruptcy Code.<sup>6</sup>

By adding these provisions to the Bankruptcy Code, Congress intended to restrict the use of bankruptcy to alter obligations that implicate two vital interests—national labor policy and retiree insurance obligations. The statutes incorporate features designed to protect these interests and *limit* the circumstances under which a debtor may alter its obligations under a labor agreement or retiree health program.<sup>7</sup> Sections 1113 and 1114 represent deliberate policy choices by Congress to restrain a debtor's discretion under federal bankruptcy policy by prescribing special treatment for collective bargaining agreements and retiree insurance obligations not applicable to executory contracts generally or to other types of monetary obligations.<sup>8</sup> Balancing these non-bankruptcy interests against federal

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collective bargaining over proposals that meet prescribed standards. See 11 U.S.C. § 1113(b); see also *Century Brass Prods., Inc. v. Int'l Union (In re Century Brass Prods. Inc.)*, 795 F.2d 265, 272 (2d Cir. 1986) (discussing reversal of *Bildisco* by section 1113 which created of "an expedited form of collective bargaining with several safeguards").

<sup>5</sup> See *In re Chateaugay Corp.*, 64 B.R. 990, 992–93 (S.D.N.Y. 1986) (describing events surrounding LTV's bankruptcy filing); Susan J. Stabile, *Protecting Retiree Medical Benefits in Bankruptcy: The Scope of Section 1114 of the Bankruptcy Code*, 14 CARDOZO L. REV. 1911, 1912 (1993) (indicating "heated public response" to LTV's actions and "a union strike at several LTV steel mills"). LTV contended that the health benefits obligations were pre-petition claims based on the pre-bankruptcy service of former employees. *Chateaugay*, 64 B.R. at 993 ("LTV concluded that the Retirees held pre-petition unsecured claims which could not be paid absent court order or under a confirmed plan of reorganization.").

<sup>6</sup> 11 U.S.C. § 1114 (2006). Temporary legislation was passed in 1986 to halt the suspension of retiree medical, life and disability coverage in pending bankruptcy cases. See *LTV Steel Co. v. United Mine Workers of Am. (In re Chateaugay)*, 922 F.2d 86, 88 (2d Cir. 1990) ("Congress enacted temporary legislation requiring restoration of the benefits, and giving retiree benefit payments the status of administrative expenses, thereby permitting the payments during the reorganization."); see also Daniel Keating, *Good Intentions, Bad Economics: Retiree Insurance Benefits in Bankruptcy*, 43 VAND. L. REV. 161, 174 (1990) (noting temporary stopgap legislation providing that debtor filing for chapter 11 must continue retirees benefits payments). In 1988, Congress passed the Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, 102 Stat 610 (1988), which added section 1114 to the Bankruptcy Code. See Stabile, *supra* note 5, at 1926–27. Section 1114 requires the continuation of retiree benefits upon a bankruptcy filing and prohibits the modification of retiree benefits except as permitted under the statute. See 11 U.S.C. § 1114(e). The procedures and standards governing modification of retiree benefits are similar to those under section 1113. See *In re Tower Automotive, Inc.*, 241 F.R.D. 162, 166–68 (S.D.N.Y. 2006); *In re Farmland Industries, Inc.*, 294 B.R. 903, 915–16 (Bankr. W.D. Mo. 2003); *In re Ionosphere Clubs, Inc.*, 134 B.R. 515 (Bankr. S.D.N.Y. 1991) ("When Congress enacted § 1114, it used the same procedures and standards as existed for modification or rejection of collective bargaining agreements under § 1113.").

<sup>7</sup> See, e.g., *Peters v. Pikes Peak Musicians Ass'n*, 462 F.3d 1265 (10th Cir. 2006) (noting section 1113 prohibits debtors from unilaterally changing "terms and conditions of a collective bargaining agreement"); *Teamsters Indus. Sec. Fund v. World Sales, Inc. (In re World Sales, Inc.)*, 183 B.R. 872, 878 (9th Cir. 1995) ("Section 1113 was enacted to protect employees during the interim between the filing of the bankruptcy petition and court-supervised modification or ultimate rejection of the [collective bargaining agreement].").

<sup>8</sup> See *Tower Automotive*, 241 F.R.D. at 167 (stating that "§ 1114 . . . provides retirees with rights not afforded general unsecured creditors"); Donald R. Korobkin, *Value and Rationality in Bankruptcy*

bankruptcy policy, Congress determined that labor agreements and retiree health insurance should be afforded special protections notwithstanding the prerogatives otherwise available to a debtor in a chapter 11 bankruptcy.<sup>9</sup>

How, then, to explain the wave of bankruptcy cases targeting significant reductions in labor costs, pension funding, and retiree health obligations that has surged through the airline industry, the steel industry, auto supply and other heavily unionized industries in recent years?<sup>10</sup> Restructuring professionals have denominated these cases "labor transformation" bankruptcies.<sup>11</sup> They have in common the strategic use of bankruptcy to bring about broad changes to a business, largely through substantial cost-cutting, to address conditions that are ascribed to fundamental industry change. In these cases, the debtor believes that the bankruptcy process will allow it to achieve long-term solutions through the tools available under the Bankruptcy Code, including the rejection of collective bargaining agreements, the reduction or elimination of retiree health obligations and transactions to downsize the business to "core" operations or facilitate other operational changes to lower labor costs.<sup>12</sup> In these cases, debtors have been able to

*Decisionmaking*, 33 WM. & MARY L. REV. 333, 362-63 (1992) (stating section 1113 "embodies normative constraints to promote certain strongly held values associated with the integrity of collective bargaining agreements").

<sup>9</sup> See PBGC v. LTV Corp., 496 U.S. 633, 646-47 (1990) ("Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice . . .") (quoting *Rodriguez v. United States*, 480 U.S. 522, 525-26 (1987)).

<sup>10</sup> Among the bankruptcy cases in which companies principally targeted labor, pension and retiree health costs are: *In re UAL Corp.*, No. 02-48191 (Bankr. N.D. Ill.) (United Airlines, Inc.); *In re USAirways, Inc.*, No. 02-83984 (Bankr. E.D. Va.) ("USAirways I"); *In re USAirways, Inc.*, No. 04-13819 (Bankr. E.D. Va.) ("USAirways II"); *In re Delta Air Lines, Inc.*, No. 05-17923 (Bankr. S.D.N.Y.); *In re Northwest Airlines Corp.*, No. 05-17930 (ALG) (Bankr. S.D.N.Y.); *In re Mesaba Aviation*, No. 05-39258 (Bankr. D. Minn.); *In re ATA Holding Corp.*, No. 04-19866 (Bankr. S.D. Ind.); *In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006); *In re Bethlehem Steel*, No. 01-15288 (Bankr. S.D.N.Y.); *In re Tower Automotive, Inc.*, No. 05-10578 (Bankr. S.D.N.Y.); *In re Delphi Corporation*, No. 05-44481 (Bankr. S.D.N.Y.); *In re Dana Corp.*, No. 06-10354 (Bankr. S.D.N.Y.). See, e.g., U.S. Gov't Accountability Office, *Employee-Sponsored Benefits: Many Factors Affect the Treatment of Pension and Health Benefits in Chapter 11 Bankruptcy*, GAO 07-1101 (2007) (identifying companies that rejected labor agreements and/or terminated pension or non-pension benefits obligations in bankruptcy).

<sup>11</sup> See, e.g., Disclosure Statement with Respect to Joint Plan of Reorganization of Delphi Corp. and Certain Affiliates, Debtors and Debtors-in-Possession at DS 40-41, *In re Delphi Corp.*, No. 05-44481(RDD) (Bankr. S.D.N.Y. Sept. 6, 2006) [hereinafter, Delphi Disclosure Statement] (describing Delphi's "labor transformation" plan to address its "legacy labor costs as part of its restructuring" through, *inter alia*, motions under section 1113 and section 1114).

<sup>12</sup> See, e.g., Delphi Disclosure Statement at DS 30, 34-35 (describing Delphi's decision to seek relief under chapter 11 to address, *inter alia*, "U.S. legacy liabilities" and its bankruptcy transformation plan, including "labor transformation"); see also Declaration of Douglas M. Steenland, at ¶ 9, *In re Northwest Airlines Corporation*, No. 05-17930 (Bankr. S.D.N.Y. Sept. 14, 2005) (describing airline's intent to "use the salutary provisions of chapter 11" to "realize three major goals essential to the transformation of Northwest," including achieving a "competitive labor cost structure"); *id.* at ¶¶ 10, 12-13 (identifying "labor cost disadvantages *vis-a-vis* the [low cost carriers]" as "one of the fundamental causes of its difficulties"); Informational Brief in Support of First Day Motions, *In re Delta Air Lines, Inc.*, No. 05-17923 (Bankr. S.D.N.Y. Sept. 14, 2005) (describing its "Transformation Plan" initiatives and plans to use bankruptcy to obtaining additional cost savings, including pension funding, labor cost and retiree health cost savings); Supplemental Brief in Support of First Day Motions at 9-11, *In re USAirways, Inc.*, No. 04-13819 (Bankr.

extract substantial labor and benefit costs cuts, either through, or under the threat of, court-ordered relief under sections 1113 and 1114.<sup>13</sup> Many have involved the termination of defined benefit pension plans as well.<sup>14</sup>

But the proliferation of bankruptcy cases taking aim at costs attributed to collective bargaining agreements and pension and retiree health obligations is not easily squared with the special status accorded labor agreements and retiree health obligations by the addition of sections 1113 and 1114 to the Bankruptcy Code. Section 1113, in particular, was enacted to prevent companies from using bankruptcy as a strategic tool in its dealings with labor.<sup>15</sup> A principal purpose of both statutes is to protect employees and retirees from bearing a disproportionate burden of their employer's bankruptcy.<sup>16</sup> Yet the premise of the transformation bankruptcy is that bankruptcy law will enable restructuring changes that will be

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E.D. Va. Sept. 12, 2004) (describing Transformation Plan to be achieved in US Airways II, including cuts in pay and benefits, "whether by consent or through judicial resolution"); Informational Brief of United Air Lines, Inc. at 2-3, *In re UAL Corporation*, No. 02-48191 (Bankr. N.D. Ill. Dec. 9, 2002) (describing United's intention to use bankruptcy to transform its business and asserting that "the only conceivable way for United to reorganize will be to reduce its labor and other costs dramatically").

<sup>13</sup> See, e.g., *Association of Flight Attendants-CWA v. P.B.G.C.*, No. Civ A 05-1036ESH, 2006 WL 89829, at \*2 (D.D.C. Jan. 13, 2006) (describing United Air Lines' section 1113 and pension plan termination proceedings); *In re Nw. Airlines Corp.*, 346 B.R. 307, 332 (Bankr. S.D.N.Y. 2006) (approving rejection of debtor's section 1113 motion against one union and noting section 1114 proceedings against retirees and settlements reached with other unions); *In re Delta Air Lines*, 359 B.R. 468, 473 (Bankr. S.D.N.Y. 2006) (delineating labor costs saved by section 1113 proceedings at Delta's Comair subsidiary); see also Delphi Disclosure Statement at DS-49-55 (describing labor settlements, including attrition programs, modified wage, benefit and worksite agreements, elimination of retiree health obligations and pension plan freeze); First Amended Disclosure Statement With Respect to First Amended Joint Plan of Reorganization of Debtors and Debtors in Possession at 29-32, *In re Dana Corp.*, No. 06-10354(BRL) at 30-32 (Bankr. S.D.N.Y. Oct. 18, 2007) (describing "targeted" labor-related savings and estimating annual savings at \$220-245 million per year); Second Amended Disclosure Statement with Respect to Joint Plan of Reorganization of USAirways, Inc. at 63-65, *In re USAirways, Inc.*, No. 04-13819 (Bankr. E.D. Va. Aug. 9, 2005) (describing labor cost savings of over \$1 billion per year achieved during USAirways II).

<sup>14</sup> See *Kaiser Aluminum Corp.*, 456 F.3d at 332 (describing Kaiser's proceedings to terminate six pension plans in bankruptcy); see also *In re UAL Corporation*, 428 F.3d 677, 684 (7th Cir. 2005) (approving settlement between debtor and Pension Benefit Guaranty Corporation involving termination of four pension plans); *In re Aloha Airgroup, Inc.*, No. 04-3063, 2005 WL 3487724, at \*2 (Bankr. D. Hawaii Dec. 13, 2005) (describing Aloha's proceedings to terminate four pension plans); *In re US Airways, Inc.*, 296 B.R. 734, 745 (Bankr. E.D. Va. 2003) (approving termination of debtor's pension plan).

<sup>15</sup> See *Adventure Res., Inc. v. Holland*, 137 F.3d 786, 797-98 (4th Cir. 1998) (Congress acted to halt use of "bankruptcy law as an offensive weapon in labor relations") (quoting *In re Roth American, Inc.*, 975 F.2d 949, 956 (3d Cir. 1992)); see also *Century Brass Prods., Inc. v. Int'l Union (In re Century Brass Prods., Inc.)*, 795 F.2d 265, 272 (2d Cir. 1986) (noting that statute imposed "several safeguards" on a debtor seeking rejection "to insure that employers did not use Chapter 11 as medicine to rid themselves of corporate indigestion"); *In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 89-90 (2d Cir. 1992) (describing section 1113 requirements which prevent debtor "from using bankruptcy as a judicial hammer to break the union").

<sup>16</sup> See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1091 (3d Cir. 1986) (citing Congressional intent in enacting section 1113 that employees "not bear either the entire financial burden of making the reorganization work or a disproportionate share of that burden"); see also *In re Tower Automotive, Inc.*, 241 F.R.D. 162, 166 (S.D.N.Y. 2006) (describing Congress's intent in enacting section 1114 to "ensure that the debtors did not seek to effect reorganization 'on the backs of retirees' for the benefit of other parties in interest") (quoting *In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 523 (Bankr. S.D.N.Y. 1991)).

brought about in large part by cuts in collectively-bargained labor, pension and retiree health obligations.<sup>17</sup>

As a cost-cutting strategy, labor-targeted bankruptcies appear to have achieved their goals, despite the enactment of sections 1113 and section 1114. As a result, labor groups have had to absorb cumulative losses in these cases: elimination of jobs, cuts in wages and benefits, termination or freezing of pension plans and reductions in, or elimination of, retiree health benefits.<sup>18</sup> The long-term effects of these changes on individual workers and their families, and in turn, on the companies, have yet to fully unfold. At airlines that have emerged from bankruptcy, labor groups have already signaled their discontent over long-term concessionary contracts negotiated in section 1113 proceedings conducted in those bankruptcies.<sup>19</sup>

The heavy focus on labor and benefit cost cuts in the "transformation" bankruptcies offers strong proof that the substantive labor policies incorporated into the Bankruptcy Code through section 1113 are not operating as Congress intended. Despite the legislative choice made by Congress to restrain bankruptcy prerogatives where labor agreements are concerned, debtors have been free to use section 1113 and section 1114 to take broad aim at collective bargaining agreements, pension plans and retiree benefits.

In some ways this development was foreshadowed by an early split between two influential courts regarding key provisions of the statutory standard for rejection under section 1113.<sup>20</sup> But the recent transformation cases have highlighted the extent to which bankruptcy policy, rather than labor policy, prominently influences the application of section 1113.<sup>21</sup> In these cases, seeking relief from labor and benefit costs becomes closely identified with the principal aim of the restructuring case<sup>22</sup> and sections 1113 and 1114 become special-purpose provisions brought to bear on these obligations rather than (as they were intended) instruments of restraint.

This article reviews the background of section 1113, the early split between the Second Circuit and Third Circuit Courts of Appeals in interpreting the rejection

<sup>17</sup> See *supra* notes 11, 12.

<sup>18</sup> See *Ass'n of Flight Attendants-CWA v. Mesaba Aviation, Inc.*, 350 B.R. 435, 443 (D. Minn. 2006) (describing "draconian" effects of airline bankruptcies on labor unions and employees); see also *supra* notes 13, 14.

<sup>19</sup> Corey Dade, *After Delta's Recovery, New Turbulence Stirs*, WALL ST. J., Oct. 4, 2007; Liz Fedor, *Pilots to NWA Chair: Shows Us More Money*, MINNEAPOLIS STAR TRIB., September 7, 2007; *United Workers Join For Flight*, CHI. TRIB., March 28, 2007; James Miller, *Union Chief Wants United to Start Talks*, CHI. TRIB., May 31, 2007 (reporting post-bankruptcy disputes at Northwest Airlines and United Air Lines arising from contracts negotiated during the airlines' bankruptcy cases).

<sup>20</sup> See *infra* pp. 427-430.

<sup>21</sup> See *Sheet Metal Workers' Int'l Ass'n v. Mile Hi Metal Sys., Inc. (In re Mile Hi Metal Sys., Inc.)*, 899 F.2d 887, 894 (10th Cir. 1990) (Seymour, J. concurring) (noting majority ignored strong labor policy); *In re Delta Air Lines, Inc.*, 359 B.R. 468, 475 (Bankr. S.D.N.Y. 2006) (holding section 1113 is not labor law but is bankruptcy law); cf. *In re Horseshoe Indus.*, 300 B.R. 573, 585 (Bankr. S.D.N.Y. 2003) (emphasizing ultimate goal of section 1113 should be reorganization of debtor).

<sup>22</sup> See *supra* notes 11, 12.

standard, and the application of section 1113 in recent cases. The article concludes with the proposition that the erosion of labor policies in the application of section 1113 has made bankruptcy, once again the "new collective bargaining weapon."<sup>23</sup>

#### I. THE CODIFICATION OF LABOR POLICIES IN SECTION 1113

Enacted in 1984 as part of the Bankruptcy Amendments and Federal Judgeships Act,<sup>24</sup> section 1113 was intended to overturn the Supreme Court's decision in *NLRB v. Bildisco*<sup>25</sup> with respect to the treatment of collective bargaining agreements in bankruptcy.<sup>26</sup> In *Bildisco*, the Court confirmed that collective bargaining agreements could be rejected under bankruptcy law.<sup>27</sup> In addition, the Supreme Court settled a dispute among the lower courts regarding the standard to be applied to rejection of collective bargaining agreements.<sup>28</sup> The decision also addressed the consequences of unilateral modification by a debtor in the absence of court-approved rejection.<sup>29</sup>

In its ruling, the Supreme Court accepted lower court rulings that a "somewhat stricter standard" should apply to rejection of labor agreements in light of "the special nature of a collective-bargaining contract, and the consequent 'law of the

<sup>23</sup> *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1081 (3d Cir. 1986).

<sup>24</sup> The Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

<sup>25</sup> 465 U.S. 513 (1984).

<sup>26</sup> *FBI Distribution Corp. v. Official Comm. of Unsecured Creditors (In re FBI Distribution Corp.)*, 330 F.3d 36, 44 (1st Cir. 2003) ("Congress amended the Code by adding 11 U.S.C. § 1113, which provides special treatment for collective bargaining agreements."); see *Adventure Res., Inc. v. Holland*, 137 F.3d 786, 797-98 (4th Cir. 1998) (emphasizing Congress enacted section 1113 to prevent employers from using bankruptcy filings to modify or reject collective bargaining agreements); *Carpenters Health & Welfare Trust Funds v. Robertson (In re Rufner Constr.)*, 53 F.3d 1064, 1066 (9th Cir. 1995) (noting section 1113 "imposes several procedural requirements that trustees and debtors must follow in order to reject a collective bargaining agreement"); see also, *Shugrue v. Air Line Pilots Association, Intl (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 990 (2d Cir. 1990); *United Steelworkers of Am. v. Unimet Corp. (In re Unimet Corp.)*, 842 F.2d 879, 882 (6th Cir. 1988); *Wheeling-Pittsburgh*, 791 F.2d at 1076; *In re Carey Transp., Inc.*, 50 B.R. 203, 206 (Bankr. S.D.N.Y. 1985).

<sup>27</sup> *Bildisco*, 465 U.S. at 521-23.

<sup>28</sup> See, e.g., *In re Brada-Miller Freight System, Inc.*, 702 F.2d 890, 899 (11th Cir. 1983) ("We find . . . balancing of the equities test provides a more satisfactory accommodation of the conflicting interests at stake in a rejection proceeding."); *Shopmen's Local Union No. 455 v. Kevin Steel Prod., Inc.*, 519 F.2d 698, 707 (2d Cir. 1975) (finding rejection standard should not be based solely on debtor's financial status but should consider balance of equities). See generally *Bhd. of Ry., Airline and S.S. Clerks v. REA Express, Inc.*, 523 F.2d 164, 172 (2d Cir. 1975) ("[I]n view of the serious effects which rejection has on the carrier's employees it should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs. ").

<sup>29</sup> *Bildisco*, 465 U.S. at 534 ("But while a debtor-in-possession remains obligated to bargain in good faith under NLRA § 8(a)(5) over the terms and conditions of a possible new contract, it is not guilty of an unfair labor practice by unilaterally breaching a collective-bargaining agreement before formal Bankruptcy Court action."); see 29 U.S.C. § 158 (d) (2006) ("[T]hat where there is in effect a collective-bargaining contract covering employees in an industry affecting commerce, the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract . . .").

shop' which it creates [citations omitted]."<sup>30</sup> The Court rejected a strict standard favored by the National Labor Relations Board (NLRB) and articulated by the Second Circuit Court of Appeals in *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*<sup>31</sup> In that case, the court ruled that, "[i]n view of the serious effects which rejection has on the carrier's employees," rejection should be authorized "only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs."<sup>32</sup> The Court found this standard unacceptably narrow in its focus on whether rejection of a collective-bargaining agreement was needed to avoid liquidation, a limitation the Court saw as "fundamentally at odds with the policies of flexibility and equity" of chapter 11.<sup>33</sup>

Instead, the Court settled on a standard for rejection that it termed "higher than that of the 'business-judgment' rule, but a lesser one than the *REA Express*" standard.<sup>34</sup> The standard announced by the Court required a debtor to show that "the collective bargaining agreement burdens the estate and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."<sup>35</sup> In addition, before acting on a motion to reject the agreement, a bankruptcy court "should be persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution."<sup>36</sup>

The Court's nod to federal labor policy in articulating the rejection standard was overshadowed (if not undone) by its controversial ruling that a debtor does not commit an unfair labor practice by unilaterally modifying a labor agreement upon a bankruptcy filing.<sup>37</sup> The Court's rationale was that a labor agreement, like other executory contracts, is not an enforceable agreement upon the filing of a bankruptcy case.<sup>38</sup> The Court's majority did not consider its ruling to be inconsistent with federal labor policies because a debtor would still be required to bargain "over the

<sup>30</sup> *Bildisco*, 465 U.S. at 524. See *Brada Miller Freight*, 702 F.3d at 899 (accepting *Bildisco* balancing of equities test as better tool to evaluate rejection of collective bargaining agreements). See generally John Wiley & Sons, Inc., v. Livingston, 376 U.S. 543, 548 (1964) ("[A] collective bargaining agreement is not an ordinary contract. It is a generalized code to govern a myriad of cases which the draftsman cannot wholly anticipate. The collective agreement covers the whole employment relationship.").

<sup>31</sup> *REA Express*, 523 F.2d at 172.

<sup>32</sup> *Id.*

<sup>33</sup> *Bildisco*, 465 U.S. at 525.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> Section 8(d) of the National Labor Relations Act (NLRA), 29 U.S.C. § 158(d)(4) (2006), sets forth the "mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder . . . ." 29 U.S.C. § 158(d) (2006). Where there is an agreement in effect, the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract, except as set forth in the statute. The party desiring modification shall, *inter alia*, continue "in full force and effect" "all the terms and conditions of the existing contract for a period of sixty days after such notice is given or until the expiration date of such contract, whichever occurs later." *Id.*

<sup>38</sup> *Bildisco*, 465 U.S. at 521–23, 532.

terms and conditions of a new possible contract" even though "it is not guilty of an unfair labor practice by unilaterally breaching a collective-bargaining agreement before formal Bankruptcy Court action."<sup>39</sup>

In a dissent that drew heavily on federal labor policies, four justices strongly disagreed with the majority's ruling that a debtor does not commit an unfair labor practice by unilaterally modifying a collective bargaining agreement.<sup>40</sup> The dissent charged that the majority's ruling ignored the Court's long-standing recognition of the role of labor agreements in federal labor policy and would operate to "deprive[ ] the parties to the agreement of their 'system of industrial government.'"<sup>41</sup>

Lobbying efforts by labor organizations intensified after the *Bildisco* decision.<sup>42</sup> At the same time, Congress' attention was focused on another serious bankruptcy issue, this one arising from the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line*,<sup>43</sup> in which the Court ruled that the grant of authority to bankruptcy judges lacking the attributes of Article III judges was unconstitutional.<sup>44</sup> The *Marathon* decision was stayed to allow Congress to take corrective action.<sup>45</sup> The legislative solution to the *Marathon* issue thus became the vehicle for enacting Congress' response to *Bildisco*.<sup>46</sup>

As described in detailed accounts of the passage of the 1984 amendments, section 1113 was the product of compromises resulting from at least three separate bills introduced in the House and the Senate to address the *Bildisco* decision.<sup>47</sup>

<sup>39</sup> *Id.* at 534.

<sup>40</sup> *Id.* at 535-54 (Brennan, J. dissenting).

<sup>41</sup> *Id.* at 553-54 (Brennan, J. dissenting) (citation omitted). *See id.* at 548 (noting central role of collective bargaining in conflict resolution).

<sup>42</sup> Rosenberg, *supra* note 2, at 312 (noting shift in congressional interest regarding Court's *Bildisco* decision after six airline unions testified before House subcommittee and labor leaders called on Congress to adopt stricter standard under which bankrupt employer could reject collective bargaining agreement); Michael D. Sousa, *Reconciling the Otherwise Irreconcilable: The Rejection of Collective Bargaining Agreements Under Section 1113 of the Bankruptcy Code*, 18 LAB. LAW. 453, 468-69 (2003) (noting labor leaders' lobbying efforts in response to *Bildisco*); *see* *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1082 (3d Cir. 1986) (reviewing legislative history of section 1113 that began with unions' "immediate and intense lobbying effort in Congress to change the law").

<sup>43</sup> *N. Pipeline Constr. Co. v. Marathon Pipe Line*, 458 U.S. 50 (1982) (holding Bankruptcy Reform Act of 1978 unconstitutional because it "impermissibly removed most, if not all, of the essential attributes of the judicial power" from district court and vested those powers in adjunct bankruptcy court not found in Article III).

<sup>44</sup> *Id.* at 87.

<sup>45</sup> *Id.* at 88.

<sup>46</sup> *See* Bruce Charnov, *The Uses and Misuses of Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 925, 948-50 (1989) (observing deadline imposed by Supreme Court after *Marathon* influenced the passage of section 1113); *see also* Elizabeth P. Gilson, *Statutory Protection For Union Contracts in Chapter 11 Reorganization Proceedings: Wheeling-Pittsburgh Steel Corp. v. United Steelworkers*, 19 CONN. L. REV. 401, 409-10, n.38 (1987) (noting pressure on Congress to pass bill restructuring "entire system of bankruptcy courts" in light of *Marathon*); Stabile, *supra* note 5, at 1922 n.65 (stating Congress passed section 1113 as part of legislation to resolve jurisdictional issue raised by *Marathon*).

<sup>47</sup> *See* Michael St. Patrick Baxter, *Is There a Claim For Damages From the Rejection of a Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code?*, 12 BANKR. DEV. J. 703, 722 (1996).

Congressman Rodino introduced H.R. 4908 when the *Bildisco* decision was announced. Congressman Rodino's bill proposed the stringent *REA Express* test as the standard to be applied to rejection of a labor agreement and included a prohibition on unilateral modification of a collective bargaining agreement.<sup>48</sup> The Rodino proposal was incorporated into H.R. 5174, the omnibus bankruptcy bill passed by the House.<sup>49</sup> In the Senate, Senator Thurmond rejected the House proposal and introduced a bill incorporating the *Bildisco* rejection standard, adding a requirement that a debtor provide 30 days notice before unilateral modification.<sup>50</sup> This proposal was "reluctantly" accepted by the business community but rejected by labor.<sup>51</sup> Senator Packwood then introduced a separate bill with the backing of organized labor. Among other provisions, the Packwood amendment would have permitted rejection upon a showing of "minimum modifications to employees benefits and protections that would permit the reorganization, taking into account the best estimate of the sacrifices expected to be made by all classes of creditors and other affected parties . . . ."<sup>52</sup>

When fears of a deadlock led to withdrawal of both the Packwood and Thurmond amendments, the Senate passed a bankruptcy bill containing no labor provision.<sup>53</sup> The conference then took up H.R. 5174, which contained the Rodino *REA Express* formulation, and the Senate bill, which contained no labor provision. The conference agreement emerged overnight on June 28, 1984 and was passed on June 29, 1984 as the interim jurisdictional rule was expiring.<sup>54</sup>

(noting difference between new bill and original Rodino proposal); Charnov, *supra* note 46, at 946–47, 950–54 (discussing history of three different bills during legislative process); Rosenberg, *supra* note 2, 313–318.

<sup>48</sup> See, e.g., Baxler, *supra* note 47, at 721; Charnov, *supra* note 46, at 946; Rosenberg, *supra* note 2, at 313.

<sup>49</sup> See, e.g., Christopher D. Cameron, *How 'Necessary' Became the Mother of Rejection: An Empirical Look at the Fate of Collective Bargaining Agreements on the Tenth Anniversary of Bankruptcy Code Section 1113*, 34 SANTA CLARA L. REV. 841, 844 n.21 (1994); Charnov, *supra* note 46, at 946–47.

<sup>50</sup> See Charnov, *supra* note 46, at 950–51 (describing introduction of Thurmond amendment); Daniel S. Ehrnberg, *Rejecting Collective Bargaining Agreements Under Section 1113 of Chapter 11 of the 1984 Bankruptcy Code: Resolving the Tension Between Labor Law and Bankruptcy Law*, 2 J.L. & POL'Y 55, 68 (1994) (describing Thurmond's proposal incorporating balancing of equities test and thirty day waiting period); Anne J. McClain, *Bankruptcy Code Section 1113 and the Simple Rejection of Collective Bargaining Agreements: Labor Loses Again*, 80 GEO. L. J. 191, 196 (1991) (discussing Sen. Thurmond amendment).

<sup>51</sup> See *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 848 F.2d 345, 353 (2d Cir. 1988) (Feinberg, J., dissenting) (describing reaction to Sen. Thurmond bill); 130 CONG. REC. 10, 13061 (1984) (statement by Sen. Thurmond) ("[T]he business community does not prefer this but they reluctantly went along. Thus, while business has made significant and conciliatory shift in its position, labor has given little or nothing in its demands."); Rosenberg, *supra* note 2, at 318 (explaining business interests opposed Packwood amendment, while labor rejected Thurmond's proposal).

<sup>52</sup> 130 CONG. REC. 10, 13185 (1984). See Charnov, *supra* note 46, at 952–53 (describing Packwood amendment).

<sup>53</sup> See Baxler, *supra* note 47, at 721 (stating both Packwood and Thurmond withdrew their amendments in order to resolve *Marathon* issue); Charnov, *supra* note 46, at 953–54 (describing withdrawal of amendments to prevent filibuster); Gilson, *supra* note 46, at 409–10, n.38 (noting withdrawal of amendments to avoid filibuster and that, at Sen. Dole's urging, a bill was passed with no labor provisions).

<sup>54</sup> Charnov, *supra* note 47, at 954; Rosenberg, *supra* note 2, at 318–19, 321, n.155; see Bill D. Bensinger, *Modification of Collective Bargaining Agreements: Does a Breach Bar Rejection?*, 13 AM. BANKR. INST. L. REV. 809, 816 (2005) ("Ultimately a compromise was reached on June 28, to include section 1113 in the 1984 legislation that was passed by both the House and the Senate on June 29.")



As reflected in the principal bills under consideration and in the floor statements on final passage, the extent to which labor policies would apply to limit the application of bankruptcy policy was central to the legislative debate. The Rodino and Packwood proposals favored strict rejection standards and a prohibition against unilateral rejection. The Thurmond amendment would have codified *Bildisco* with a modest limit on unilateral modification. Accounts of the legislative events show that the text of section 1113 was considered by most of those who made statements about the bill to be, in substance, the labor-backed Packwood amendment, even if the language was not identical to Packwood's proposal.<sup>55</sup>

The compromise was reflected in specific provisions that made explicit the application of labor policies, while opponents of the pro-labor provisions were successful in incorporating limited circumstances in which unilateral action to implement changes could be taken.<sup>56</sup> On the pro-labor side, section 1113(f) prohibits unilateral modification of a collective bargaining agreement and establishes that a labor agreement remains in effect upon a bankruptcy filing.<sup>57</sup> In addition, a debtor seeking rejection is required to first engage in collective bargaining over proposals that must meet a standard limiting the scope of the modifications that can be sought.<sup>58</sup> Specifically, the statute requires the submission

<sup>55</sup> See, e.g., *In re Royal Composing Room*, 848 F.2d at 353 (Feinberg, J. dissenting) (describing current version as "lak[ing] most of its provisions from the Rodino and Packwood bills"); *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1087 (3d Cir. 1986) ("[C]ontemporaneous remarks of the conferees made it clear that the provision was based on the substance of Senator Packwood's proposal."); Charnov *supra* note 46, at 962 (noting both conferees viewed committee proposal to be same as Packwood's original amendment); *id.* at 966 (quoting Sen. Thurmond's floor statement that "the procedures and standards are essentially the same as those of the Packwood Amendment"); *id.* at 968 (quoting Sen. Packwood's floor statement that "approach contained in the amendment that [he] offered was, for the most part, adopted by the conferees."); see also Gilson, *supra* note 46, at 412 (stating Sen. Thurmond agreed that section 1113 was "essentially same as the Packwood amendment").

<sup>56</sup> See *In re Royal Composing Room*, 848 F.2d at 353 (Feinberg, J., dissenting) (describing legislative proposals and bill reported out of conference committee, "which takes most of its provisions from the Rodino and Packwood bills but contains a provision for interim relief pending a ruling on rejection application, see § 1113(e), that is inspired by the Thurmond bill"); see also Rosenberg, *supra* note 2, at 321 (describing new law as "a nearly perfect compromise" requiring an employer to bargain over "necessary modifications in the employees' benefits and protections" yet allowing debtor to take unilateral action if court fails to timely rule and to seek interim relief).

<sup>57</sup> 11 U.S.C. § 1113(f) (2006) ("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 title."); see *United Food and Commercial Workers Union v. Almac's Inc.*, 90 F.3d 1, 7 (1st Cir. 1996) ("In Section 1113, Congress provided that collective bargaining agreements are enforceable against the debtor after the filing of a petition for reorganization."); *Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 990 (2d Cir. 1990) (construing section 1113(f) and citing statement of Sen. Packwood that "[t]he amendments also prohibit the trustee from unilaterally altering or terminating the labor agreement prior to compliance with the provisions of the section. The provision encourages the collective bargaining process, so basic to federal labor policy." (quoting 130 CONG. REC. S8898 (daily ed. June 29, 1984))).

<sup>58</sup> 11 U.S.C. § 1113(b)(1), (2) (denoting proposal standards and bargaining requirement); see 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Packwood) (explaining that proposals must be limited to "necessary" proposals so that "the debtor will not be able to exploit the bankruptcy procedure to rid itself of unwanted features of the labor agreement" not bearing on its financial condition, that word "necessary" appears twice "to emphasize[] this required aspect of the proposal" and "guarantee[] the

of a proposal that "is based on the most complete and reliable information available at the time" and "which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably[.]"<sup>59</sup> The statute also requires good faith bargaining following the submission of the proposal, providing that, "the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement."<sup>60</sup> These requirements were incorporated to "place[] the primary focus on the private collective-bargaining process and not in the courts."<sup>61</sup>

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sincerity of the debtor's good faith in seeking contract changes"); 130 CONG. REC. H7490 (statement of Rep. Morrison) ("[L]anguage makes plain that the trustee must limit his proposal . . . to only those modifications that must be accomplished [if] the reorganization is to succeed."); see *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1087 (3d Cir. 1986) (citing Sen. Thurmond's concession that "the Senate conferees had been required to accept a bankruptcy bill, if there was to be one at all, that contained 'a labor provision acceptable to organized labor,' and that the provision was one whose 'procedures and standards are essentially the same as those of the Packwood amendment.'").

<sup>59</sup> 11 U.S.C. § 1113(b)(1)(A).

Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section 'trustee' shall include a debtor in possession) shall

(A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably . . .

*Id.*

<sup>60</sup> 11 U.S.C. § 1113(b)(2) ("During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.").

<sup>61</sup> 130 CONG. REC. S8898 (daily ed. June 29, 1984) (statement of Sen. Packwood). See *N.Y. Typographical Union v. Maxwell Newspapers* (*In re Maxwell Newspapers*) 981 F.2d 85, 90 (2d Cir. 1992) (statute's "entire thrust" is to "ensure that well-informed and good faith negotiations occur in the market place, not as part of the judicial process."); see also *Century Brass Prod. Inc. v. Int. Union, United Automobile, Aerospace and Agricultural Implement Workers of Am.* (*In re Century Brass Prods., Inc.*), 795 F.2d 265, 273 (2d Cir. 1986) (reaffirming section 1113 "encourages the collective bargaining process as a means of solving a debtor's financial problems insofar as they affect its union employees"); 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Kennedy) (stating intent "to overturn the *Bildisco* decision which had given the trustee all but unlimited discretionary power to repudiate labor contracts and to substitute a rule of law that encourages the parties to solve their mutual problems through the collective bargaining process"); Richard H. Gibson, *The New Law on Rejection of Collective Bargaining Agreements in Chapter 11: An Analysis of 11 U.S.C. § 1113*, 58 AM BANKR. L. J. 325, 327 (1984) (analyzing law and legislative history and describing principal purpose to "discourage both unilateral action by the debtor and recourse to the bankruptcy court. Instead, the law seeks to encourage solution of the problem through collective bargaining").

In addition, the standard expresses Congress's intent that an employer's restructuring not disproportionately burden the employees. As expressed by Senator Packwood, the language "guarantees that the focus for cost cutting must not be directed exclusively at unionized workers. Rather the burden of sacrifices will be spread among all affected parties."<sup>62</sup> In ruling on a motion to reject a labor agreement, the court must find that the debtor has complied with the procedural and substantive requirements, that the union rejected the proposal "without good cause," and that the balance of the equities "clearly favors rejection" of the agreement.<sup>63</sup>

Opponents of the labor provisions pressed for the inclusion of terms that would accommodate time-sensitive contingencies in a bankruptcy case. Thus, a provision permitting emergency, interim relief without requiring the pre-rejection procedures was incorporated as section 1113(e).<sup>64</sup> Another provision permits the debtor to implement modifications unilaterally if the court fails to issue a decision in a

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<sup>62</sup> 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Packwood).

This language [fair and equitable contained in 11 U.S.C. § 1113(b)(1)(A)] guarantees that the focus for cost cutting must not be directed exclusively at unionized workers. Rather the burden of sacrifices in the reorganization process will be spread among all affected parties. This consideration is desirable since experience shows that when workers know that they alone are not bearing the sole brunt of the sacrifices, they will shoulder their fare share and in some instances without the necessity for a formal contract rejection.

*Id.* See *Century Brass Prods., Inc. v. Int'l Union (In re Century Brass Prods. Inc.)*, 795 F.2d 265, 273 (2d Cir. 1986) (ruling purpose is "to spread the burden of savings the company to every constituency while ensuring that all sacrifice to a similar degree"); 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Senator Moynihan) (noting provision "ensures that a company's workers will not have to bear an undue burden to keep the company solvent. The union would have to make the necessary concessions. Nothing more. Nothing less.").

<sup>63</sup> 11 U.S.C. § 1113(c). See *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 755-60 (Bankr. D. Minn. 2006), *aff'd* in part, *rev'd* in part, *Ass'n of Flight Attendants-CWA v. Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006) (quoting *In re American Provision Co.*, 44 B.R. 907, 909-10 (Bankr. D. Minn. 1984) and recognizing that section 1113(c) introduces principles of equity into the court's consideration of the facts by requiring the debtor to satisfy a burden of production and persuasion regarding the consequences of its proposals on all parties involved).

<sup>64</sup> 11 U.S.C. § 1113(e) (authorizing interim changes in terms of collective bargaining agreement "if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate"); see *United Food and Commercial Workers Union v. Almac's Inc.*, 90 F.3d 1, 4 (1st Cir. 1995) ("Congress recognized in enacting section 1113(e) that on occasion a debtor may require emergency relief from the collective bargaining agreement prior to rejection, assumption, or agreed-upon modification of the agreement."); Gibson, *supra* note 61, at 333 (describing statement of Sen. Hatch regarding interim relief provision as being critical to preserving business).

rejection proceeding within the time specified.<sup>65</sup> Opponents of the labor provisions also opposed the application of the new law to pending cases.<sup>66</sup>

Statements on final passage confirm that proponents of the labor policies deemed the resulting version of section 1113 acceptable. For example, Senator Kennedy expressed reservations about the subsections permitting unilateral action where the court fails to timely rule, as well as the interim relief provision, but was "convinced that both of these defects are sufficiently limited by appropriate safeguards that they do not detract from the overall product."<sup>67</sup> Senator Packwood also expressed concern about these provisions but felt they would have only limited application.<sup>68</sup> Those who opposed the labor provisions reluctantly accepted the labor-backed Packwood-based provisions and focused their comments on the addition of sections 1113(e) and section 1113(d)(2).<sup>69</sup>

## II. BANKRUPTCY POLICY HAS ECLIPSED LABOR POLICIES IN APPLYING SECTION 1113

Interpretive disagreements erupted almost immediately following enactment as the courts tackled language the drafters may have understood more as markers for the respective policy interests than as precise instructions for implementing those policies.<sup>70</sup> The most prominent division in the application of the rejection standard occurred when the Second and Third Circuit Courts of Appeals issued conflicting rulings concerning the scope of proposed modifications permitted under section 1113—the "necessary" and "fair and equitable" standard.<sup>71</sup> This statutory test

<sup>65</sup> 11 U.S.C. § 1113(d)(2); see Charnov, *supra* note 46, at 966 (describing statement of Sen. Thurmond regarding provisions for emergency relief and unilateral action pending court ruling added "at the insistence of the Senate conferees" to "insure the flexibility and finality of the labor language"); Rosenberg, *supra* note 2, at 305–08, 317 (1984) (recounting Thurmond amendment, which included emergency relief provision); Gibson, *supra* note 61, at 331 (describing statement of Sen. Hatch that conference agreement "emphasizes the need for expedition" in process through addition of 30-day ruling deadline).

<sup>66</sup> Rosenberg, *supra* note 2, at 317; 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Dole) ("[I]mportantly, Mr. President, the labor provision is prospective only in application to ensure that it will not be applied to cases pending in the courts today, such as the Continental [case] . . .").

<sup>67</sup> 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Kennedy).

<sup>68</sup> *Id.* (statement of Sen. Packwood) (adding, "on balance" the bill "should stimulate collective bargaining and limit the number of cases when a judge will have to authorize the rejection of a labor contract").

<sup>69</sup> See *supra* notes 50, 51; 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Thurmond) (stating, absent need to take corrective action in light of *Marathon Pipe Line* decision, he "could not have agreed to [the labor provisions]" but "the compromise that was reached was, in my opinion, the fairest and most equitable one that could have been reached under the circumstances").

<sup>70</sup> See *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984) (observing section 1113 "is not a masterpiece of drafting").

<sup>71</sup> See 11 U.S.C. § 1113(b)(1)(A) (2006). Compare *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1088–89 (3d Cir. 1986), with *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 89 (2d Cir. 1987).

reflects the incorporation of labor policies<sup>72</sup> and has been a key determinant in the outcome of a rejection motion.<sup>73</sup>

The *Wheeling-Pittsburgh* court examined the legislative history in detail in order to resolve the disputed interpretations of the statute's "necessary" and "fair and equitable" requirements.<sup>74</sup> The court's opinion drew "significant guidance" from the legislative history, examining "the sequence of events leading to adoption of the final version of the bill, and the statements on the House and Senate floor of the legislators most involved in its drafting."<sup>75</sup> While the court defined "necessary" to mean "essential" and limited the focus of the standard to "the somewhat shorter term goal of preventing the debtor's liquidation,"<sup>76</sup> the significance of the court's ruling was its conclusion that the "necessary" requirement was "conjunctive with the requirement that the proposal treat 'all of the affected parties . . . fairly and equitably.'"<sup>77</sup> The court interpreted both the language of the statute and the legislative history to prohibit the rejection of a contract "merely because [the court] deems such a course to be equitable to the other affected parties, particularly creditors."<sup>78</sup> Such a construction, the court warned, "would nullify the insistent congressional effort to replace the *Bildisco* standard with one that was more sensitive to the national policy favoring collective bargaining agreements, which was accomplished by inserting the 'necessary' clause as one of the two prongs of the standard that the trustee's proposal for modifications must meet."<sup>79</sup> The court drew its conclusion from legislative events that pointed to a "congressional consensus that the 'necessary' language was substantially the same as the phrasing in Senator Packwood's [labor-backed] amendment."<sup>80</sup>

The Third Circuit's conclusion led it to reject the company's proposal for a wage cut under a five-year contract predicated on "worst-case scenario" projections by the company.<sup>81</sup> Based upon its "conjunctive" reading of the "necessary" and "fair and equitable" standard, the court faulted the proposal for failing to incorporate a "snap-back" provision to compensate the workers if the business fared better than

<sup>72</sup> See *supra*, notes 61, 62.

<sup>73</sup> Christopher D. Cameron, *How 'Necessity' Became the Mother of Rejection: An Empirical Look at the Fate of Collective Bargaining Agreements on the Tenth Anniversary of Bankruptcy Code Section 1113*, 34 SANTA CLARA L. REV. 841, 920 (1994) (analysis of section 1113 opinions revealed that "necessity" requirement was "the single most important factor" in court's evaluation of rejection).

<sup>74</sup> *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1082-84.

<sup>75</sup> *Id.* at 1086.

<sup>76</sup> *Id.* at 1089.

<sup>77</sup> *Id.* See N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc. (*In re Royal Composing Room, Inc.*), 78 B.R. 671, 673-74 (S.D.N.Y. 1987) (discussing interpretation of word necessity as requiring both "necessity" and "fairly and equitable" requirements).

<sup>78</sup> *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1081.

<sup>79</sup> *Id.* at 1089.

<sup>80</sup> *Id.* at 1088. See *id.* at 1087 (commenting on Sen. Packwood's amendment "supported by labor" and concluding that "[t]he contemporaneous remarks of the conferees made it clear that the provision was based on the substance of the Senator Packwood's proposal").

<sup>81</sup> *Id.* at 1093.

the debtor's pessimistic projections.<sup>82</sup> The court ruled that the proposal could not be considered "necessary" because it consisted of "an unusually long five-year term at markedly reduced labor costs based on a pessimistic five-year projection without at least also providing for some 'snap-back' to compensate for workers' concessions."<sup>83</sup> The Court of Appeals was also critical of the bankruptcy court's application of a rejection standard "closer to, if not taken direct from, *Bildisco*, rather than a standard informed by the legislative history."<sup>84</sup>

The Second Circuit Court of Appeals took up the "necessary" and "fair and equitable" standards in *Truck Drivers Local 807 v. Carey Transportation*.<sup>85</sup> In *Carey* the court announced that it "declined to adopt" the *Wheeling-Pittsburgh* view that "necessary" should be construed as "essential" or bare minimum," or that "necessary" referred to a debtor's short-term survival.<sup>86</sup> Unlike the Third Circuit's deference to the legislative history, the Second Circuit gave it short shrift. Instead, the court based its interpretation principally on the text of the statute itself.<sup>87</sup> The court did not address the *Wheeling-Pittsburgh* court's ruling that the "necessary" standard in section 1113(b)(1)(A) should be read in conjunction with the "fair and equitable" language. Instead, the *Carey* court addressed the "necessary" standard and the "fair and equitable" standards separately.<sup>88</sup> Focusing on the Third Circuit's "necessary means essential" formulation, the *Carey* court concluded that a debtor could not be limited to proposing "truly minimal changes" because it would be constrained from further bargaining, while a debtor that agreed to change its proposal in bargaining "would be unable to prove that its initial proposals were minimal."<sup>89</sup> In addition, the court compared the requirements of section 1113(b)(1) to the interim relief provision of section 1113(e) and concluded that the language difference suggested that the standard in section 1113(b)(1) was aimed at longer-term relief, again contrary to the Third Circuit's reading of the language.<sup>90</sup> The court summarized that "the necessity requirement places on the debtor the burden of proving that its proposal is made in good faith, and that it contains necessary, but

<sup>82</sup> *Id.* at 1090 ("In failing to focus on the Union's contention about the 'snap back' provision when deciding whether the modifications were 'necessary,' the bankruptcy court erroneously treated the two prongs of the standard as disjunctive rather than conjunctive.").

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 1090-91 (critiquing district court's failure "to appreciate Congress' substantial modification of the standard for rejection").

<sup>85</sup> 816 F.2d 82 (2d Cir. 1987).

<sup>86</sup> *Id.* at 89 ("[T]he *Wheeling-Pittsburgh* court did not adequately consider the significant differences between interim relief requests and post-petition modification proposals.").

<sup>87</sup> *Id.* (rejecting contention based on legislative events by noting that while legislative language might be based on Packwood proposal, precise language chosen was not same as Packwood amendment).

<sup>88</sup> *Id.* at 88-90 (addressing "necessary" and "fair and equitable" language as separate elements of section 1113(b)(1)(A) standard).

<sup>89</sup> *Id.* at 89.

<sup>90</sup> *Id.* The court also cited the feasibility standard for confirmation of a reorganization plan, see 11 U.S.C. § 1129(a)(11), as grounds for its view that the "necessary" standard required the court to look to the debtor's "ultimate future" and estimate its longer term financial needs. *Id.*

not absolutely minimal, changes that will enable debtor to complete the reorganization process successfully.<sup>91</sup>

A year later in *Royal Composing Room*,<sup>92</sup> a case in which a printing company sought to modify its labor agreement as a result of changing technologies in the industry, the Second Circuit held that where the debtor's proposal as a whole was determined to be "necessary" under the *Carey* standard, the union could not attack a particular element of the proposal under that standard if the union refused to bargain over it.<sup>93</sup> The majority opinion cited tactical considerations for this ruling.<sup>94</sup> The court feared that if a debtor were required to test individual components of its proposal against the standard, the union could tactically refuse to bargain and then claim that the proposal failed the statutory test.

In a strongly worded dissent, Chief Judge Feinberg criticized the majority's ruling in *Royal Composing* as contrary to the purposes underlying section 1113: "This appeal raises the question of whether a statute designed to make it more difficult for employers in bankruptcy proceedings to reject labor contracts can be used in a way that Congress obviously sought to avoid."<sup>95</sup> Like the opinion in *Wheeling-Pittsburgh*, the dissent's analysis was founded on a detailed review of the legislative history: "[the legislative history] reinforces what is implied by the statutory language itself: Congress intended Section 1113 to make rejection of signed labor contracts difficult (but not impossible) and was especially concerned that bankruptcy not become a union-busting tool."<sup>96</sup> The dissent concluded that by disregarding the backdrop of the statute, the majority had disrupted the workings of the statute in its focus only on aggregate savings and by supporting its "necessity" determination with a critique of the union's negotiating record.<sup>97</sup>

The Third Circuit's *Wheeling-Pittsburgh* decision and the Feinberg dissent in *Royal Composing*, each guided by a detailed review of legislative history, similarly

<sup>91</sup> *Id.* at 90. The court did not substantively address arguments regarding the proposed contract duration or the absence of a snap-back because the union had not raised these objections in the courts below. *Id.*

<sup>92</sup> N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc. (*In re Royal Composing Room, Inc.*), 848 F.2d 345 (2d Cir. 1988).

<sup>93</sup> See *id.* at 348 (holding "at least in these circumstances, the focus should be at the proposal as a whole"); see also *id.* at 349 ("[S]o long as the total quantum savings is necessary under the *Carey Transportation* standard, the union may not prevent rejection by belatedly attacking a specific element."); *In re Delta Air Lines*, 342 B.R. 685, 694 (Bankr. S.D.N.Y. 2006) (applying majority test of necessity "focus[ing] . . . on the proposal as a whole").

<sup>94</sup> *In re Royal Composing Room*, 848 F.2d at 348 (acknowledging logic of union argument that any unnecessary modification amounts to non-compliance with section 1113, but that literal construction of statute would allow union "to play 'hit and run': refusing to negotiate toward a compromise, safe in the knowledge that it will almost certainly be able to defeat a rejection application by attacking some vital modification [as not] 'necessary'").

<sup>95</sup> *Id.* at 351 (Feinberg, J., dissenting).

<sup>96</sup> *Id.* at 352. See *id.* at 354 ("I believe [the legislative history] shows that a political battle was fought over section 1113, and that . . . those who wished to make rejecting a labor contract more difficult were successful.").

<sup>97</sup> *Id.* at 351-52, 354 (Feinberg, J., dissenting); see *id.* at 356-57 (criticizing majority's acquiescence to debtor's proposal in order to give debtor "flexibility," while union is forced to sacrifice contract "seniority" which is often most crucial element of collective bargaining agreements for unions in general).

concluded that the interpretation of the rejection standard must be informed by labor policies.<sup>98</sup> By contrast, neither the Second Circuit's formulation of the "necessary" standard in *Carey* nor the majority opinion in *Royal*, incorporated labor policies or credited the statute's legislative history.<sup>99</sup> But it is the *Carey* decision that has gained ground as courts that have addressed the statute have framed their analysis by selecting only from the *Wheeling-Pittsburgh* interpretation or the *Carey* interpretation.<sup>100</sup>

Because the more widely followed *Carey* decision was not informed by labor policy and did not follow the *Wheeling-Pittsburgh* court's "conjunctive" reading of the "necessary" and "fair and equitable" standards,<sup>101</sup> the split in the case law over these critical requirements has greatly weakened the application of labor policies. In the *Carey* formulation, whether a proposal is "necessary" is reviewed without regard to whether it is "fair and equitable" to the union. Viewed under *Carey*, the rejection standard tilts decidedly towards a bankruptcy-centered consideration about the prospects for a long-term reorganization and away from a labor policy frame of reference (for example, the degree to which proposed cuts invade the expectations reflected in the collective bargaining agreement or are modulated by snap-backs or other compensatory features of interest to the union).<sup>102</sup> Labor policies were further weakened by the *Royal Composing Room* decision, where the court added a limitation on the union's bargaining options to an analysis of the "necessity" standard.<sup>103</sup>

<sup>98</sup> See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am.*, 791 F.2d 1074, 1089 (3d Cir. 1986) ("The language as well as the legislative history makes plain that a bankruptcy court may not authorize rejection of a labor contract merely because it deems such a course to be equitable to the other affected parties, particularly creditors." The construction must be "more sensitive to the national policy favoring collective bargaining agreements."); *In re Royal Composing Room*, 848 F.2d at 353 (Feinberg, J. dissenting) ("[S]ection 1113 in its final form is a pro-labor law."); see also *Sheet Metal Workers' Int'l Ass'n v. Mile Hi Metal Sys., Inc. (In re Mile Hi Metal Sys., Inc.)*, 899 F.2d 887, 894 (10th Cir. 1990) (Seymour, J., concurring) (criticizing majority opinion for construing "necessary" standard in lenient manner based on "conclusory statements, not arguments" while "ignoring strong labor policy favoring collective bargaining agreements").

<sup>99</sup> But see *Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 989-90 (2d Cir. 1990) (looking to language of statute, legislative history and "the context in which § 1113 was enacted" to determine Congressional intent in interpreting section 1113(f)). See *United States v. Dauray*, 215 F.3d 257, 264 (2d Cir. 2000) ("When the plain language and canons of statutory interpretation fail to resolve statutory ambiguity, we will resort to legislative history.").

<sup>100</sup> See *In re Mile Hi Metal Sys.*, 899 F.2d at 892-93 (noting "majority of cases decided since *Wheeling-Pittsburgh* have declined to interpret section 1113(b)(1)(A) as requiring that a proposal be absolutely necessary"); *Ass'n of Flight Attendants-CWA v. Mesaba Aviation, Inc.*, 350 B.R. 435, 449 (D. Minn. 2006) (contrasting Third Circuit and Second Circuit standards and concluding "the bankruptcy court correctly adopted the more flexible standard set forth in *Carey*").

<sup>101</sup> See Gilson, *supra* note 46, at 428-29 (observing that court's interpretation is based on plain language of statute).

<sup>102</sup> See *id.* at 89 ("[I]n virtually every case, it becomes impossible to weigh necessity as to reorganization without looking into the debtor's ultimate future and estimating what the debtor needs to attain financial health.").

<sup>103</sup> *In re Royal Composing Room*, 848 F.2d at 348-49 (describing unions' options to argue employer bad faith or negotiate moderation of offensive proposal and warning of risks of adopting hard-line position).



That the *Wheeling-Pittsburgh* interpretation has not gained favor may reflect too narrow a view of that court's ruling. While courts have focused on the semantic question whether "necessary" is synonymous with "essential," and whether the phrase "necessary to permit the reorganization" reflects a shorter time horizon, a court need not accept either interpretation in order to follow the more labor-sensitive *Wheeling-Pittsburgh* ruling. Instead, a court following *Wheeling-Pittsburgh* would address the "necessary" and "fair and equitable" standards together in a manner that tempers the debtor's case for its reorganization needs with a heightened regard for the effect of the proposal on the workers' labor agreement.<sup>104</sup>

Recent cases clearly reflect the influence of *Carey* and *Royal* and show that bankruptcy policies heavily predominate in applying section 1113. In the *Delta Air Lines* bankruptcy, Delta's affiliated regional carrier, Comair, initiated section 1113 proceedings against its unionized workforce, leading to decisions rejecting the pilots' collective bargaining agreement and the flight attendants' collective bargaining agreement.<sup>105</sup> In granting the motion to reject the pilots' labor agreement, the court explicitly declared that bankruptcy policy governs the application of the statute: "[t]he fact that section 1113 is a bankruptcy law and therefore instinct with the fundamental objectives of chapter 11 has consequences for the implementation of the statute . . . ."<sup>106</sup> The test applied by the court looked to "the long-term economic viability of the reorganized debtor . . . ."<sup>107</sup> Analogizing Comair's circumstances to the debtor in *Royal*, the court centered on the debtor's "long-term ability to compete in the marketplace" in its review of the statutory standards.<sup>108</sup> The court's focus on Comair's reorganization prospects led it to overrule the union's contention that its rejection of Comair's proposals had been justified because Comair failed to moderate its demands through a commitment to job security.<sup>109</sup> The court ruled that Comair could not be expected to make commitments to job security that could "further erode the airline's ability to compete."<sup>110</sup>

Similarly, in *Mesaba Aviation, Inc.*, the district court upheld the bankruptcy court's application of the "necessary" standard as interpreted in *Carey* and concluded that the "*Carey* interpretation provides the more accurate reading of section 1113 in its context as part of the larger bankruptcy statute aimed at

<sup>104</sup> *Wheeling-Pittsburgh Steel*, 791 F.2d at 1085 (rejecting bankruptcy court's analysis regarding effects of proposal on workers).

<sup>105</sup> See generally *In re Delta Air Lines*, 351 B.R. 67 (Bankr. S.D.N.Y. 2006); *In re Delta Air Lines, Inc.*, 359 B.R. 468 (Bankr. S.D.N.Y. 2006). The court initially denied Comair's motion with respect to the flight attendants' labor agreement without prejudice to renewal. The denial was not based on the "necessary" standard, but on the debtor's intransigence regarding a flawed savings proposal which allocated too much of the savings to the flight attendant group. See *In re Delta Air Lines*, 342 B.R. 685, 697-99 (Bankr. S.D.N.Y. 2006).

<sup>106</sup> *In re Delta Air Lines, Inc.*, 359 B.R. at 476. See *id.* at 475 ("It is important to bear in mind the context in which this statute operates. Section 1113 is not a labor law, it is a bankruptcy law.")

<sup>107</sup> *Id.* at 477.

<sup>108</sup> *Id.* at 478.

<sup>109</sup> *Id.* at 488.

<sup>110</sup> *Id.*

'providing for the long-term rehabilitation of distressed businesses."<sup>111</sup> Mesaba, a regional carrier providing services for Northwest Airlines, sought a 19.4% reduction in its labor costs through pay and other cuts, reductions that would have dramatically reduced pay and dropped less senior, lower-wage employees to rates comparable to poverty level.<sup>112</sup> The carrier sought fixed six-year agreements with its unions and refused to negotiate a snap-back or recopener provision.<sup>113</sup> Mesaba's case was premised on attaining an 8% profit margin as a means of attracting exit financing.<sup>114</sup>

In applying the statutory standard, the court defined "the real issue" as "what, in the complex and dynamic world of the current market, will best promote the longer-term viability of the Debtor. Clearly, the Debtor must be able to project a future attractive enough to a lender or investor that it can have its emergence from bankruptcy underwritten."<sup>115</sup> The harsh effects of the wage cuts on the labor groups were found not to constitute "good cause" for the unions' rejection of Mesaba's proposal.<sup>116</sup> The bankruptcy court concluded that, while the effect on the employees was "an utter horror," on "the macro-economics of this case, the [poverty-level wage] outcome is unavoidable. And that has to drive the whole analysis, under the statute."<sup>117</sup> While the district court reversed the bankruptcy court on appeal, in part, for its failure to "even consider" a snap-back given the proposed six-year duration of the contract, the basic elements of the debtor's case, *i.e.*, the "necessity" case premised on attaining an 8% profit margin and the unwavering demand for labor cost cuts of 19.4%, were upheld.<sup>118</sup>

Notwithstanding the courts' rulings regarding the necessity of the proposed savings rate and the six-year contract term, Mesaba reached negotiated resolutions with its labor groups that yielded an agreement less draconian than the proposals on which the debtor based its litigation case. The aggregate savings was estimated by the debtor at less than 16%.<sup>119</sup> In addition, the agreements were for four-year, rather than six-year terms and ameliorated the wage cuts with future increases tied to the number of aircraft in Mesaba's fleet.<sup>120</sup> In defending the settlement, the debtor asserted that the resulting agreements were "consistent with the assumptions in the

<sup>111</sup> *Ass'n of Flight Attendants-CWA, v. Mesaba Aviation, Inc.*, 350 B.R. 435, 449 (D. Minn. 2006).

<sup>112</sup> *Id.* at 445.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 740 (Bankr. D. Minn. 2006), *aff'd* in part, *rev'd* in part, *Ass'n of Flight Attendants-CWA, v. Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006).

<sup>116</sup> See 11 U.S.C. § 1113(c)(2) (2006) (providing court shall approve rejection motion only where court finds, among other things, that "the authorized representative of the employees has refused to accept [the debtor's] proposal without good cause").

<sup>117</sup> *Mesaba Aviation*, 341 B.R. at 759, n.100. The district court upheld the bankruptcy court's finding on appeal. *Mesaba Aviation*, 350 B.R. at 462.

<sup>118</sup> *Mesaba Aviation*, 350 B.R. at 462; *In re Mesaba* 350 B.R. 105, 106 (Bankr. D. Minn. 2006) (decision on remand).

<sup>119</sup> See *Mesaba Aviation*, 350 B.R. at 443 (noting Mesaba's new agreement).

<sup>120</sup> See *id.* at 443 (discussing new agreement).

Debtor's business plan and will put the Debtor's cost structure with respect to these employees on competitive terms with other regional carriers."<sup>121</sup>

The *Mesaba* case, in particular, illustrates the pitfalls of applying section 1113 with a bankruptcy-centric frame of reference. Indeed, the case exhibits attributes similar to those identified by the court in *Wheeling-Pittsburgh*. Mesaba's proposal for a long-term agreement at a specified rate of savings, with no prospect of renegotiation or snap-back, was premised on its attempt to develop conservative projections in order to attract exit financing.<sup>122</sup> Yet even the recognition that the 8% profit margin "would be built on the backs of" the employees, many of whom could not afford it,<sup>123</sup> did not divert the courts from their principal focus based upon bankruptcy concerns nor require Mesaba to provide for mitigation of its proposal as in *Wheeling-Pittsburgh*.

In these cases, rejection motions were approved without acknowledging the need for mitigating factors such as renegotiation, snap-back provisions or counterproposals reflecting particular interests of the union. They were also approved despite candid recognition regarding the effects on the employees.<sup>124</sup> These rulings send clear signals that the protected labor policies Congress intended to incorporate into the Bankruptcy Code through section 1113 have been lost in the application of a bankruptcy policy-centered interpretation of the rejection standard.

Mesaba and Comair based their cases for rejection of the labor agreements on attaining financial metrics the companies hoped would be attractive in winning bids and securing exit financing.<sup>125</sup> Defining the rejection case in the same terms as the objective for the bankruptcy case places the burden of the restructuring squarely on the shoulders of the employees by targeting their labor agreements. A debtor seeking to transform its labor costs through bankruptcy uses section 1113 as if it were an operational confirmation hearing instead of an effort to balance protected labor policies with bankruptcy policy favoring restructuring. Factors that would give effect to the policies section 1113 was designed to protect, such as mitigating the impact of a concessionary proposal, minimizing the interference with expectations created by the labor agreement, and avoiding a disproportionate and "disastrous" burden on the affected employees,<sup>126</sup> are given scant recognition in the larger scheme of the debtor's reorganization case.

For industries facing significant changes, or plagued by complex conditions largely beyond the control of an individual company, the emphasis on cost-cutting underscores the deficiencies in the section 1113 process as applied in the

<sup>121</sup> Motion to Approve Compromise and For Relief Under 1113(c) Approving Amended Agreements with ALPA, AFA and AMFA, at 5-7, *In re Mesaba Aviation, Inc.*, No. 05-39258(GFK), (Bankr. D. Minn. Nov. 7, 2006).

<sup>122</sup> *Mesaba Aviation*, 341 B.R. at 740-41.

<sup>123</sup> *Id.* at 741 n.64.

<sup>124</sup> See *Mesaba Aviation*, 350 B.R. at 443 (noting effects of proposed cuts on employees, including those who will leave their jobs, "join the ranks of the uninsured," and "work too much for too little money.").

<sup>125</sup> See *Mesaba Aviation*, 341 B.R. at 739-40; *In re Delta Airlines, Inc.*, 359 B.R. 468, 481-82 (Bankr. S.D.N.Y. 2006).

<sup>126</sup> *Mesaba Aviation*, 350 B.R. at 443 (noting "disastrous" results of airline bankruptcies for labor).

transformation cases. Airline debtors, for example, acknowledged that the difficulties faced by the network carriers went beyond cost-cutting, pointing to factors such as persistently high fuel prices, depressed ticket revenues, and a fall-off in business travel.<sup>127</sup> Unable to address these factors through bankruptcy, the airline debtors turned to substantial cost-cutting.<sup>128</sup> Bankruptcy allowed the airline debtors to claim control over labor, pension and retiree health costs through the use of sections 1113 and 1114 where outside forces could not be controlled.<sup>129</sup> The "disastrous" results for labor in these cases becomes a particularly difficult outcome to sustain as a matter of policy when the vehicle is the very statute designed to avoid those results.

#### CONCLUSION

The transforming business restructurings described in this article are not so different from the cases that brought attention to the need for reform after the *Bildisco* decision. Put simply, in these cases, bankruptcy has once again become a deliberate strategy used to broadly target costs associated with collective bargaining agreements and collectively-bargained pension and retiree health obligations. A bankruptcy premised upon the transformation of labor cost obligations, where the consequences to workers are sacrificed to bankruptcy policy, is plainly at odds with a statute designed to give meaningful effect to vital policies protecting labor agreements, workers and retirees.

<sup>127</sup> See Supplemental Brief in Support of First Day Motions at 6–5, *In re USAirways, Inc.*, No. 04-13819 (Bankr. E.D. Va. Sept. 12, 2004) (ascribing failure of USAirways I bankruptcy to high fuel costs and weak domestic unit revenues); see also *id.* at 22–25 (describing cost reduction needs to meet challenges of low cost carrier competition); Information Brief of United Air Lines, Inc., No. 02-48191 at 36–44 (Bankr. N.D. Ill. December 9, 2002) (describing industry challenges, including September 11, 2001 attacks, fall-off in business travel, internet shopping, and low cost carrier competition); *id.* at 49–59 (describing labor cost issues); U.S. Gov't Accountability Office, GAO 05-945, *Bankruptcy and Pension Problems Are Symptoms of Underlying Structural Issues* (September 2005) (showing that airlines have used bankruptcy to cut costs with "mixed" results).

<sup>128</sup> See *supra*, note 12.

<sup>129</sup> See Daniel P. Rollman, *Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics*, 21 EMORY BANKR. DEV. J. 381 (2004) (noting airline's use of chapter 11 to obtain significant cost cuts "[enables] the carrier to delay fundamental changes to an outdated business model").

## ATTACHMENT 2

Reprinted by Permission of American Bankruptcy Institute  
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THE RETURN OF GOVERNMENT BY INJUNCTION IN AIRLINE  
 BANKRUPTCIES

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## INTRODUCTION

Holmes wrote that "[h]ard cases[] make bad law," because "some accident of immediate overwhelming interest . . . appeals to the feelings and distorts the judgment."<sup>1</sup> In the Second Circuit's recent decision in *Northwest Airlines Corp. v. Association of Flight Attendants ("AFA")*,<sup>2</sup> a hard case that has made bad law, the "accident of immediate overwhelming interest" was the possibility of a strike, a traditional judicial bete noire.<sup>3</sup> Faced with a labor dispute triggered by Northwest's resort to contract rejection under section 1113 of the Bankruptcy Code,<sup>4</sup> the court labored in (what it characterized as) "a peculiar corner of our law more evocative of an Eero Saarinen interior of creative angularity than the classical constructions of Cardozo and Holmes" in order to enjoin self-help.<sup>5</sup> Like Saarinen's most noteworthy design for aviation, which was abandoned for commercial purposes because of its

\* The authors are partners in Cohen, Weiss and Simon LLP and represented the Air Line Pilots Association, International in *In re Northwest Airlines*, Case No. 05-17930 (Bankr. S.D.N.Y.), including in the strike litigation reviewed in this paper, and other airline bankruptcies. The authors wish to acknowledge the research assistance of two Cohen, Weiss and Simon LLP law clerks, Nathaniel Hargress and Evan R. Hudson-Plush.

<sup>1</sup> N. Sec. Co. v. United States, 193 U.S. 197, 364 (1904) (Holmes, J., dissenting).

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

<sup>3</sup> N. Sec. Co., 193 U.S. at 364. Certain bankruptcy commentators do not limit their distaste for strikes. See Harvey R. Miller, Michele J. Meises & Christopher Marcus, *The State of the Unions in Reorganization and Restructuring Cases*, 15 AM. BANKR. INST. L. REV. 465, 465 (2007) ("The role of unions as the representative of organized labor has evolved from the proponent of fair and reasonable employment practices and a fierce advocate of collective bargaining to archaic organizations that appear to rigidly defend their organizations despite the economic realities and the effects of globalization."). Miller's view ignores the economic reality of collective bargaining. As democratic institutions responsive to employee interests, labor organizations must out of necessity make judgments in light of the economic viability of employers and like any economic actor face risks from adopting unreasonable positions in the marketplace. See Douglas Bordewick & Vern Countryman, *The Rejection of Collective Agreements by Chapter 11 Debtors*, 57 AM. BANKR. L.J. 293, 319 (1983) (stating union's desire to preclude Ch.11 debtor from rejecting collective bargaining agreement should be afforded considerable weight because union has much to lose if it adopts an incorrect decision). In the airline industry, for example, the advent of airline deregulation and with it competitive pressures on carriers lead to rapid concessionary contract modifications. See *Barthelemy v. Air Lines Pilots Ass'n*, 897 F.2d 999, 1002 (9th Cir. 1990) (noting deregulation of airline industry lead to intensified competition and caused many airlines to seek concession from labor); Jalmer D. Johnson, *Trends in Pilots' Pay and Employment Opportunities in CLEARED FOR TAKEOFF: AIRLINE LABOR RELATIONS SINCE DEREGULATION* 67, 71 (Jean T. McKelvey ed., 1988) (outlining pay concessions negotiated in pilot contracts immediately following deregulation). See generally Karen Van Wezel Stone, *Labor Relations On The Airlines: The Railway Labor Act in the Era of Deregulation*, 42 STAN. L. REV. 1485, 1490-91 (1990) (noting dependence of airline employees on carrier survival because of carrier-based seniority systems).

<sup>4</sup> 11 U.S.C. § 1113 (2006).

<sup>5</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 164 (2d Cir. 2007).

impracticality,<sup>6</sup> the Second Circuit's design in *AFA*, the subject of antagonistic views by its very architects, is not built to last.

The issues presented in *AFA* require consideration of three federal statutes: the Railway Labor Act ("RLA"),<sup>7</sup> which governs labor relations in the air transport industry, the Norris LaGuardia Act ("NLGA"),<sup>8</sup> which limits federal jurisdiction to enter injunctive relief in labor disputes, and section 1113,<sup>9</sup> which provides a mandatory collective bargaining process applicable when a debtor seeks to reject a collective bargaining agreement ("CBA") in bankruptcy.

In Part I we review the process of collective bargaining under the RLA, the history of negotiations relevant to *AFA*, and analyze the decision of the Bankruptcy Court denying Northwest's request for a strike injunction and the district court decision reversing that denial. In Part II A we argue that the fractured Second Circuit panel majority in *AFA* could only ground its decision affirming a strike injunction by rewriting, indeed "abrogating," consistent and settled law on the effect of contract rejection in bankruptcy. While the concurrence noted the inconsistency of the majority's approach, we show in Part II B that its alternative route to a strike injunction cannot be squared with the reciprocal obligations of labor and management under the RLA.

The *AFA* decision will surely undermine the effectiveness in bankruptcy of collective bargaining, which is the cornerstone of federal labor policy and should be of paramount importance under section 1113. Federal labor policy favors private bargaining and consensual agreement on terms and conditions of employment—not government or court dictated terms and conditions of employment enforced by injunction under power of contempt. Collective bargaining can only work if there is the mutual possibility of self-help in the absence of agreement.<sup>10</sup> We show that Congress did not undertake in section 1113 to revise that considered balance which is reflected in the jurisdictional limits on the entry of strike injunctions Congress imposed both in the NLGA and in the RLA. Further, the majority's unfounded conclusion that a CBA is abrogated rather than breached causes further mischief by eliminating rejection damages claims for unions on behalf of organized

<sup>6</sup> This was the terminal Saarinen designed for (the later thrice bankrupt) Trans World Airways at John F. Kennedy International airport in New York. See Randy Kennedy, *Airport Growth Squeezes the Landmark TWA Terminal*, N.Y. TIMES, Apr. 4, 2001, at B1 ("the terminal quickly became a dazzling architectural relic in southern Queens"); see also Mia Fineman, *Now Boarding At Terminal 5: New Visions*, N.Y. TIMES, Oct. 10, 2004, at AR28 (noting Saarinen's Terminal 5 has remained vacant since 2001).

<sup>7</sup> 45 U.S.C. §§ 151–188 (2000).

<sup>8</sup> 29 U.S.C. §§ 101–115 (2000).

<sup>9</sup> 11 U.S.C. § 1113 (2006).

<sup>10</sup> This is the declared policy of federal law in labor relations as declared in the NLGA. See 29 U.S.C. § 102 (2000) (finding in order for employees to negotiate the terms of his employment employees need to be free to engage in "self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection"); *NLRB v. City Disposal Sys. Inc.*, 465 U.S. 822, 835 (1984) (section 102 was enacted to foster equal bargaining power between employees and employers by allowing employees to "band together in confronting an employer regarding the terms and conditions of their employment").

employees.<sup>11</sup> This result is at odds with federal bankruptcy policy that treats creditors with equivalent claims—here parties to rejected executory contracts—equally in the distribution of the limited resources of the bankruptcy estate. The inequality fostered by the *AFA* majority could work a potentially massive redistribution of wealth from employees to other creditors or, potentially, equity interests, a result plainly unintended by Congress in section 1113, which, after all, was prophylactic labor legislation.<sup>12</sup>

Finally, in Part III we argue that when a court grants contract rejection under section 1113, a debtor is at liberty to impose new terms and conditions found by the court to be necessary under section 1113(b). Rejection and imposition of those new terms therefore constitute a material breach of the labor agreement, as does rejection of any executory contract. Section 1113 supplants the RLA bargaining process in bankruptcy.<sup>13</sup> As there is nothing in section 1113 that reverses the NLGA's withdrawal of jurisdiction from the federal courts to enjoin a strike if a CBA is rejected, there can be no basis to enjoin a strike triggered by contract rejection. This result is also consistent with the RLA's mutual scheme. Under the RLA, the parties are required to maintain status quo working conditions pending exhaustion of that Act's collective bargaining process: a carrier may not implement terms of its own choosing and a union may not strike to force changes in contractual terms. However, the right to self-help is similarly reciprocal: a union may strike when the negotiating process is exhausted and a carrier may then modify negotiated terms and conditions of employment.<sup>14</sup> Under settled RLA law a union may therefore also strike when a carrier implements new terms before exhausting the RLA process.<sup>15</sup> Given the jurisdictional limits of the NLGA, and in the face of the

<sup>11</sup> See *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 170 (2d Cir. 2007) (concluding it was most plausible "Northwest abrogated the CBA in its entirety and replaced it"); *In re Nw. Airlines Corp.*, 366 B.R. 270, 276 (Bankr. S.D.N.Y. 2007) (citing *In re Nw. Airlines Corp.*, 483 F.3d at 172) (confirming court excluded possibility of damages when it stated "[i]f a carrier that rejected a CBA simultaneously breached that agreement and violated the RLA, the union would be correspondingly free to seek damages or strike, results inconsistent with Congress' intent in passing § 1113.").

<sup>12</sup> See, e.g., *Sheet Metal Workers Int'l Ass'n, Local 9 v. Mile Hi Metal Systems, Inc. (In re Mile Hi Metal Systems, Inc.)*, 899 F.2d 887, 895 (10th Cir. 1990) ("Congress enacted The Bankruptcy Amendments and Federal Judgeship Act of 1984, of which section 1113 is a part . . . in direct response to labor concerns about employers' tactical use of bankruptcy laws . . .").

<sup>13</sup> See *Shugrue v. ALPA (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 989–90 (2d Cir. 1990) (noting language and legislative intent of section 1113 supports indication "that Congress intended § 1113 to be the sole method by which a debtor could terminate or modify a collective bargaining agreement and that application of other provisions of the Bankruptcy Code that allow a debtor to bypass the requirements of § 1113 are prohibited").

<sup>14</sup> See *Trans Int'l Airlines, Inc. v. Int'l Bhd. of Teamsters*, 650 F.2d 949, 960 (9th Cir. 1980) ("[I]f after reasonable efforts the parties have exhausted the bargaining procedures specified by the RLA without agreement, the statute does not bar such remedies, including a strike."); see also *Trans World Airlines, Inc. v. Indep. Fed'n of Flight Attendants*, 489 U.S. 426, 439 (1989) (citing *Burlington N. R.R. Co. v. Bhd. of Maint. Way Employees*, 481 U.S. 429, 444 (1987)) (noting cases have "read the RLA to provide greater avenues of self-help to parties that have exhausted the statute's 'virtually endless' . . . dispute resolution mechanisms"); *In re Nw. Airlines*, 483 F.3d at 160.

<sup>15</sup> See *Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union*, 396 U.S. 142, 150 (1969) (explaining if railroad violates the status quo provision of RLA, union cannot be expected not to resort to

labor relations process Congress enacted in section 1113, there can be no basis for the sort of strike injunction affirmed in *ATA*.

# I. BACKGROUND

## A. The RLA Bargaining Process

Enacted in 1926 and extended to cover the nascent air transport industry in 1936, the "RLA embodies a conception of labor relations in which all existing conditions and practices are presumed to be the product of agreements between management and labor" and establishes a process that requires collective bargaining before changes may be implemented.<sup>16</sup> Under the RLA, bargaining is purposefully long and drawn out—"virtually endless"<sup>17</sup>—with the aim that the parties will reach agreement and avoid the interruption to commerce that a strike would afford. To this end, the RLA requires direct negotiation between the parties and then, at the insistence of either, mediation under the auspices of the National Mediation Board ("NMB").<sup>18</sup> Throughout this process, the parties are required to refrain from self-help in support of their bargaining objectives and maintain the status quo ante, *i.e.*, the carrier may not modify collectively-bargained terms and conditions of employment and the union may not strike.<sup>19</sup> When the NMB concludes that further

self-help); *CSX Transp., Inc. v. Bhd. of Maint. of Way Employees*, 327 F.3d 1309, 1320 (11th Cir. 2003) ("If the party proceeds to implement the disputed policy, in breach of the status quo, the other party is entitled to resort to self-help, *i.e.*, a union can call a strike.")

<sup>16</sup> Stone, *supra* note 3, at 1487. The RLA requires collective bargaining wherever a carrier's employees have selected representation. See 45 U.S.C. § 152, Second (2000) ("All disputes between a carrier or carriers and its or their employees shall be considered, and, if possible, decided, with all expedition, in conference between representatives designated and authorized so to confer, respectively, by the carrier or carriers and by the employees thereof interested in the dispute."), Fourth (guaranteeing the right of employees to "organize and bargain collectively through representatives of their own choosing") and Ninth (requiring a carrier to "treat with the representative so certified as the representative of the craft or class for the purposes of this chapter"); *United Air Lines, Inc. v. Airline Div., Int'l Bhd. of Teamsters* 874 F.2d 110, 115 (2d Cir. 1989) (holding once union is certified the carrier "had an absolute duty under section 152 Ninth to sit down at the bargaining table with the union."); *Int'l Ass'n of Machinists and Aerospace Workers v. Nc. Airlines, Inc.*, 536 F.2d 975, 977 (5th Cir. 1976) (explaining duty to bargain under RLA imposes a duty to bargain with representative of employees); *Virginian Ry. Co. v. System Fed. No. 40*, 300 U.S. 515, 548 (1937) (asserting duty to bargain under RLA compels duty to bargain solely with chosen representative of employee class).

<sup>17</sup> *Burlington N. R.R. Co. v. Bhd. of Maint. Way Employees*, 481 U.S. 429, 444 (1987); *Bhd. of Ry. & S.S. Clerks v. Fla. E. Coast Ry. Co.*, 384 U.S. 238, 246 (1966) (describing process as "purposely long and drawn out, based on the hope that reason and practical considerations will provide in time an agreement that resolves the dispute"); *Shore Line*, 396 U.S. at 150 (stating RLA purposefully delays time when parties may invoke self-help, thereby allowing "tempers to cool" and creating an atmosphere of "rational bargaining").

<sup>18</sup> See *Bhd. of R.R. Trainmen v. Jacksonville Terminal Co.*, 394 U.S. 369, 377–78 (1968) (outlining RLA's major dispute resolution process); *Hiatt v. Union Pac. R.R. Co.*, 859 F. Supp. 1416, 1420 (D. Wyo. 1994) (acknowledging if parties cannot reach an agreement under RLA, they may seek assistance from National Mediation Board); MICHAEL E. ABRAM et al., *THE RAILWAY LABOR ACT*, 322–42 (BNA Books 2d ed. 2005) (discussing RLA's dispute resolution process).

<sup>19</sup> See *Shore Line*, 396 U.S. at 150 (explaining RLA requires parties to maintain status quo, which has immediate affect of preventing union strike and management from modifying collectively bargained terms); *United Air Lines, Inc. v. Int'l Ass'n of Machinist & Aerospace Workers*, 243 F.3d 349, 361–62 (7th Cir.



mediation would not be effective, it will proffer voluntary interest arbitration of the remaining unresolved issues under section 5 (First) of the RLA. If either party declines to arbitrate, both sides may exercise self-help at the end of a thirty-day cooling-off period.<sup>20</sup> The President may, under section 10 of the RLA, appoint an Emergency Board to investigate the dispute and recommend resolution (during which time the parties must maintain the status quo).<sup>21</sup> At the conclusion of such further cooling-off period the parties may resort to self-help.<sup>22</sup> During the status quo

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2001) (indicating court may issue injunctions to stop a "party's illegal self-help and to restore the status quo"). Section 6 ("Procedure in changing rates of pay, rules and working conditions") is the RLA's major dispute provision. 45 U.S.C. § 156 (2000). It provides:

Carriers and representatives of the employees shall give at least thirty days' written notice of an intended change in agreements affecting rates of pay, rules, or working conditions, and the time and place for the beginning of conference between the representatives of the parties interested in such intended changes shall be agreed upon within ten days after the receipt of said notice, and said time shall be within the thirty days provided in the notice. In every case where such notice of intended change has been given, or conferences are being held with reference thereto, or the services of the Mediation Board have been requested by either party, or said Board has proffered its services, rates of pay, rules, or working conditions shall not be altered by the carrier until the controversy has been finally acted upon, as required by section 155 of this title, by the Mediation Board, unless a period of ten days has elapsed after termination of conferences without request for or proffer of the services of the Mediation Board.

45 U.S.C. § 156, Section 2 (Seventh) provides that "[n]o carrier . . . shall change the rates of pay, rules, or working conditions of its employees, as a class, as embodied in agreements except in the manner prescribed in such agreements or in section 156 of this title." 45 U.S.C. § 152 (Seventh). Section 2 (First) generally provides that "[i]t shall be the duty of all carriers, their officers, agents, and employees to exert every reasonable effort to make and maintain agreements concerning rates of pay, rules, and working conditions, and to settle all disputes, whether arising out of the application of such agreements or otherwise, in order to avoid any interruption to commerce or to the operation of any carrier growing out of any dispute between the carrier and the employees thereof." 45 U.S.C. § 152 (First).

In the rail industry, collective bargaining agreements historically have been negotiated without fixed duration, and in the absence of any contract limits may serve section 6 notices at any time. *See Fla. E. Coast Ry. Co.*, 384 U.S. at 248 ("The collective bargaining agreement remains the norm; the burden is on the carrier to show the need for any alteration of it."); *Abram*, *supra* note 18, at 375; *Stone*, *supra* note 3, at 1495 (stating agreements under RLA are everlasting unless changed pursuant to RLA's altering provisions). In the airline industry, the parties typically negotiate clauses which limit their ability to serve section 6 notices until a stated amendable date. *See Abram*, *supra* note 18, at 376-78; *Stone*, *supra* note 3, at 1496 (stating airline agreements "typically have a clause waiving the right to initiate bargaining procedures until a specified 'amendable date.'"); *see also TWA, Inc. v. Indep. Fed'n of Flight Attendants*, 809 F.2d 483, 490 (8th Cir. 1987).

<sup>20</sup> *See* 45 U.S.C. § 155 (First) (2000) (stating no changes to be made "in the rates of pay, rules, or working conditions or established practices in effect prior to the time the dispute arose" during thirty day period following refusal to arbitrate by either or both parties); *Chicago & N.W. Ry. Co. v. United Transp. Union*, 402 U.S. 570, 586 (1971); *Natl R.R. Passenger Corp. v. Transp. Workers Union of Am.*, 373 F.3d 121, 124 (D.C. Cir. 2004).

<sup>21</sup> *See* 45 U.S.C. § 160 (2000) (allowing President to "create a board to investigate and report" regarding the unresolved disputes); *Pittsburgh & Lake Erie R.R. Co. v. Ry. Labor Executives' Ass'n*, 491 U.S. 490, 496 n.4 (1989); *Burlington N.*, 481 U.S. at 436.

<sup>22</sup> *See Bhd. of R.R. Trainmen*, 394 U.S. at 378 ("Implicit in the statutory scheme, however, is the ultimate right of the disputants to resort to self-help . . ."); *Elgin, Joliet & E. Ry. Co. v. Burley*, 325 U.S. 711, 725 (1945) (acknowledging "compulsions go only to insure that those procedures [negotiation, mediation,

period, and once a first CBA has been achieved, if a carrier modifies terms and conditions of employment, union may strike in response.<sup>23</sup>

#### *B. Bargaining At Northwest Before and After Bankruptcy*

Following the economic downturn beginning early in 2001 and accelerated by the September 11 attacks, the nation's passenger aviation industry experienced severe financial stress, which led to the bankruptcies of the vast majority of the mainline carriers, as well as a host of smaller airlines.<sup>24</sup> In the case of Northwest, the financial crisis was played out in a toxic labor relations environment—an environment which had over the years been punctuated by strikes by its major labor groups.<sup>25</sup> In October 2004, Northwest reached agreement with ALPA on pilot concessions worth in excess of \$250 million which intended to "bridge" the company until consensual agreements could be reached with its other major labor groups: AMFA, which represents Northwest's mechanics, the IAM, which represents its passenger reservations and ramp personnel, and the PFAA which then represented Northwest's flight attendants.<sup>26</sup> However, in the following year Northwest was unable to reach agreements with its other groups.

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voluntary arbitration, and conciliation] are exhausted before resort can be had to self-help."); Abram, *supra* note 18, at 340.

<sup>23</sup> See *Shore Line*, 396 U.S. at 155 (acknowledging a "union cannot be expected to hold back its own economic weapons, including the strike" if railroad resorts to self-help); Order of R.R. Telegraphers v. Chicago & N.W. Ry. Co., 362 U.S. 330, 343 (1960); Rutland Ry. Corp. v. Bhd. of Locomotive Eng'rs, 307 F.2d 21, 41 (2d Cir. 1962) ("If in fact the railroad has failed to take the steps required of it by the Railway Labor Act, it is not entitled to injunctive relief against the strike of its employees.").

<sup>24</sup> US Airways (and its subsidiary carriers) led the way with its 2002 bankruptcy filing, to be followed by a second reorganization case in 2004. See Frank Gamrat & Jake Haulk, *Taken for a ride by US Airways*, PITTSBURGH TRIBUNE REVIEW, Oct. 14, 2007; Micheline Maynard, *US Airways Files for Bankruptcy for Second Time*, N.Y. TIMES, Sept. 13, 2004, at A1. United Airlines filed for chapter 11 in 2002 and American Airlines narrowly avoided a filing that year after negotiating concessionary labor agreements. Daniel P. Rollman, *Flying Low: Chapter 11's Contribution to the Self-Destructive Nature of Airline Industry Economics*, 21 EMORY BANKR. DEV. J. 381, 383 n.17 (2004) (listing various airlines that filed for bankruptcy). Northwest and Delta both filed on September 14, 2005. Richard D. Cudahy, *The Airlines: Destined to Fail?*, 71 J. AIR L. & COM. 3, 6 n.15 (2006); Micheline Maynard, *Delta's Filing Was Not Unexpected, But Northwest Had Hoped to Hold Out*, N.Y. TIMES, September 15, 2005, at C1. Smaller carriers also sought to reorganize: Hawaiian and Aloha in 2003, ATA in 2004, Mesaba and Comair in 2005. Independence Air filed for reorganization in 2005, but ceased operations in early 2006. See Peter J. Howe, *Independence Air to Shut Down*, BOSTON GLOBE, Jan. 3, 2006, at C2.

<sup>25</sup> Most recently in 1998, as the collective bargaining processes under the RLA were exhausted Northwest shut down operations in the face of an impending pilot strike, crippling air travel throughout the upper Midwest. See Significant Events in Northwest's History (Sept. 14, 2005), <http://msnbc.msn.com/id/9344497> (indicating 15 day pilot's strike shut down operations for 18 days); Press Release, Northwest Airlines Ceases Operations Due To Strike (August 28, 1998) <http://www.nwa.com/corpinfo/newsc/1998/pr082898e.html>; see also Michael H. LeRoy, *Creating Order Out of CHAOS and Other Partial and Intermittent Strikes*, 95 NW. U.L. REV. 221, 223 n.16 (2000) (noting that 1998 pilots' strike was latest of 15 against the carrier).

<sup>26</sup> *In re Nw. Airlines Corp.*, 346 B.R. 307, 315 n.3 (S.D.N.Y. 2006) (listing labor cost savings including \$250 million pre-petition Bridge Agreement from ALPA). At the time Northwest filed for bankruptcy, its flight attendants were represented by PFAA. *Id.* at 314. As discussed *infra* p. 506, AFA became the collective bargaining representative of Northwest's flight attendants in July, 2006. *Id.* at 318 n.11.

At the time both AMFA and PFAA were in mediated negotiations under auspices of the NMB. In August 2005, the NMB declared negotiations between Northwest and AMFA to be at an impasse and proffered interest arbitration. Northwest declined to arbitrate. At the conclusion of the cooling-off period, AMFA struck and Northwest implemented demanded concessions, including the outsourcing of hundreds of aircraft maintenance positions.

Although Northwest asserted that the strike had no lasting or substantial effects on its operations,<sup>27</sup> the impact of other conditions led Northwest to file for bankruptcy in the Southern District of New York on September 14, 2005. Shortly thereafter, by motion dated October 12, 2005, Northwest sought an order pursuant to 11 U.S.C. § 1113(c) to allow it to reject CBAs with all of its unions, including ALPA, the PFAA, and the IAM.<sup>28</sup> Agreements were reached with several smaller unions.<sup>29</sup> In order to provide additional time for negotiations, interim concessionary agreements were reached with ALPA and PFAA and interim relief was imposed on the IAM pursuant to 11 U.S.C. § 1113(e).<sup>30</sup>

Northwest continued to negotiate with ALPA, PFAA and the IAM after filing the section 1113(c) motion.<sup>31</sup> After a lengthy evidentiary hearing and extensive negotiation, Northwest reached a tentative agreement with ALPA on March 3, 2006, which was subsequently ratified by the pilot group on May 3, 2006.<sup>32</sup> Northwest also reached tentative agreements with IAM, the last of which was ratified in July 2006.<sup>33</sup>

PFAA reached a tentative agreement with Northwest on March 1, 2005 subject to membership ratification.<sup>34</sup> The tentative agreement was turned down by a margin of four to one.<sup>35</sup> Following this failure, the bankruptcy court, by memorandum dated June 29, 2006 and order dated July 5, 2006, granted Northwest's section 1113(c) motion with respect to PFAA, authorized Northwest to implement the terms of the failed tentative agreement, but stayed the effective date of the order for fourteen

<sup>27</sup> See *One Year After Mechanics Strike, NWA Still in the Air*, DULUTH NEWS TRIB., Aug. 14, 2006 (reporting AMFA strike "failed"). The strike was only settled in October 2006. See Tom Walsh, *Flight Attendants Would Hurt Themselves By Striking NWA*, DETROIT FREE PRESS, Oct. 13, 2006, (noting AMFA strike "failed to halt Northwest operations" and settlement was imminent); Doug Cunningham, *AMFA Reaches Tentative Settlement In 14 Month Northwest Airlines Strike* (Oct. 10, 2006) <http://www.laborradio.org/node/4372> (emphasizing under settlement agreement "AMFA members will have recall rights"); Press Release, Northwest Airlines, *Northwest Airlines Reaches A Tentative Contract Agreement With AMFA* (Oct. 9, 2006) <http://www.nwa.com/corpinfo/newsc/2006/pr100920061710.html> (describing Northwest's tentative settlement with AMFA).

<sup>28</sup> *Nw. Airlines*, 346 B.R. at 313–14.

<sup>29</sup> *Id.* at 315 n.2 (including Transport Workers Union of America, Northwest Meteorologists Association and Aircraft Technical Support Association).

<sup>30</sup> *Id.* at 316 (stating proposals "provided for interim labor concessions that approximated 60% of the labor savings being sought from the unions in the Motion").

<sup>31</sup> *Id.* at 317–19.

<sup>32</sup> *Id.* at 318.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 317.

<sup>35</sup> *Id.* at 318 (indicating reasons for rejection were unclear).

days.<sup>36</sup> On July 31, 2006 Northwest unilaterally implemented the terms and conditions contained in the failed tentative agreement.

Concurrently, AFA petitioned for and won a representation election conducted by the NMB. AFA was certified by the NMB, in place of PFAA, as the flight attendants' collective bargaining representative on July 7, 2006.<sup>37</sup> Immediately thereafter, in an attempt to reach a consensual agreement between the parties, AFA engaged in round-the-clock negotiations with Northwest.<sup>38</sup>

On July 17, 2006, pursuant to Northwest's self-imposed deadline and after only 10 days of negotiation, the AFA leadership was able to reach a new tentative agreement.<sup>39</sup> Noting that Northwest had not contended that AFA bargained in bad faith, the bankruptcy court found that "AFA commenced round-the-clock negotiations on the day it was certified and reached a new agreement with the Debtors in a ten-day period, a period set by the Debtors . . . . It cannot be said that AFA refused to bargain in good faith."<sup>40</sup> The July 17, 2006 tentative agreement was submitted to the AFA membership for ratification under an expedited schedule, but failed on July 31, 2006, now by a substantially closer vote of 45% for and 55% against the agreement.<sup>41</sup>

That same day, Northwest exercised the authority granted to it by the bankruptcy court, rejected the flight attendant collective bargaining agreement, and unilaterally implemented the terms of the failed tentative agreement.<sup>42</sup> In response, AFA gave Northwest notice of its intent to engage in self-help in 15 days.<sup>43</sup> AFA said it would use its trademarked CHAOS strategy,<sup>44</sup> indicating that CHAOS activity could begin on any date on or after August 15, 2006. On August 1, 2006, Northwest filed an adversary proceeding seeking a declaratory judgment and a preliminary injunction barring a strike by AFA. The bankruptcy court conducted an evidentiary hearing and heard oral argument on Northwest's preliminary injunction motion on August 9, 2006.<sup>45</sup>

<sup>36</sup> *Id.* at 315.

<sup>37</sup> See *In re Representation of Employees of Nw. Airlines, Inc. Flight Attendants*, 33 N.M.B. 289 (2006).

<sup>38</sup> See *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 346 B.R. 333, 343 (Bankr. S.D.N.Y. 2006).

<sup>39</sup> *Id.* at 336-337.

<sup>40</sup> *Id.*, 346 B.R. at 343. As noted *infra* p. 511, these findings were ignored on appeal.

<sup>41</sup> *Id.* at 337.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 336-37 (stating that the PFAA previously agreed to provide 15-day notice of its intent to take self-help and AFA honored that commitment).

<sup>44</sup> CHAOS, "Create Havoc Around Our System," is a strategy which results in sporadic and relatively brief work stoppages. See *id.* at 337; *Ass'n of Flight Attendants v. Alaska Airlines*, 847 F. Supp. 832, 836 (W.D. Wash. 1993) (upholding legality of CHAOS tactic). The Second Circuit held in *Pan Am World Airways, Inc. v. Int'l Bhd. of Teamsters*, 894 F.2d 36 (2d Cir. 1990), that such intermittent strikes are lawful under the RLA.

<sup>45</sup> In light of reported terrorist threats and new security precautions put into effect in early August, AFA postponed its CHAOS start date for 10 days until August 25, 2006. See *In re Nw. Airlines*, 346 B.R. at 338.

*C. The Bankruptcy Court Denies Northwest a Strike Injunction*

The bankruptcy court, in a focused decision, held that it lacked jurisdiction to enjoin a strike. It noted the many decisions by the Second Circuit holding that the jurisdictional limits of the NLGA were fully applicable to bankruptcy proceedings.<sup>46</sup> While recognizing that the NLGA did not deprive it of jurisdiction to enjoin compliance with a "mandate" of the RLA,<sup>47</sup> the court concluded there was no such mandate here.<sup>48</sup> Instead, Judge Gropper found the right of a union under the RLA to take self-help following unilateral carrier action was an "apt analogy" supporting a union's right to take self-help following a contract rejection, citing the Supreme Court's admonition that "[o]nly if both sides are equally restrained can the Act's remedies work effectively."<sup>49</sup>

The bankruptcy court rejected a suggested analogy to Second Circuit decisions limiting union self-help in the period prior to a first contract under the RLA,<sup>50</sup> noting clear precedent holding that a contract is breached, not eliminated, when rejected in bankruptcy.<sup>51</sup> Emphasizing that the Debtors did not, and could not, show that AFA failed to bargain in good faith, the bankruptcy court held that *Chicago & North Western Railway v. United Transportation Union* ("*Chicago & N.W.*"),<sup>52</sup> did not support an injunction under section 2 (First) of the RLA.<sup>53</sup> In this respect the

<sup>46</sup> See *id.* at 338; see also *Petrusch v. Teamsters Local 317* (*In re Petrusch*), 667 F.2d 297, 300 (2d Cir. 1981) (affirming reversal of bankruptcy court's strike injunction for lack of jurisdiction under Norris-LaGuardia Act by concluding nothing in the Bankruptcy Code's text or legislative history support the notion that Congress sought to "supersede or transcend" the Norris-LaGuardia Act's limitations); *Truck Drivers Local Union 807 v. Bohack Corp.*, 541 F.2d 312, 318 (2d Cir. 1976) ("[T]he power to permit rejection of the agreement in particular circumstances does not confer an antecedent jurisdiction on the court to enjoin picketing in spite of the Norris-LaGuardia Act."); *Lehman v. Quill* (*In re Third Ave. Transit Corp.*), 192 F.2d 971, 973 (2d Cir. 1951) ("The well established power of the reorganization court to issue orders necessary to conserve the property in its custody must be exercised within the scope of a jurisdiction which is limited by the broad and explicit language of the Norris-LaGuardia Act.").

<sup>47</sup> *In re Nw. Airlines*, 346 B.R. at 339.

<sup>48</sup> *Id.* at 344-45.

<sup>49</sup> *Id.* at 344 (citing *Detroit & Toledo Shore Line R.R. v. United Transp. Union*, 396 U.S. 142, 155 (1969)).

<sup>50</sup> See *Aircraft Mech's. Fraternal Ass'n v. Atl. Coast Airlines, Inc.*, 55 F.3d 90, 91-92 (2d Cir. 1995) (denying union's motion for preliminary injunction when question was whether unilateral changes "are allowed after bargaining has commenced, and after the services of the National Mediation Board have been invoked, but before an agreement is reached."). The Second Circuit answered the question in the affirmative. *Id.* at 92. It first held that section 2 (Seventh) and section 6 only apply when there has been an agreement in effect. *Id.* at 93 ("Sections 2 Seventh and 6 of the Act simply do not impose an obligation . . . to maintain the status quo in the absence of an agreement."). The court also concluded, relying on *Williams v. Jacksonville Terminal Co.*, 315 U.S. 386, 400 (1942), that section 2 (First) does not prohibit unilateral changes in the status quo where no contract has ever been negotiated. *Atl. Coast Airlines*, 55 F.3d at 93; but see *Int'l Ass'n of Machinists & Aerospace Workers v. Transportes Aereos Mercantiles Pan Americanos, S.A.*, 924 F.2d 1005, 1008 (11th Cir. 1991) (holding that a unilateral change after negotiations begin but before a CBA is executed violate the status quo provisions of the RLA); *United Transp. Union v. Wis. Cent. Ltd.*, No. 98 C 3936, 1999 WL 261714, \*3 (N.D. Ill. Apr. 15, 1999) (holding that a unilateral change after negotiations begin but before a CBA is executed violate the status quo provisions of the RLA).

<sup>51</sup> *In re Nw. Airlines*, 346 B.R. at 340.

<sup>52</sup> 402 U.S. 570 (1971).

<sup>53</sup> *In re Nw. Airlines*, 346 B.R. at 343.

court held that there was no basis to find that AFA's self-help was "in bad faith" or that the union was required to "begin bargaining all over again, as if this were a first-time contract."<sup>54</sup> Consistent with the Debtors' concession that they did not rely on section 1113 as basis for injunctive relief, the bankruptcy court also concluded that nothing in section 1113 could be read to "bind the union anew to the almost endless requirements of negotiation and mediation provided for in the RLA."<sup>55</sup>

The bankruptcy court found that a CHAOS action would have "a seriously adverse effect on the Debtors' prospects for reorganization and on the traveling public generally"<sup>56</sup> and would "likely cause the Debtors serious injury, perhaps leading to their liquidation, and that it would be highly detrimental to the interest of the public."<sup>57</sup> However, the court also concluded that the absence of injunctive relief "does not necessarily leave a debtor free of any remedy," and that the "parties had not briefed the ability of the bankruptcy court to provide other relief," including authorization for the debtor to implement different terms and conditions of employment.<sup>58</sup>

#### *D. The District Court Reverses*

Northwest moved for an expedited appeal and an injunction pending appeal. The district court initially issued an injunction pending appeal.<sup>59</sup> Engaging in what it described as a "long and complex" analysis,<sup>60</sup> the district court issued a 43-page decision reversing the bankruptcy court, and issued a preliminary injunction pending a final decision on the merits by the bankruptcy court.<sup>61</sup>

Emphasizing the need to "define a systemic vehicle of public policy" that would be unlikely to "justify a potentially disastrous walkout by an airline's employees,"<sup>62</sup> the district court somehow concluded that the overarching goal of the RLA, the Bankruptcy Code, and the NLGA (as well as the National Labor Relations Act ("NLRA")<sup>63</sup>), whether considered "individually or in tandem," was to prevent strikes.<sup>64</sup> The district court concluded that the RLA precluded a right to strike, and,

<sup>54</sup> *Id.* at 343.

<sup>55</sup> *Id.* at 344.

<sup>56</sup> *Id.* at 337.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 344.

<sup>59</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, No. M-47, 05-17930, 2006 WL 2462892 (S.D.N.Y. Aug. 25, 2006).

<sup>60</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 349 B.R. 338, 344 (S.D.N.Y. 2006).

<sup>61</sup> *Id.* at 384-85.

<sup>62</sup> *Id.* at 346.

<sup>63</sup> 29 U.S.C. §§ 101-115 (2006).

<sup>64</sup> *In re Nw. Airlines*, 349 B.R. at 344-47, 351-52, 354, 368-69, 373-74, 378-83. The district court found irrelevant: (1) cases holding that unions could strike following a rejection of a CBA because those cases arose under the NLRA, *id.* at 357-58, and (2) cases holding that in considering a rejection motion courts should consider the impact of a possible strike. *Id.* at 363-64; see *In re Royal Composing Room, Inc.*, 62 B.R. 403, 406 (Bankr. S.D.N.Y. 1986) (considering threat of union strike in deciding whether to reject

despite the debtors' prior disavowal of section 1113 as a basis for injunctive relief, held that the Bankruptcy Code generally and section 1113 specifically also provided a basis to enjoin a strike.<sup>65</sup>

The court initially noted an "arguable flip side" to the RLA's prohibition on self-help was that "if one party makes a unilateral change in the status quo, the section 6 procedures terminate automatically and the other side is free to engage in self-help."<sup>66</sup> After initial questioning the court ultimately appeared to accept this principle.<sup>67</sup> However, citing the use of the word "arbitrar[y]" in one statement in the RLA's legislative history describing employer action that would justify self-help,<sup>68</sup> decisions by the Second Circuit involving parties' rights under the RLA prior to a first contract, and the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*,<sup>69</sup> which did not discuss the right to strike, the district court found RLA precedent inapplicable here.<sup>70</sup> The district court concluded that a union's right to strike, "insofar as it exists," did not "accrue" following an 1113 rejection decision because the carrier's "technically" unilateral action was nonetheless lawful under another statute and not arbitrary or in bad faith.<sup>71</sup>

The district court emphasized that self-help would be a "suicide weapon" and inconsistent with the goals of the Bankruptcy Code because it would "undermine whatever benefit the debtor-in-possession otherwise obtains [from a rejection order]."<sup>72</sup> It conceded that this policy analysis could also apply to NLRA unions except for what the court described as the RLA's uniquely strong anti-strike policy.<sup>73</sup>

Finally, in reviewing a party's obligations under section 2 (First) of the RLA to exert every reasonable effort to make and maintain agreements,<sup>74</sup> the district court looked to section 1113 and found that "an implied limit on the union's ability to strike can be inferred from the existence of § 1113 itself . . . ."<sup>75</sup> The court held that the reasonableness of self-help was a matter for judicial determination under the RLA and that strike action against an "insolvent carrier" raised the "bar of

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CBA); *In re Ky. Truck Sales, Inc.*, 52 B.R. 797, 805 (Bankr. D. Ky. 1985) (recognizing union's ability to strike upon rejection of CBA).

<sup>65</sup> *In re Nw. Airlines*, 349 B.R. at 383-84.

<sup>66</sup> *Id.* at 359.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 360.

<sup>69</sup> 465 U.S. 513 (1984).

<sup>70</sup> *In re Nw. Airlines*, 349 B.R. at 362.

<sup>71</sup> *Id.* at 361-62. The district court also found that a strike would "prematurely curtail" and "effectively eliminate" the NMB's role "as a neutral determinant of the timing of when the section 6 process should properly end . . . ." *Id.* at 366. The court ignored that a 1113 rejection order pursued and implemented by a carrier obliterated the NMB's control over the status quo. Nor did the court consider whether the NMB would necessarily be involved in negotiations under section 1113. *Id.* at 364-68.

<sup>72</sup> *Id.* at 368-70, 380.

<sup>73</sup> *Id.* at 369.

<sup>74</sup> *Id.* at 377-79.

<sup>75</sup> *Id.* at 382.

reasonableness" under section 2 (First).<sup>76</sup> Concluding that self-help against a bankrupt carrier was unreasonable, the court held it was properly enjoined.<sup>77</sup>

## II. THE SECOND CIRCUIT'S CONTORTED DECISION

On appeal the Second Circuit affirmed in an opinion by Senior Judge Walker joined by Judge Raggi. Chief Judge Jacobs filed a concurrence. The majority concluded that (1) Northwest's rejection "abrogated (without breaching)" the CBA which "thereafter ceased to exist," (2) the RLA's status quo obligations, including section 2 (First), "ceased to apply," to Northwest, but (3) the duty under section 2 (First) continued to bind AFA, as the court had ruled in the case of initial negotiations towards a first CBA,<sup>78</sup> and (4) self-help by the union was incompatible with its section 2 (First) duty.<sup>79</sup>

With respect to its core conclusion that contract rejection under section 1113 abrogates a CBA, the Court attempted to distinguish contract rejection under section 365 which, as the Court noted, unquestionably constitutes a breach of the rejected contract.<sup>80</sup> Without referencing any language of section 1113 or section 365, any legislative history, or any precedent, the majority held, *ipso facto*, that rejection under section 1113 (captioned "Rejection of collective bargaining agreements") "is an exception to this general principle" because a damages claim would be "inconsistent with . . . §1113."<sup>81</sup> The Court essentially conceded that it was obligated to engage in this contortion because if rejection under section 1113 constituted a breach of the CBA (as with other executory contracts) such rejection "would surely violate Section 2 (Seventh) of the RLA," which requires a carrier to maintain terms and conditions embodied in agreements pending exhaustion of the

<sup>76</sup> *Id.* at 377-79.

<sup>77</sup> *Id.* at 379-82 (describing the injunction after reviewing the "virtually endless" and "almost interminable" section 6 process as: "essentially temporary," an "authorized emergency remedy" that only "defer[red] the right to strike").

<sup>78</sup> See *Aircraft Mechanics Fraternal Ass'n v. Atl. Coast Airlines*, 125 F.3d 41, 43 (2d Cir. 1997).

<sup>79</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 164 (2d Cir. 2007).

<sup>80</sup> *Id.* at 170-73.

<sup>81</sup> *Id.* at 170 n.3, 172. The Court suggested that the "unique purpose" of section 1113—the rejection of a CBA and authorizing a debtor to establish new terms with which it must comply—"cannot be reconciled with the continued existence of its prior contract," and thereby attempted to distinguish cases dealing with the rejection and breach of commercial contracts. *Id.* at 171. See Miller, *supra* note 3, at 480-82. Of course, as the Court itself noted, the concept of breach under 365 is a "legal fiction." *In re Nw. Airlines*, 483 F.3d at 172. The right to reject pursuant to section 365—and the concomitant right to stop providing services or product or pay for them as would otherwise be required under a commercial contract—cannot be any more logically reconciled with the continued existence—and breach—of said contract than in the case of a CBA. The Second Circuit—and the Miller article—further ignore that for over 100 years bankruptcy law has treated rejection as a breach of an executory contract, *regardless of the legal consequences of the rejection in question*. See *infra*, pp. 512-16.



RLA bargaining process,<sup>82</sup> and "the union would be correspondingly free to seek damages or strike . . . ."<sup>83</sup>

The newly created "abrogation" theory of the majority instead brought about the desired result: it left the parties as if no CBA had existed, there was no longer a status quo in the absence of mutual agreement, and Northwest was therefore freed from the duty under section 2 (First) to "make every reasonable effort to make and maintain" CBAs.<sup>84</sup> In concluding that AFA had not yet fulfilled its duty under section 2 (First), the majority chose to ignore the trial court's *factual* finding that AFA bargained in good faith, instead concluding that the union leadership had not sufficiently "sought to persuade" the membership to accede to the TA.<sup>85</sup> The panel failed to explain how AFA could meet its duty other than by agreeing to Northwest's demands.<sup>86</sup>

In a concurring opinion, Chief Judge Jacobs caustically noted that "[n]o one can accuse the majority of attempting to harmonize the statutes at issue, or of succeeding."<sup>87</sup> The Chief Judge found himself unable to "possibly explain" to the flight attendants the majority's reasoning.<sup>88</sup> The concurrence concluded that Northwest's modification of the status quo somehow did not privilege a reciprocal right to strike because the modification was pursuant to a rejection order.<sup>89</sup> While conceding that section 1113 authorized Northwest with court approval to change collectively bargained terms without having exhausted the RLA process (contrary to the express commands of section 2 (First) and (Seventh)), the concurrence reasoned that the RLA status quo need not be mutual, and (conveniently) that AFA (but not Northwest) continued to be bound by section 2 (First).<sup>90</sup>

#### A. The Majority Rewrites the Law of Contract Rejection

The majority's holding—integral to its affirmance of the strike injunction—that rejection "abrogate[s] (without breaching)" a CBA, was not advanced by Northwest at any stage of the litigation. It is unprecedented and wholly inconsistent with decisions concerning rejection of collective bargaining agreements both before and

<sup>82</sup> *In re Nw. Airlines*, 483 F.3d at 171.

<sup>83</sup> *Id.* at 172.

<sup>84</sup> *Id.* at 173–75.

<sup>85</sup> *Id.* at 175 (holding union did not make every reasonable effort to reach agreement by not exhausting dispute resolution processes).

<sup>86</sup> *Id.* at 175–76. Because there is no statutory provision in the NLRA limiting a union's right to strike at any time, and as any no-strike obligation is purely contractual, *e.g.*, *Buffalo Forge v. United Steelworkers*, 428 U.S. 397 (1976), the *AFA* decision, as the majority concluded, would have no effect on an NLRA union's ability to strike upon contract rejection under section 1113. *In re Nw. Airlines*, 483 F.3d at 173.

<sup>87</sup> *Id.* at 183 (Jacobs, D., concurring).

<sup>88</sup> *See id.* at 177.

<sup>89</sup> *Id.* at 177–78 ("A debtor-carrier's rejection of labor agreement in bankruptcy . . . cannot be described fairly as a unilateral divergence from the status quo, and does not trigger a reciprocal right to strike."). Of course, the exercise of self-help at the end of the RLA process, while authorized is also not "unilateral" in the sense of the concurrence's reasoning.

<sup>90</sup> *Id.* at 177–78, 183.

after the enactment of section 1113 as well as the leading cases articulating the section 1113 rejection standard which all require the bankruptcy courts to consider the likely effect of rejection damages claims upon the reorganization.<sup>91</sup> It ignores the central bankruptcy policy of treating claimants with equal priority equivalently by, in effect, voiding claims for breach of an executory contract solely where the agreement happens to be a CBA.<sup>92</sup>

# 1. The Long History of the Rejection Doctrine

## a. *The Rule of Copeland v. Stephens*

Rejection is a longstanding term in bankruptcy with remedies for the party whose contract has been rejected, as was well known to section 1113's drafters. This principal power of a debtor in bankruptcy evolved over time but by the early years of the last century the contours of the modern doctrine—that a debtor has a right to either assume or reject an executory agreement and that rejection constitutes a breach of agreement entitling the creditor to a pre-petition claim—were established in common law and thereafter codified in federal bankruptcy statutes.<sup>93</sup>

The necessary background to the doctrine is the distinction drawn in bankruptcy law between the debtor and the estate. As section 541(a)(1) of the 1978 Bankruptcy Code now reflects,<sup>94</sup> a bankruptcy filing creates an estate which consists (with exceptions) of "all legal or equitable interests of the debtor in property."<sup>95</sup> The "fountainhead of U.S. executory contracts doctrine is largely a single English case"<sup>96</sup> decided in 1818, *Copeland v. Stephens*,<sup>97</sup> involving a suit over real property.

<sup>91</sup> See, e.g., *United Food & Commercial Workers Union v. Official Unsecured Creditors Comm. (In re Hoffman Bros. Packing Co., Inc.)*, 173 B.R. 177, 182 (B.A.P. 9th Cir. 1994) (recognizing standard courts should use to authorize rejection is "equitable sharing of the burden of rejection"); *In re North American Royalties, Inc.*, 276 B.R. 587, 592 (Bankr. E.D. Tenn. 2002) ("[T]he supreme court warned that the bankruptcy court, when deciding whether to allow rejection . . . it should focus on the relationship of the equities to the reorganization process.").

<sup>92</sup> *In re Nw. Airlines*, 483 F.3d 160, 169 (2d Cir. 2007); Robert E. Scott, *Sharing the Risks of Bankruptcy: Timbers, Ahlers, and Beyond*, 1989 COLUM. BUS. L. REV. 183, 187 (1989) ("No one seriously doubts that similar claims should be treated similarly.").

<sup>93</sup> See *Cheadle v. Appleatchee Riders Ass'n (In re Lovitt)*, 757 F.2d 1035, 1040 41 (9th Cir. 1985) (reviewing derivation of authority to reject executory contracts); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding Rejection*, 59 U. COLO. L. REV. 845, 870 (1988) (stating 1916 Supreme Court decision in *Chicago Auditorium Ass'n* is "the precursor of the statutory rule . . . that a rejection constitutes a 'breach' of a contract or lease."); Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 447-50 (1973) (describing statutory changes in 1933, 1934, and 1938, all providing for rejection of "executory" contracts and damages resulting from such rejection); 3 COLLIER ON BANKRUPTCY ¶ 365, I.H. (Alan N. Resnick et al. eds., 15th ed. rev. 2004) (reviewing history of rejection of executory contracts in bankruptcy, the common law principle that a bankruptcy trustee could reject or assume executory contracts, and, as relevant here, that the Bankruptcy Act largely adopted these common law principles); 4A COLLIER ON BANKRUPTCY ¶ 70.43(1) at 516-17 (14th ed. 1978).

<sup>94</sup> 11 U.S.C. § 541(a) (2006).

<sup>95</sup> 11 U.S.C. § 541(a)(1) (2006). As Andrew notes, this concept has been in place in federal bankruptcy statutes dating from 1800. Andrew, *supra* note 93, at 851 n.30.

<sup>96</sup> Andrew, *supra* note 93, at 856.

In *Copeland*, the lessor under an unexpired lease, Copeland, sued to recover unpaid rent from Stephens, his bankrupt tenant.<sup>98</sup> Stephens argued that since he was bankrupt and made a general assignment of all of his property to a bankruptcy assignee, the lease automatically passed to Stephens' bankruptcy assignee along with the rest of Stephen's property.<sup>99</sup> Stephens argued that because he was no longer in privity of estate with Copeland he could not be held liable for the unpaid rent.<sup>100</sup>

Rejecting Stephens' argument the court found that the bankruptcy assignees were protected from assuming lease obligations "unless they do some act to manifest their assent to the assignment . . . ."<sup>101</sup> Otherwise, the assignment was to remain in "suspension" unless and until the bankruptcy assignees accepted the lease.<sup>102</sup>

*Copeland's* significance was not in trying to protect the bankruptcy assignee from the continuing liabilities of the debtor unless they specifically assented, because prior case law already established this right.<sup>103</sup> The significance of *Copeland* instead was its conceptualization that "the right to accept or refuse" meant that the lease would be treated differently than all other assets as never passing to the bankruptcy assignees unless they affirmatively assumed it.<sup>104</sup> This would permit the trustee in bankruptcy to assume economically advantageous agreements while declining to take on burdensome ones.<sup>105</sup>

While the rule of *Copeland* was abandoned in England,<sup>106</sup> the principle behind *Copeland* flourished in the United States, where it was applied to both leaseholds and executory contracts.<sup>107</sup> Before the power to assume or reject became part of the

<sup>97</sup> 106 Eng. Rep. 218 (K.B. 1818).

<sup>98</sup> *Copeland*, 106 Eng. Rep. at 218.

<sup>99</sup> *Id.* at 218–19.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 222.

<sup>102</sup> *Id.* at 222–23.

<sup>103</sup> See *Wheeler v. Bramah*, 170 Eng. Rep. 1404 (1813) (stating cases prior to *Copeland* held assignees were not liable for debtor's obligations unless they consented); *Turner v. Richardson*, 103 Eng. Rep. 129 (K.B. 1806) (citing *Bourdillon v. Dalton*, 170 Eng. Rep. 340 (1794); Andrew, *supra* note 93, at 857).

<sup>104</sup> *Copeland*, 106 Eng. Rep. at 222. See Andrew, *supra* note, 93 at 857; David G. Epstein & Steve H. Nickles, *The National Bankruptcy Review Commission's Section 365 Recommendations and the "Larger Conceptual Issues,"* 102 DICK. L. REV. 679, 681 (1998) ("The effect (of bankruptcy) is to transfer to the trustee all of the property of the debtor except his executory contracts. . . ." (citing *Watson v. Merrill*, 136 F.2d 359 (8th Cir. 1905)); Kotary & Inman, *supra* note 96, at 514–15 (explaining court in *Copeland* held debtor's obligations under lease were not delegated to estate unless trustee assumed).

<sup>105</sup> See Andrew, *supra* note 93, at 857 (stating court in *Copeland* allowed debtor to assume or reject lease); Mary O. Guynn, *In Re Thinking Machines: The Only Thought Is In The Name*, 14 BANKR. DEV. J. 227, 230 (1997) (explaining assignee's decision in *Copeland* to assume or reject lease depended upon its economic benefit); Kotary, *supra* note 96, at 515, ("By 1893 . . . courts gave the trustee discretion to assume or reject contracts . . . based solely on the burden or benefit imposed thereby.").

<sup>106</sup> Andrew, *supra* note 93, at 858 ("Copeland's conceptual approach did not endure in England . . .").

<sup>107</sup> See *id.* at 858 (explaining *Copeland* was "imported into the U.S. largely intact, and was applied to both leases and other contracts.") (citing *Ex parte Houghlon*, 12 F. Cas. 584, 585 (D. Mass. 1871); see also *Journey v. Brackley*, 1 Hilt. 447, 453–54 (N.Y. Ct. C.P. (1857)); Guynn, *supra* note 105, at 230 (determining holding in *Copeland* was adopted by the U.S.).

federal bankruptcy statutes, courts repeatedly relied on the *Copeland* principle.<sup>108</sup> These cases recognized contracts and leases as assets that could potentially impose administrative liabilities upon the estate by virtue of its succession to the debtor's ownership rights.<sup>109</sup> Courts responded by permitting assignees to exclude contracts and leases from the bankruptcy estate.<sup>110</sup> Their reasoning was that if the estate did not succeed to lease or contract assets, it could not be liable for the responsibilities that accompanied them.<sup>111</sup> The resulting doctrine was that the bankruptcy assignee would have to act affirmatively to admit either a contract or lease into the estate, and only at that point would the estate become bound to debtor's contracts or lease liabilities.<sup>112</sup> American courts recognized that bankruptcy assignees "were not bound . . . to accept property of an onerous and unprofitable nature, which would burden instead of benefiting the estate, and they could elect whether they would accept or not . . ."<sup>113</sup>

However, the doctrine also recognized that "the trustee could elect to accept a contract or lease into the estate if it appeared desirable or profitable to do so."<sup>114</sup> That "election would entitle the estate to the benefits of the other party's performance, at the cost of obligating the estate to the debtor's liabilities as an administrative expense, as if the estate itself had entered into the same contract or lease . . ."<sup>115</sup> "Even though the trustee was charged with the ultimate duty to accept

<sup>108</sup> See *In re Frazin*, 183 F. 28, 30, 32 (2d Cir. 1910) (noting *Copeland* and surmising "a trustee, having the option to assume or reject a lease, takes title to such lease only in case he elect to accept it"); Andrew, *supra* note 93, at 858 nn.67-68 (referencing 19th-century bankruptcy cases which cited to *Copeland*).

<sup>109</sup> See Andrew, *supra* note 93, at 860; Guynn, *supra* note 105, at 230.

<sup>110</sup> See Andrew, *supra* note 93 (stating courts prior to statutory provisions excluded contracts and leases from estate); Frazin, 183 F. at 32 (2d Cir. 1910) (holding in bankruptcy, a trustee has "option to assume or reject a lease"); *Streeter v. Sumner*, 31 N.H. 542, 558 (1855) ("[T]he assignee must be understood to have an election as to contracts of every kind, to repudiate and reject the assignment . . .").

<sup>111</sup> Andrew, *supra* note 93, at 860-61. See *In re Roth & Appel*, 181 F. 667, 670 (2d Cir. 1910) (holding that bankruptcy does not "sever such relation, [and] the tenant remains liable, and [t]he obligation to pay rent is not discharged as to the future, unless the trustee elect[s] to retain the lease as an asset"); *Watson v. Merrill*, 136 F. 359, 363 (8th Cir. 1905) ("Bankruptcy neither releases nor absolves the debtor from any of his contracts or obligations, but . . . leaves him bound by his agreements, and subject to the liabilities he has incurred.").

<sup>112</sup> See Andrew, *supra* note 93, at 858-59. See, e.g., *United States Trust Co. v. Wabash W. Ry. Co.*, 150 U.S. 287, 299-300 (1893) (holding assignee or receiver must not assume leases, but if he does, he is liable under terms of lease); *Sunflower Oil Co. v. Wilson*, 142 U.S. 313, 322 (1892) (asserting receivers right to accept or reject contract).

<sup>113</sup> *Sparhawk v. Yerkes*, 142 U.S. 1, 13 (1891) (citing *American File Co. v. Garrett*, 110 U.S. 288, 295 (1884)). See *Dushane v. Beall*, 161 U.S. 513, 515 (1896) (holding assignees may reject property which would burden estate); *Glenny v. Langdon*, 98 U.S. 20, 31 (1878).

<sup>114</sup> Andrew, *supra* note 93, at 861. See, e.g., *Menke v. Wilcox*, 275 F. 57, 59 (S.D.N.Y. 1921) (holding trustee may adopt or reject a contract as its "interests dictate"); *Rosenblum v. Uber*, 256 F. 584, 588-89 (3d Cir. 1919) (holding bankruptcy trustee may assume a lease considered to be of value to the estate).

<sup>115</sup> Andrew, *supra* note 93, at 861; *Atchison, T. & S.F. Ry. Co. v. Hurley*, 153 F. 503, 510 (8th Cir. 1907) ("If they elect to assume such a contract, they are required to take it . . . as the bankrupt enjoyed it, subject to all its provisions and conditions, in the same plight and condition that the bankrupt held it.") (citations omitted); *Central Trust Co. v. Continental Trust Co.*, 86 F. 517, 525 (8th Cir. 1898) (adoption of the lease carries with it the obligation of the receiver to pay according to the stipulations of the lease).

or reject, the bankruptcy court still retained the authority to approve the assumption or rejection."<sup>116</sup>

*b. The Rule of Chicago Auditorium*

In *Central Trust Co. v. Chicago Auditorium Ass'n*,<sup>117</sup> the Supreme Court held that where an executory contract was not assumed it is deemed breached and the creditor is entitled to a claim for damages thereby.<sup>118</sup> *Chicago Auditorium* involved a debtor who agreed to provide livery services to a hotel.<sup>119</sup> When the bankruptcy trustee declined to assume the agreement the hotel asserted a claim for breach of the agreement.<sup>120</sup> In holding that the rejection amounted to a breach of contract, the Court focused on the central bankruptcy policies: equality of treatment among creditors and the ability of the debtor to achieve a fresh start free of prior obligations.<sup>121</sup> The Court explained:

It is the purpose of the Bankruptcy Act [of 1898], generally speaking, to permit all creditors to share in the distribution of the assets of the bankrupt, and to leave the honest debtor thereafter free from liability upon previous obligations. Executory agreements play so important a part in the commercial world that it would lead to most unfortunate results if, by interpreting the act in a narrow sense, persons entitled to performance of such agreements on the part of bankrupts were excluded from participation in bankrupt estates, while the bankrupts themselves, as a necessary corollary, were left still subject to action for nonperformance in the future, although without the property or credit often necessary to enable them to perform.<sup>122</sup>

The rule of *Chicago Auditorium* implements and is animated by one of the central policies of the federal bankruptcy system: the equality of treatment among creditors whose claims against the bankrupt are of the same character.<sup>123</sup> A creditor whose

<sup>116</sup> Guynn, *supra* note 105, at 230. See, e.g., Greif Bros. Cooperage Co. v. Mullinix, 264 F. 391, 398 (8th Cir. 1920); *In re Grainger*, 160 F. 69, 75 (9th Cir. 1908).

<sup>117</sup> 240 U.S. 581 (1916).

<sup>118</sup> *Id.* at 592. While *Chicago Auditorium* held that the bankruptcy itself was an anticipatory breach of an executory contract, the Court "made clear that it was addressing exclusively the non-assumption situation." Andrew, *supra* note 93, at 872. See *Chicago Auditorium*, 240 U.S. at 590 ("[T]he trustee in bankruptcy did not elect to assume performance, and so the matter is left as if the law had conferred no such election.").

<sup>119</sup> *Chicago Auditorium*, 240 U.S. at 586.

<sup>120</sup> *Id.* at 587.

<sup>121</sup> *Id.* at 591.

<sup>122</sup> *Id.* (citations omitted).

<sup>123</sup> See Andrew, *supra* note 93, at 871, 882 (arguing *Copeland* rule created equality among other creditors); see also *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 587 (1935) ("[T]he original purpose of our bankruptcy act was the equal distribution of the debtor's property among his creditors . . .");

pre-petition executory contract is rejected in bankruptcy gains equality of treatment with other pre-petition creditors of the debtor. Both share equally in the debtor's estate in proportion to their claim amounts.<sup>124</sup> By the same token, the rejection power permits the debtor to shed economically burdensome commitments by converting the resulting damages from the breach of the agreement to a pre-petition unsecured claim.<sup>125</sup>

*c. Doctrine Codified in the Chandler Act of 1938*

In 1938, Congress codified these developments in the Chandler Act. Section 70(b) of the Bankruptcy Act of 1938 provided that "the trustee shall assume or reject any executory contract, including unexpired leases of real property . . . ."<sup>126</sup> Section 63(c) provided that: "Notwithstanding any State law to the contrary, the rejection of an executory contract or unexpired lease, as provided in this Act, shall constitute a breach of such contract or lease as of the date of the filing of the petition in bankruptcy . . . ."<sup>127</sup> Additionally, Congress added a provision that permitted "claims for anticipatory breach of contracts, executory, in whole or in part, including unexpired leases of real or personal property . . . ."<sup>128</sup>

Along with section 70(b), Congress implemented Bankruptcy Rule 607, requiring court approval for assumption of leases and executory contracts.<sup>129</sup> However, the rule did not expressly state whether the requirement applied to rejections, which led to much debate among court and commentators.<sup>130</sup> Some courts looked to the intent of the rule and found that court approval was required to

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Mayer v. Hellman, 91 U.S. 496, 501 (1875) ("The great object of the Bankrupt Act, so far as creditors are concerned, is to secure equality of distribution among them of the property of the bankrupt.").

<sup>124</sup> See THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 108-10 (Harv. Univ. Press 1986) (discussing because the assume-or-reject approach appropriately treats rejection as an anticipatory breach and permits a damages claim, in effect it treats creditor like other unsecured creditors in bankruptcy); Andrew, *supra* note 93, at 883 ("It assures non-debtor parties to executory contracts and leases that, for purposes of the bankruptcy distribution, they will not be treated differently than other claimants . . . .").

<sup>125</sup> See Burns Mortg. Co. v. Bond Realty Corp., 47 F.2d 985, 987 (5th Cir. 1931) (discussing broad holding in *Chicago Auditorium* to treat rejection as an anticipatory breach, in line with the purposes behind the Bankruptcy Act meant when debtor cannot carry out specific performance, remedy should be limited to damages); Andrew, *supra* note 93, at 873, n.116 (analyzing deeming rejection a "breach" allows presumption that debtor will not perform obligations and "removes uncertainty about the debtor's performance that might stand in the way of establishing a claim").

<sup>126</sup> Chandler Act of 1938, 75 Cong. Ch. 575, § 70(b), 52 Stat. 840, 880 (1938).

<sup>127</sup> Chandler Act of 1938, 75 Cong. Ch. 575, § 63(c), 52 Stat. 840, 874 (1938).

<sup>128</sup> Chandler Act of 1938, 75 Cong. Ch. 575, § 63(a)(9), 52 Stat. 840, 873 (1938).

<sup>129</sup> Fed. R. Bankr. P. 607 (1982) (repealed 1983).

<sup>130</sup> *Id.* ("Whenever practicable, the trustee shall obtain approval of the court before he assumes [an executory contract]."). See *In re S.N.A. Nut Co.*, 191 B.R. 117, 121 (Bankr. N.D. Ill. 1996) (discussing former Bankruptcy Rule 607 created "a division of authority on whether assumption or rejection of an executory contract required court approval under the Act."); *In re 1 Potato 2, Inc.*, 182 B.R. 540, 542, n.11 (Bankr. D. Minn. 1995) ("The courts were split as to whether rejection required court approval."); *In re A.H. Robins Co.*, 68 B.R. 705, 708 (Bankr. E.D. Va. 1986) ("This court is very much aware of the ambiguity surrounding the procedure for rejection or assumption of executory contracts and is well acquainted with the case law which reveals a split of authority on the question of whether assumption by conduct is possible.").

reject a lease or contract, even though the rule did not explicitly state this.<sup>131</sup> Other courts found that the text of the rule itself made clear that court approval was not required to reject a lease or contract.<sup>132</sup>

*d. Section 365 in the Bankruptcy Code of 1978*

As part of bankruptcy reform in the 1970s, Congress created a commission to address the issue of whether, among other things, court approval was necessary to reject a lease or an executory contract.<sup>133</sup> In the Report of the Commission on the Bankruptcy Laws of the United States, the commission recommended the clarification of the treatment afforded executory contracts and unexpired leases.<sup>134</sup>

In the Bankruptcy Code of 1978, Congress resolved the split in newly-enacted section 365 which provides that the "trustee [or debtor in possession], subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."<sup>135</sup> The rejection-as-breach rule in section 63(c) was carried into section 365(g) of the Bankruptcy Code basically unchanged. Section 365(g) provides that "[e]xcept as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease[.]"<sup>136</sup> Not surprisingly, every court of appeals has held that rejection of an executory contract entitles the creditor to an unsecured claim against the estate.<sup>137</sup> As one prominent commentator notes, "[r]ejection does not . . . cause

<sup>131</sup> See *S.N.A. Nut Co.*, 191 B.R. at 121 (acknowledging some courts under Former Rule 607 required approval for assumption and rejection); *Bradshaw v. Loveless (In re Am. National Trust)* 426 F.2d 1059, 1063-64 (7th Cir. 1970) (rejecting argument court lacks power to approve rejection of the contract.); *Tex. Importing Co. v. Banco Popular de P.R.*, 360 F.2d 582, 584 (5th Cir. 1966) ("Chapter X does not expressly provide that executory contracts may be adopted or assumed only with the approval of the court, but we think by necessary implication it requires judicial approval for such adoption or assumption.")

<sup>132</sup> See, e.g., *Vilas & Sommer, Inc. v. Mahoney (In re Steelship Corp.)*, 576 F.2d 128, 133 n.2 (8th Cir. 1978) ("[§] 70(b) does not state any particular method by which the trustee shall assume an executory contract."); *Brown v. Presbyterian Ministers Fund*, 484 F.2d 998, 1005 (3d Cir. 1973) (rejecting the necessity of approval); *In re Forgee Metal Prod., Inc.*, 229 F.2d 799, 802 (3d Cir. 1956) ("[I]f the reorganization trustee take over the contract under the authorization of the bankruptcy court through under 70, sub. B, only the bankruptcy trustee had been expressly given such power.")

<sup>133</sup> See *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 793 F.2d 1380, 1393 (5th Cir. 1986); Gynn, *supra* note 105, at 231.

<sup>134</sup> H.R. Doc. No. 93-137 pt. 1, at 198 (1973). See Gynn, *supra* note 105, at 232 ("At least one of the recommended changes involved the standardization and clarification of treatment afforded, executory contracts and unexpired leases."); Epstein, *supra* note 104, at 685 (discussing Commission's recommendations regarding assumption, assignment, and rejection of executory contracts).

<sup>135</sup> 11 U.S.C. § 365(a) (2006).

<sup>136</sup> 11 U.S.C. § 365(g) (2006).

<sup>137</sup> *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294, 1312 (11th Cir. 2007) ("[R]ejection of an executory contract under 11 U.S.C.S. § 365(g) constitutes a pre-petition breach, and the non-debtor party to the rejected contract becomes a general unsecured creditor who may seek contract damages against the debtor as a pre-petition claim in the bankruptcy."); *Bank of Montreal v. Am. Home Patient, Inc.*, 414 F.3d 614, 619 (6th Cir. 2005) ("[R]ejection of an executory contract gives rise to a legal fiction that a breach of the contract occurred immediately prior to the filing of the petition."); *Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.)*, 378 F.3d 511, 519 (5th Cir. 2004) ("The rejection of an executory contract . . . constitutes a breach of such contract . . .") (citation omitted); *CPC Health Corp. v. Goldstein, (In re CPC*

an executory contract to vanish . . . [it] leav[es] the liabilities of the debtor intact to form the basis of a claim."<sup>138</sup>

## 2. A Unanimous View: CBAs are Executory Contracts Governed by Section 365

Before section 1113 was enacted all courts which had considered the issue had held that CBAs were executory contracts and that their rejection constituted a breach of contract giving rise to a pre-petition claim.<sup>139</sup> The decision in *NLRB v. Bildisco & Bildisco*<sup>140</sup> reflected that uniform position. *Bildisco* held that a CBA was an executory contract to which adherence was not required by the debtor, as with any other executory agreement.<sup>141</sup> When a debtor elected to reject the agreement and that decision was thereafter judicially approved, the breach of the CBA gave rise to a bankruptcy claim. In this connection, the *Bildisco* Court noted that recovery for such a breach could only be had under the claims administration process and that "losses occasioned by the rejection of a collective-bargaining agreement must be estimated, including unliquidated losses attributable to fringe

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Health Corp.), 81 Fed. App'x 805, 807 (4th Cir. 2003) ("[A] trustee's rejection of a contract is tantamount to a breach and gives rise to an unsecured claim against the estate."); *Mason v. Official Comm. of Unsecured Creditors*, (*In re* FBI Distribution Corp.), 330 F.3d 36, 42 (1st Cir. 2003) ("If the contract is rejected . . . the contract is deemed breached on the date immediately before the date of the filing of the petition . . ."); *Auction Co. of Am. v. Fed. Deposit Ins. Corp.*, 141 F.3d 1198, 1201 n.3 (D.C. Cir. 1998) (citing 11 U.S.C. § 365(g)) ("[R]ejection of an executory contract by bankruptcy trustee is treated as breach occurring immediately before filing of bankruptcy petition"); *Aslan v. Sycamore Inv. Co.* (*In re* Aslan), 909 F.2d 367, 371 (9th Cir. 1990) (stating executory contracts are subject to unequivocal language of 11 U.S.C. § 365(g), which states rejection constitutes breach); *Al Kopelow v. P.M. Holding Corp.* (*In re* Modern Textile), 900 F.2d 1184, 1191(8th Cir. 1990) ("[T]he trustee's rejection operates as a breach of an existing and continuing legal obligation of the debtor, not as a discharge or extinction of the obligation itself. In other words, the lessor's claim against the debtor for breach of the lease survives the trustee's rejection of the lease."); *Freuhauf Corp. v. Jartran, Inc.*, (*In re* Jartran, Inc.), 886 F.2d 859, 869 n.11 (7th Cir. 1989) (quoting 11 U.S.C. § 365(g)) ("The rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease"); *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp.*, 872 F.2d 36, 41 (3d Cir. 1989) (quoting 11 U.S.C. § 365(g)) ("[R]ejection of an executory contract or lease constitutes a breach of such contract or lease . . . immediately before the date of the filing of the petition . . ."); *Int'l Bhd. of Teamsters v. IML Freight, Inc.* (*In re* IML Freight Inc.), 789 F.2d 1460, 1463 (10th Cir. 1986) ("The rejection of any executory contract constitutes a breach of that contract under 11 U.S.C. § 365(g) . . ."); *Truck Drivers Local Union No. 807 v. Bohack Corp.*, 541 F.2d 312, 321 n.15 (1976) ("If the contract is rejected by the bankruptcy court, it will be deemed to have been breached as of the date of filing of the petition under Ch. XI.")

<sup>138</sup> *Andrew*, *supra* note 93, at 888.

<sup>139</sup> See *O'Neill v. Con'l Airlines Inc.*, (*In re* Continental Airlines, Inc.), 981 F.2d 1450, 1459 (5th Cir. 1993) (holding rejection of CBA, like rejection of executory contract, constitutes breach that gives rise to pre-petition claim.); *U.S. Truck Co. v. Teamsters National Freight Indus. Negotiating Comm.* (*In re* U.S. Truck Co.), 89 B.R. 618, 623 (E.D. Mich. Bankr. 1988) (stating CBAs are executory contracts and when they are rejected, they are treated as being breached immediately prior to bankruptcy); *Int'l Bhd. of Teamsters v. IML Freight, Inc.* (*In re* IML Freight, Inc.), 789 F.2d 1460, 1463 (10th Cir. 1986) (treating CBA like rejected executory contract); *Bohack Corp.*, 541 F.2d at 321 n.15 ("If the contract is rejected by the bankruptcy court, it will be deemed to have been breached as of the date of filing of the petition under Ch. XI.")

<sup>140</sup> 465 U.S. 513 (1984).

<sup>141</sup> See *id.* at 523-26.



benefits or security provisions like seniority rights" under section 502(c) of the Code.<sup>142</sup>

### 3. Where in Section 1113 Does Rejection Become Abrogation?

The *AFIA* majority concluded that Congress in section 1113 somehow altered this settled law and, in so doing, in effect, dictated different treatment for rejection of a CBA on one hand and all other executory contracts on the other.<sup>143</sup> The Supreme Court has held that amendments to the Code will not be read to "erode past bankruptcy practice absent a clear indication that Congress intended such a departure."<sup>144</sup> What basis is there in section 1113 for the majority's conclusion that Congress chose to abandon the bankruptcy policy of equality of treatment in the case of CBAs rejected under section 1113? There is nothing in the language or legislative history of section 1113 to that effect (and the Second Circuit did not claim otherwise), and we submit there is no basis, much less a "clear" one, to somehow infer a *sub silentio* wholesale revision of bankruptcy doctrine. While the Court suggested that the purpose of section 1113 was to permit rejection and the imposition of new terms "without fear of liability," seemingly at least in part referring to damages,<sup>145</sup> it cited no authority for its suggestion.<sup>146</sup> As the First Circuit has concluded, Congress did not enact section 1113 to eliminate damages in

<sup>142</sup> *Id.* at 530 n.12.

<sup>143</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 166 (2d Cir. 2007).

<sup>144</sup> *Pa. Dept. of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990). *See Dewsnap v. Timm*, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate' . . . this Court has been reluctant to accept arguments that would interpret the Code . . . to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history."); *Emil v. Hanley*, 318 U.S. 515, 521 (1943) ("We cannot help but think that if Congress has set out to make such a major change, some clear and unambiguous indication of that purpose would appear. But we can find none. Moreover, such an interpretation would lead in many cases to a division of authority between state and federal courts.")

<sup>145</sup> *In re Nw. Airlines*, 483 F.3d at 171–72.

<sup>146</sup> The parade of horrors painted in the *Miller* article—that if rejection is necessary "then allowing a claim for rejection damages that might dwarf all other general unsecured claims might stymie the reorganization," because the union's claim might "effectively control the class of creditors" and potentially block confirmation of a plan "reflects a blindness to the 'economic realities' of which creditors are providing the estate with the greatest value and the equality of treatment in this area emphasized since *Chicago Auditorium*, an attitude perhaps emanating from a 'rigid' opposition to the interests of employee creditors. Compare *Miller*, *supra* note 3, at 483, with *supra* note 1 and accompanying text. The concerns expressed are without basis. First, if employees have inordinately contributed to a reorganization they, as would be the case with any other creditors, deserve an appropriate return in unsecured claims, and in appropriate cases such claims should be voted with other unsecured claims. Further, there are many protections in the Code concerning approval of a plan of reorganization which have potential application to the vote of a large creditor. In certain circumstances a plan of reorganization can be confirmed if one impaired class approves, even if other impaired classes vote against confirmation. *See* 11 U.S.C. § 1129(a)(7)–(10) (2006). A vote of a creditor can be disallowed if the vote was not in good faith. 11 U.S.C. § 1126(d)–(e) (2006). And in at least one circumstance a court has upheld the separate classification of a union's rejection claim. *See Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d 581, 586 (6th Cir. 1986) (placing union in class separate from other impaired creditors).

the event a labor agreement was rejected in bankruptcy.<sup>147</sup> Rather, in section 1113 Congress sought to prevent debtors "from using bankruptcy as a judicial hammer to break the union" and to promote "good faith negotiations," based on a judgment that the decision in *Bildisco* did not adequately protect collectively bargained agreements.<sup>148</sup>

Congress accomplished its objective in two ways. First, in section 1113(f) it provided that the terms of a collectively bargained agreement continue in full force and effect until and unless the agreement is rejected pursuant to section 1113's procedures.<sup>149</sup> This, in effect, altered the traditional power of a debtor from the time of *Copeland* to elect not to be bound by a pre-petition executory contract. Under the regime of section 1113 a debtor must continue to adhere to its CBAs until and unless it makes out a case for rejection.<sup>150</sup> The tension between the traditional rejection power and the federal policy of collective bargaining were amply demonstrated in Continental Airlines' 1983 bankruptcy filing. There the airline, under the control of Frank Lorenzo, declared bankruptcy and almost immediately declared its collective bargaining agreements to be without force and effect, imposing in their place degraded terms and conditions of employment which had not been agreed to and triggering a strike by all of Continental's major labor groups. The misuse of the rejection power in Continental was a major factor in Congress's swift effort to overrule *Bildisco* and to require adherence to the terms of a CBA pending rejection in section 1113(f).

Second, Congress mandated a collective bargaining process applicable where a debtor seeks to reject an agreement with procedural and substantive safeguards applicable to rejection of a labor agreement.<sup>151</sup> In so doing, Congress made clear

<sup>147</sup> See *United Food & Commercial Worker's Union v. Almac's Inc.*, 90 F.3d 1, 4 (1st Cir. 1996) (noting this "holding[] [was] not what motivated the enactment of section 1113"). In analyzing the "scant" case law since the *Blue Diamond* decision the Miller article ignores Almac's. Miller, *supra* note 3, at 480; cf. 11 U.S.C. § 1113(f) (2006) (legislatively overruling *Bildisco*'s holding that a debtor need not adhere to terms of collective bargaining agreement before obtaining rejection order); *Massachusetts v. Blackstone Valley Elec. Co.*, 67 F.3d 981, 986 (1st Cir. 1995) ("[P]lain meaning must govern [a statute's] application, unless a palpably unreasonable outcome would result.").

<sup>148</sup> See *N.Y. Typographical Union No. 6 v. Maxwell Newspapers, Inc.* (*In re Maxwell Newspapers, Inc.*), 981 F.2d 85, 89-90 (2d Cir. 1992); *In re Century Brass Products, Inc.*, 795 F.2d 265, 273 (2d Cir. 1986); *International Union v. Gatke Corp.*, 151 B.R. 211, 213 (N.D. Ind. 1991) (mentioning section 1113 "was enacted to protect and foster collective bargaining"); *In re Mile Hi Metal Systems, Inc.*, 51 B.R. 509, 510 (Bankr. Colo. 1985).

<sup>149</sup> 11 U.S.C. § 1113(f) (2006) ("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."). See *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 88 (2d Cir. 1987).

<sup>150</sup> *Adventures Res., Inc. v. Holland*, 137 F.3d 786, 796 (4th Cir. 1998) (holding section 1113 "plainly imposes a legal duty on the debtor to honor the terms of a collective bargaining agreement until the agreement is properly rejected").

<sup>151</sup> See *ALPA v. Shugrue* (*In re Ionosphere Clubs, Inc.*), 22 F.3d 403, 406 (2d Cir. 1994) (stating section 1113 requires debtor to attempt negotiation with union prior to seeking rejection of CBA); *In re Blue Diamond Coal Co.*, 147 B.R. 720, 731-32 (Bankr. E.D. Tenn. 1992) (holding Congress "erected both procedural and substantive barriers to debtor's rejection or modification of agreements" (quoting *In re Roth American, Inc.*, 975 F.2d 949, 956 (3d Cir. 1992))).

that the section 1113 process and not the RLA would apply to modifications of collectively-bargained agreements in bankruptcy.<sup>152</sup> In the case of railroad reorganization Congress directed that the major dispute process of the RLA must be followed to modify agreements; for the air transport industry section 1113 would apply.<sup>153</sup>

But nothing in section 1113 addresses, much less makes inapplicable, the relationship of section 365 of the Code to other consequences of rejection. The general provision of the Code dealing with the rejection and the consequences of rejection of an executory contract is section 365.<sup>154</sup> Section 1113 defines that in the case of collective bargaining agreements that power can only be exercised "in accordance with the provisions of this section [1113]."<sup>155</sup> As the Fifth Circuit concluded in *Continental*, rejection of a collective bargaining agreement "does not invalidate the contract, or treat the contract as if it did not exist"; rather the contract is considered "breached."<sup>156</sup>

Of course, nothing in section 1113 provides that there is no damages claim for rejection of a collective bargaining agreement. As noted above, the Supreme Court in *Bildisco* affirmed that rejection of a collective bargaining agreement triggered a rejection damages claim. Congress was obviously aware of *Bildisco* when it enacted section 1113, yet nothing in section 1113 explicitly revises this aspect of the decision.<sup>157</sup>

Nor does anything in the text of section 1113 provide that a rejected CBA is "abrogated." No court has, up to now, described a rejected agreement as abrogated or used the word "abrogate" in construing section 1113. Rather, the courts have consistently interpreted section 1113 (titled "Rejection of collective bargaining agreements") as providing standards for "rejection" and authorization for "rejection" when the standards are met.<sup>158</sup> This is certainly how the Second Circuit understood

<sup>152</sup> See, e.g., *United Steelworkers of America v. Unimet Corp.* (*In re Unimet Corp.*), 842 F.2d 879, 884 (6th Cir. 1988) (recognizing section 1113 "prohibits the employer from unilaterally modifying any provision of the collective bargaining agreement").

<sup>153</sup> See 11 U.S.C. § 1167 (2006) (stating debtor may not change CBA which is subject to RLA except in accordance with RLA); 11 U.S.C. § 103(h) (2006); *In re Air Florida System, Inc.* 48 B.R. 440, 443 (Bankr. S.D. Fl. 1985) (noting section 1167 applies only to railroad reorganization proceedings and therefore airlines were not subject to that section); *In re Concrete Pipe Machinery Co.*, 28 B.R. 837, 840 (Bankr. N.D. Iowa 1983) (explaining "[t]hrough 11 U.S.C. § 1167, Congress chose to limit the Court's power with regard to collective bargaining agreements governed by Railway Labor Act").

<sup>154</sup> 11 U.S.C. § 365 (2006) (stating trustee's power, with bankruptcy court's permission, to reject executory contracts).

<sup>155</sup> 11 U.S.C. § 1113(a) (2006). See 11 U.S.C. § 1113(f) (2006).

<sup>156</sup> *O'Neill v. Continental Airlines, Inc.* (*In re Continental Airlines, Inc.*), 981 F.2d 1450, 1459 (5th Cir. 1993).

<sup>157</sup> See *United Food & Commercial Worker's Union v. Almac's Inc.*, 90 F.3d 1, 4 (1st Cir. 1996) (recognizing Congress was not motivated by *Bildisco's* holding rejection of CBA would result in a general unsecured claim, when passing 11 U.S.C. § 1113).

<sup>158</sup> See, e.g., *ALPA v. Shugrue* (*In re Ionosphere Clubs, Inc.*), 22 F.3d 403, 406 (2d Cir. 1993); *Nw. Airlines Corp. v. Ass'n of Flight Attendants* (*In re Nw. Airlines Corp.*), 349 B.R. 338, 356 (S.D.N.Y. 2006) (discussing how § 1113 creates more stringent standard that debtor must meet before rejecting collective bargaining agreement).

the effect or rejection before *AFA*. In *Century Brass*, the Second Circuit described section 1113 as "control[ing] the rejection of collective bargaining agreements in Chapter 11 proceedings,"<sup>159</sup> a formulation followed in *Maxwell Newspapers*.<sup>160</sup> In *Carey*, the court concluded that "the statute permits the bankruptcy court to approve a rejection application" only if the debtor meets the statute's requirements.<sup>161</sup> Similarly in *Royal Composing*, the court expressed hope for a negotiated agreement to "replace the rejected contract . . ."<sup>162</sup> No circuit has concluded that section 1113 permits "abrogation" of a CBA, and all circuits considering the issue have concluded that a rejected CBA is breached.

In *Northwest* the Second Circuit suggested that the "unique purpose" of section 1113—the rejection of a CBA and authorization for a debtor to establish new terms with which it must comply—"cannot be reconciled with the continued existence of its prior contract," and thereby attempted to distinguish cases dealing with the rejection and breach of all other executory contracts.<sup>163</sup> The reasoning behind that conclusion is opaque. Of course, CBAs are treated differently from all other executory contracts because in section 1113(f), the estate is bound to the CBA until and unless it is rejected.<sup>164</sup> But terms and conditions which are imposed pursuant to a rejection order under section 1113 are not a new CBA precisely because they do not (by definition) involve mutual consent. There is thus no basis in the section 1113 process to conclude that a rejected CBA is abrogated simply because the debtor is free to impose new terms found to be necessary under section 1113(b) in place of collectively bargained ones.<sup>165</sup>

<sup>159</sup> *Century Brass Prods., Inc. v. International Union (In re Century Brass Prods., Inc.)*, 795 F.2d 265, 272 (2d Cir. 1986).

<sup>160</sup> *N.Y. Typographical Union No. 6 v. Maxwell Newspapers, Inc. (In re Maxwell Newspapers)*, 981 F.2d 85, 89 (2d Cir. 1992) ("Section 1113 of the Bankruptcy Code 'controls the rejection of collective bargaining agreements in Chapter 11 proceedings.'" (quoting *In re Century Brass Prods., Inc.* 795 F.2d 265, 272 (2d Cir. 1986))).

<sup>161</sup> *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 88 (2d Cir. 1987).

<sup>162</sup> *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc. (In re Royal Composing room, Inc.)*, 848 F.2d 345, 351 (2d Cir. 1988).

<sup>163</sup> *See Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 170–71 (2d Cir. 2007); *In re Delta Air Lines, Inc.*, 359 B.R. 491, 505 (Bankr. S.D.N.Y. 2007) ("Section 1113 is forward-looking . . . [and] it necessarily terminates the debtor's obligation to comply with the [prior] agreement."); Miller, *supra* note 3, at 480–82.

<sup>164</sup> *See* 11 U.S.C. 1113(f) (2006) (ruling trustee cannot unilaterally terminate or alter any provision of collective bargaining agreement prior to compliance with rest of section); *In re Certified Air Technologies, Inc.* 300 B.R. 355, 366 (Bankr. C.D. Cal. 2003) (noting more rigorous standards exist for rejection of collective bargaining agreements than other executory contracts).

<sup>165</sup> The court's abrogation notion also runs roughshod over basic RLA doctrine that contract terms that have not been the subject of section 6 negotiations continue to bind the parties even after the parties are free to conduct self-help. *See Bhd. of Ry. Clerks v. Fla. E. Coast Ry.*, 384 U.S. 238, 247 (1966) ("Were a strike to be the occasion for a carrier to tear up and annul, so to speak, the entire collective bargaining agreement, labor-management relations would revert to the jungle."); *Manning v. American Airlines, Inc.*, 329 F.2d 32, 34 (2d Cir. 1964) ("The effect of § 6 is to prolong agreements subject to its provisions regardless of what they say as to termination."). *See generally* ADRAM, *supra* note 18; K. Stone, *supra* note 3, at 1495 ("[U]nlike collective bargaining agreements under the NLRA, agreements under the RLA never expire.

The *AFA* majority ultimately rests its decision on a new legal fiction: the notion that in passing section 1113, Congress made CBAs binding on the estate and afforded employees limited collective bargaining rights and, in exchange, removed the damages claim that modification of contractual terms would otherwise provide—as well as the right to strike for RLA employees.<sup>166</sup> The majority cites to nothing in the language or legislative history of section 1113 as evidence of such a grand bargain and there is none. As a general matter, there is no basis to treat contracts rejected under section 1113 any differently than other executory contracts under section 365 (captioned “Executory contracts and unexpired leases”). Section 365(g) provides that:

Except as provided in subsections (h)(2) and (i)(2) of this section, *the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—*  
(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition[.]<sup>167</sup>

Thus, by its terms the provisions of section 365 stating that a breach is the consequence of rejection applies to all executory contracts and is not limited to contracts rejected under section 365.<sup>168</sup> Congress created two limited exceptions where rejection may be treated as termination of a contract, sections 365(h)(2) and (i)(2), both of which deal with timeshare lease agreements. Congress did not include CBAs as a further exception to the rule that a rejected contract is breached.

The Fourth Circuit in *Adventure Resources Inc. v. Holland*,<sup>169</sup> recognized that section 1113 did not displace the general applicability of section 365 to claims generated by rejection of a collective bargaining agreement:

However, in erecting § 1113's substantive and procedural obstacles to the unilateral rejection of collective bargaining agreements, Congress did not indicate that it intended to otherwise restrict the general application of § 365 to those agreements. Section 1113 'governs only the conditions under which a debtor may modify or reject a collective bargaining agreement[.]' Thus, § 365 continues to

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Rather, they stay in effect indefinitely, unless or until changed in accordance with the statutory provisions for altering them.”)

<sup>166</sup> See *In re Nw. Airlines Corp.*, 346 B.R. 307 (Bankr. S.D.N.Y. 2006).

<sup>167</sup> 11 U.S.C. § 365(g)(1) (2006) (emphasis added).

<sup>168</sup> *Id.*; Michael St. Patrick Baxter, *Is There A Claim For Damages From The Rejection Of A Collective Bargaining Agreement Under § 1113 Of The Bankruptcy Code?*, 12 BANKR. DEV. J. 703, 717–18 (1996) (“Section 365(g) does not require that rejection occur under section 365. It requires only that the executory contract ‘has not been assumed under’ section 365. A collective bargaining agreement that has been rejected under section 1113 qualifies as a contract that has not been assumed under section 365.”) (citation omitted).

<sup>169</sup> 137 F.3d 786, 798 (4th Cir. 1998).

apply to collective bargaining agreements, except where such an application would create an irreconcilable conflict with § 1113.<sup>170</sup>

Other courts have reached the same result.<sup>171</sup> Similarly, courts have properly looked to section 365 to fill in what would otherwise be gaps in section 1113 on issues other than the rejection process and standards themselves, and have analyzed section 1113 as a specialized and delineated modification of section 365.

For example, the court in *Moline Corp.* noted that section 1113 did not provide the damages consequences of either rejection or assumption of a labor agreement.<sup>172</sup> Notwithstanding that silence the court concluded that "if the debtor never rejects the collective bargaining agreement and thus assumes the agreement by inaction, the plan of reorganization must provide for the payment of the unsecured pre-petition and post-petition claims according to the priority scheme set out in section 507[.]" reasoning that "section 365 must apply to fill in the gap left by section 1113."<sup>173</sup>

In the case of the assumption of labor agreements the courts have routinely looked to section 365 because although section 1113(a) provides that a debtor may "assume or reject" a labor agreement "only in accordance with the provisions of this section,"<sup>174</sup> Section 1113 has no provisions dealing with assumption.<sup>175</sup>

There is no basis in the language of section 1113 to conclude that Congress intended to remove CBAs from the ambit of section 365(g) of the Code and afford unionized employees whose contracts were rejected dramatically different and inferior treatment to other unsecured creditors whose contracts are rejected. *The ATA majority's inability to point to any language in the statute or legislative history reflecting such a material departure from settled bankruptcy policy tellingly reveals that in this hard case the court made bad law without reasoned underpinning.*<sup>176</sup>

<sup>170</sup> *Id.* 137 F.3d at 798 (citation omitted).

<sup>171</sup> See, e.g., *United Food & Commercial Workers Union, Local 211 v. Family Snacks, Inc.* (*In re Family Snacks, Inc.*), 257 B.R. 884, 900 (B.A.P. 8th Cir. 2001) ("[T]he better reading is that § 365 covers assumption and rejection of CBAs, except as specifically modified with regard to rejection in § 1113"); *Mass. Air Conditioning & Heating Corp. v. McCoy*, 196 B.R. 659, 663 (D. Mass. 1996) ("Section 1113 is designed to provide additional procedural requirements for rejection or modification of collective bargaining agreements, and only to that degree supersedes and supplements the provisions in § 365."); *In re Moline Corp.*, 144 B.R. 75, 78 (Bankr. N.D. Ill. 1992) ("Collective bargaining agreements are simply executory contracts with a special provision governing their assumption or rejection by the debtor or the trustee in a Chapter 11 case.")

<sup>172</sup> 144 B.R. at 78–79.

<sup>173</sup> *Id.* at 78.

<sup>174</sup> 11 U.S.C. § 1113(a).

<sup>175</sup> See *Wien Air Ala., Inc. v. Bachner*, 865 F.2d 1106, 1111 n.5 (9th Cir. 1989) (applying section 365 to assumption of a collective bargaining agreement because section 1113 only contains procedures for rejection or unilateral modification); *Mass. Air Conditioning & Heating Corp. v. McCoy*, 196 B.R. 659, 663 (D. Mass. 1996) ("assumption of a collective bargaining agreement—like any other executory agreement—remains within the province of § 365"); *Holland*, 137 F.3d at 798 (stating section 1113 only governs a debtor's ability to reject or modify CBAs).

<sup>176</sup> See Baxter, *supra* note 168, at 728 ("Congress did not intend for section 1113 to remove collective bargaining agreements from the purview of section 365(g) for purposes of determining the effects of rejection."); see also *In re Young*, 193 B.R. 620, 624 (Bankr. D.C. 1996) (declining to interpret amendment to § 362(a)(3) in a manner that would result in a "dramatic shift" in both pre-Code and pre-amendment

The majority apparently relied on the bankruptcy court's decision in *Blue Diamond Coal* (summarily affirmed by the district court) for the notion that rejection of a labor agreement does not create an unsecured damages claim.<sup>177</sup> The *Blue Diamond Coal* court's conclusion that rejection of a collective bargaining agreement creates no claim in bankruptcy because Congress did not also specifically amend section 502(g) to so provide places the cart before the horse.<sup>178</sup> Bankruptcy policy favors equality in treatment of creditors,<sup>179</sup> and as section 365(g) applies to all creditors with claims founded on executory contracts, if Congress wanted to eliminate claims founded on rejection of CBAs it would have done so affirmatively. As one commentator has already persuasively concluded:

The likely explanation is that section 1113 was not intended to entirely remove collective bargaining agreements from the purview of section 365. Instead, section 1113 generally overrules section 365 to the extent the latter is inconsistent with the former. Put differently, section 365 generally and section 365(g) in particular continue to apply to collective bargaining agreements to the extent

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practice without "one word of legislative history" to support such an interpretation). The suggestion that the debtor's authority to impose new terms and conditions of employments creates a different rule concerning breach and damages than for commercial contracts is without basis.

<sup>177</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 172 (2d Cir. 2007); see *In re Blue Diamond Coal Co.*, 147 B.R. 720, 732 (Bankr. E.D. Tenn. 1992) ("[A] claim for damages alleged to have resulted from the rejection of a collective bargaining agreement under § 1113 cannot be premised on 365(g) nor can the claim be asserted pursuant to § 502(g)."). Although concluding that appeal of the issue was moot, the district court in *Blue Diamond* proceeded to affirm *in dicta* the merits of the bankruptcy court's decision. *Blue Diamond Coal*, 147 B.R. at 734 (denying motion). The court, apparently motivated by a misguided policy concern, believed that the allowance of a rejection claim "for damages, especially if the amount of that claim represents lost future wages and benefits, would necessarily assure the failure of the reorganization" because of an antecedent finding that rejection of the labor agreement met the requirements of section 1113 of the Code. *Southern Labor Union, Local 188 v. Blue Diamond Coal Co. (In re Blue Diamond Coal Co.)*, 160 B.R. 574, 577 (D. Tenn. 1993). In that regard, the court apparently ignored that a rejection damages claim would be a general unsecured pre-petition claim, and not a claim of administration, a confusion also raised during oral argument before the Second Circuit in the *ATA* case. See *Medical Malpractice Ins. Ass'n v. Hirsch (In re Lavigne)*, 114 F.3d 379 (2d Cir. 1997) (stating that a rejection claim is considered a pre-petition claim); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 60 (Bankr. S.D.N.Y. 2004) ("[R]ejection claims are pre-petition claims, with no priority over the claims of other unsecured creditors . . ."); *In re Nat'l Refractories & Minerals Corp.*, 297 B.R. 614, 616 (Bankr. N.D. Cal. 2003) (stating that the rejection of a lease before it is assumed is considered to have occurred pre-petition and thus any claim for damages is general, unsecured claim).

Even if one were to accept *Blue Diamond Coal's* conclusion that no damages claim is provided for rejection of a CBA under section 502(b) that would not support the majority's conclusion that rejection of a CBA abrogates rather than breaches the agreement, *Blue Diamond Coal* did not hold that the rejected CBA was not breached but just that there was no provision in the Code for allowance of a claim based on such a breach. See *Blue Diamond Coal*, 160 B.R. at 574.

<sup>178</sup> *Blue Diamond Coal*, 147 B.R. at 730. See generally Baxter, *supra* note 168.

<sup>179</sup> Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal Of Non-Debtor Releases In Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 980 (1997) ("One of the most enduring bankruptcy policies is that favoring equal treatment of similarly situated creditors.").

that such application would not be inconsistent with section 1113.<sup>180</sup>

As noted above, the Fourth Circuit subsequently reached this same conclusion in *Adventure Resources*.<sup>181</sup> *Blue Diamond Coal* was wrongly decided and the *AFA* majority's reliance on it misplaced.<sup>182</sup>

The strength of the majority's drive to reach a particular result—a strike injunction—is revealed by its willingness to ignore years of circuit precedent construing the substantive rejection standards under section 1113. In the leading case on the substantive rejection standards of section 1113, *Carey Transportation*,<sup>183</sup> the Second Circuit held that a bankruptcy court must consider both "the possibility and likely effect of any employee claims for *breach of contract* if rejection is approved" and the "likelihood and consequences of a strike."<sup>184</sup> The likely effect of unsecured claims triggered by rejection of a labor agreement has universally been considered by the courts as one of the equitable factors to be considered in deciding whether a contract should be rejected or not both before and after the enactment of section 1113.<sup>185</sup> Of course, if a CBA were abrogated, not breached, there would be no damage claims to consider.

The majority never addresses this inconsistency with settled 1113 law. Instead it compounds the confusion by citing, with approval,<sup>186</sup> the portion of *Carey Transportation* recognizing rejection damages claims, albeit, as the concurrence

<sup>180</sup> Baxter, *supra* note 168, at 729.

<sup>181</sup> *Adventure Res. Inc. v. Holland*, 137 F.3d 786, 797 (4th Cir. 1998).

<sup>182</sup> See *In re Blue Diamond Coal*, 160 B.R. at 574; see also *Mass. Air Conditioning & Heating Corp. v. McCoy*, 196 B.R. 659, 663 (D. Mass. 1996) (noting the limited times and to the degree where § 1113 supersedes § 365). But see *United Food & Commercial Workers Unions v. Family Snacks, Inc.* (*In re Family Snacks, Inc.*), 257 B.R. 884, 900 (B.A.P. 8th Cir. 2001) ("§ 365 covers assumption and rejection of CBAs, except as specifically modified with regard to rejection in § 1113."). The majority's reliance on the differences between sections 1113 and 1114 is also misplaced. Indeed, if anything, the wording of section 1114 supports the existence of a rejection damages claim here. Section 1114 (i) provides for a claim resulting from the *modification* (rather than rejection) of retiree benefits. *In re Tower Automotive*, 342 B.R. 158, 161 (Bankr. S.D.N.Y. 2006) (section 1114 "both protects and sets out a procedure for the modification of retiree benefits . . ."), *aff'd* 241 F.R.D. 162 (S.D.N.Y. 2006).

<sup>183</sup> *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82 (2d Cir. 1987).

<sup>184</sup> *Id.* at 93.

<sup>185</sup> See *Ass'n of Flight Attendants v. Mesaba Aviation, Inc.*, 350 B.R. 435, 463 (D. Minn. 2006) (considering "the possibility and likely effect of any employee claims for breach of contract if rejection is approved."); *In re Moline Corp.*, 144 B.R. 75, 78–79 (Bankr. N.D. Ill. 1992) ("[T]he employees' prepetition claims under the collective bargaining agreement would automatically become Chapter 11 administration claims as part of the cure of defaults required to assume an executory contract."); *In re Garofalo's Finer Foods, Inc.*, 117 B.R. 363, 373 (Bankr. N.D. Ill. 1990) ("Any section 502(g)(2) employee damage claims may be significant . . ."); *In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 272–73 (Bankr. S.D. Tex. 1988) (considering damages claim for breach of contract that will be brought by employees); *In re Blue Ribbon Transp. Co., Inc.*, 30 B.R. 783, 785 (Bankr. D.R.I. 1983) (stating one prong of the test as whether debtor can "provide facts sufficient for the Court to weigh the competing equities in the case and make a determination in favor of the contract"); *In re Braniff Airways, Inc.*, 25 B.R. 216, 219 (Bankr. N.D. Tex. 1982) ("Those equities which the court must balance include the employee claims arising from rejection . . .").

<sup>186</sup> See *In re Nw. Airlines*, 483 F.3d at 169 n.2 (directing bankruptcy courts to consider possibility and effects of employee claims for breach of contract if rejection is approved).



notes,<sup>187</sup> based on the mistaken belief that *Carey Transportation* involved issues under the RLA.<sup>188</sup>

The panel's reasoning, in effect, facilitates a significant redistribution of wealth in the bankruptcy process: from unionized employees whose contracts are rejected and who will thereafter labor under degraded terms, towards other unsecured creditors and, potentially equity holders who might, by virtue of CBA "abrogation" now move "into the money." This judicial legislation is fundamentally incompatible with both the intent to provide increased protection for labor through the enactment of section 1113 and general bankruptcy policy which insists upon like treatment of similarly situated creditors.<sup>189</sup> The potential magnitude of the panel's redistribution effort can be gauged by claims negotiated in recent airline bankruptcies. In filings since September 11, ALPA has on behalf of the airline pilots its represents, negotiated for claims (or equity in the reorganized company) worth several billions of dollars. This occurred both in *Northwest* where ALPA negotiated an \$888 million unsecured claim, among other things,<sup>190</sup> and in the *US Airways*, *United* and *Delta* bankruptcies as well.

In the first *US Airways* bankruptcy pilots received 19.33% of the Company's stock as part of a concessionary agreement, and in the second bankruptcy received a new profit sharing plan and an allocation of equity.<sup>191</sup> In the *United* bankruptcy pilots received a \$3 billion unsecured claim. In addition, in return for certain contractual changes agreed to by ALPA, a profit sharing plan and \$550 million in

<sup>187</sup> *Id.* at 182 n.3 (Jacobs, D., concurring) ("[N]early all of the cases cited by the majority had nothing to do with the Railway Labor Act or its status quo provisions.")

<sup>188</sup> *Id.* at 165-66 ("This appeal turns on Northwest's likelihood of success on the merits, any assessment of which, in turn, requires us to interpret and heed . . . the Railway Labor Act of 1926 (RLA)."). With respect to the strike issue, the majority characterized that part of the holding in *Carey* as an "intimat[ion]" or a "hint[ing]." *Id.* at 172 ("We have intimated that a union would be free to strike following contract rejection under § 365."); *Id.* at 173 ("In cases governed by the NLRA, we have also hinted that a union is free to strike, even following contract rejection under § 1113.")

<sup>189</sup> See *Int'l Union v. Galtke Corp.*, 151 B.R. 211, 213 (N.D. Ind. 1991) ("Further, § 1113 was enacted to protect and foster collective bargaining."); *Begier v. IRS*, 496 U.S. 53, 58 (1990) ("equality of distribution among creditors is a central policy of the Bankruptcy Code"); JACKSON, *supra* note 124, at 30-31 (Harvard Univ. Press 1986) (discussing general unsecured creditors' entitlement to pro rata treatment under bankruptcy policy of treating similarly situated creditors equally).

<sup>190</sup> See *In re Northwest Airlines Corp.*, Debtors' Motion for Approval of Compromise and Agreements with the Airline Pilots Association, International, May 31, 2006, Exhibit A (Letter 2006-01, ¶¶ C, E, H, I; Letter 2006-3, ¶ 7), (Case No. 05-17930, Bankr. S.D.N.Y.) [Docket No. 2690] (agreeing to pay \$16.8 million as a lump sum upon emergence from bankruptcy, an incentive performance plan, a profit sharing plan, and a general unsecured pre-petition claim in the Company's chapter 11 case in the amount of \$888 million).

<sup>191</sup> Press Release, Air Line Pilots Ass'n, Int'l, US Airways ALPA Pilots Ratify Transformation Plan Agreement, ALPA, (Oct. 21, 2004), available at [http://www.alpa.org/DesktopModules/ALPA\\_Documents/ALPA\\_DocumentsView.aspx?itemid=909&ModuleId=785](http://www.alpa.org/DesktopModules/ALPA_Documents/ALPA_DocumentsView.aspx?itemid=909&ModuleId=785) ("The agreement . . . also offers returns for the pilots, including a profit sharing plan and equity participation shares."); Press Release, US Airways Group, Inc., US Airways Completes Restructuring; Secures \$1.24 Billion in New Financing and Investment as it Emerges from Chapter 11 (March 31, 2003), available at <http://www.prnwire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/03-31-2003/0001917282&EDATE> ("Consistent with the plan of reorganization [t]he remaining stock will be divided as follows: Air Line Pilots Association (19.3 percent) . . .").

convertible notes were issued as a result of United moving for and obtaining a termination of the pilots' pension plan.<sup>192</sup> In settlement of Delta's 1113 filing ALPA and the Company reached agreement on a restructuring agreement that provided a \$2.1 billion pre-petition unsecured claim, \$650 senior unsecured "Pilot Notes" notes, and a profit sharing plan providing for 15% of all pre-tax (as defined) income up to a maximum of \$1.5 billion, and a 20% share of all pre-tax profits over \$1.5 billion.<sup>193</sup> Other unions representing airline employees have also negotiated substantial unsecured claims when faced with section 1113 demands. The ability to negotiate possible future returns in the form of allowed claims has been a substantial factor in the ability of unions to negotiate consensual agreements in bankruptcy.<sup>194</sup> That tool may be eaten away by the *AFA* decision.<sup>195</sup>

#### 4. Is There an Anti-Strike Policy in Section 1113? Whatever Happened to the Norris-LaGuardia Act?

Contrary to the majority, there is nothing inconsistent between either section 1113(f)'s command that a debtor maintain a CBA until rejection is approved, or the imposition of revised terms and conditions of employment and any obligation to adhere to those terms and conditions, and the statutory provision that a rejected CBA is breached. The majority's rewriting of the Code is based on the unsupportable notion that self-help in the face of CBA rejection is "inconsistent with Congress's intent in passing § 1113."<sup>196</sup> But nothing in section 1113 addresses, much less curtails the right to self-help. The majority points to nothing in either the language or legislative history for this remarkable proposition. There is no anti-strike policy in section 1113.<sup>197</sup>

There is, by contrast, a strong policy against strike injunctions enacted in the NLGA. Because the federal courts repeatedly issued strike-breaking injunctions based on their own "views of social and economic policy" and their "disapproval" of strikes,<sup>198</sup> Congress in the NLGA took the "extraordinary step of divesting the

<sup>192</sup> *United Retired Pilots Benefit Protection Ass'n v. United Airlines, Inc. (In re UAL Corp.)*, 443 F.3d 565, 568 (7th Cir. 2006).

<sup>193</sup> Delta Air Lines, Inc., Quarterly Report (Form 10-Q), at 8 (June 30, 2006), available at [http://www.sec.gov/Archives/edgar/data/27904/000118811206002418/t11194\\_10q.htm](http://www.sec.gov/Archives/edgar/data/27904/000118811206002418/t11194_10q.htm).

<sup>194</sup> See, e.g., Debtors' Motion for Approval of Compromise and Agreements with the Airline Pilots Association, *supra* note 190; US Airways Completes Restructuring, *supra* note 191.

<sup>195</sup> See *In re Nw. Airlines, Inc.*, 366 B.R. 270, 276 (Bankr. S.D.N.Y. 2007) (sustaining objection to AFA's bankruptcy claims based on holding of the panel majority).

<sup>196</sup> *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 172. See *supra* note 79 and accompanying text.

<sup>197</sup> Compare *Int'l Union v. GATCO Corp.*, 151 B.R. 211, 213 (N.D. Ind. 1991) (stating section 1113 was enacted to further protect collective bargaining power, not cripple it), with *Ass'n of Flight Attendants v. Mesaba Aviation, Inc.*, 350 B.R. 435, 463 (D. Minn. 2006) (weighing potential strike as determining factor, since strike could cause liquidation). See generally 11 U.S.C.A. § 1113 (2006).

<sup>198</sup> *Jacksonville Bulk Terminals, Inc. v. Int'l Longshoremen's Ass'n*, 457 U.S. 702, 715-16 (1982); *Bedford Cut Stone Co. v. Journeymen Stone Cutters' Ass'n*, 274 U.S. 37, 54-55 (1927) (imposing injunction, stating that a dangerous probability of restraint on interstate commerce is enough to interpose with an injunction);

federal courts of equitable jurisdiction" in labor disputes.<sup>199</sup> The NLGA took "the federal courts out of the labor injunction business"<sup>200</sup> by drastically limiting the circumstances under which a court may enjoin a strike.

In particular, the anti-injunction provisions of the NLGA were intended to "prevent overactive courts from interfering in labor-management disputes, and from undermining the ability of labor groups to effectively negotiate labor contracts."<sup>201</sup> Congress achieved this goal by eliminating judicial examination of the principles, motives, and objectives of union activity from scrutiny by the courts. "[T]he licit and the illicit . . . are not to be distinguished by any judgment regarding the wisdom or unwisdom, the rightness or wrongness, the selfishness or unselfishness of the end of which the particular union activities are the means."<sup>202</sup> Most recently the Supreme Court, by unanimous decision, reaffirmed this basic tenet by rejecting a "substantial-alignment test" and refusing to allow judicial second-guessing of union means and motives in taking self-help.<sup>203</sup> That jurisdictional limitation fully applies to bankruptcy courts. Indeed, "[n]o series of cases contributed more to the feeling that the federal courts abused their equity jurisdiction than those involving employees of railroads in equity receivership."<sup>204</sup>

For this reason, the federal courts have consistently ruled that the equitable jurisdiction of the bankruptcy courts is defined and limited by NLGA. In cases going back over a half century under both the Act and the Code courts concluded that nothing in the text or legislative history of the bankruptcy law support that Congress sought to "supersede or transcend" the NLGA's limitations and that there was no basis to "believe the [NLGA] was to be superseded, *sub silentio*."<sup>205</sup>

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Archibald Cox, *Current Problems in the Law of Grievance Arbitration*, 30 ROCKY MOUNTAIN L. REV. 247, 256 (1958) ("The greatest evils [of labor injunctions] lay in the doctrines of tort law which made the lawfulness of a strike depend upon judicial views of social and economic policy.").

<sup>199</sup> *Burlington N. R.R. Co. v. Bhd. of Maint. of Way Employees*, 481 U.S. 429, 437 (1987); see Cox, *supra* note 198, at 256 ("The Norris-LaGuardia Act abolished the objectives test by making the legality of employee activities depend upon external conduct rather than an appraisal of the rightness or wrongness, or the desirability [sic] or impropriety, of their goals."); 29 U.S.C. § 101 (2006) (NLGA) ("No court . . . shall have jurisdiction to issue any restraining order or temporary or permanent injunction in a case involving or growing out of a labor dispute, except in a strict conformity with the provisions of this chapter.").

<sup>200</sup> *Marine Cooks & Stewards, AFL v. Panama S.S. Co.*, 362 U.S. 365, 369 (1960).

<sup>201</sup> *E. Air Lines, Inc. v. ALPA*, 710 F. Supp. 1342, 1344 (S.D. Fla. 1989), *aff'd*, No. 89-5229, 1989 WL 409874 (11th Cir. June 7, 1989). See *Marine Cooks & Stewards v. Panama S.S. Co.*, 362 U.S. 365, 369 (1960) ("The language is broad because Congress was intent upon taking the federal courts out of the labor injunction business except in the very limited circumstances left open for federal jurisdiction under the Norris-LaGuardia Act."). See generally 29 U.S.C. § 102 (2006).

<sup>202</sup> *United States v. Hutcheson*, 312 U.S. 219, 232 (1941).

<sup>203</sup> *Burlington N.*, 481 U.S. at 434, 441-43.

<sup>204</sup> *United States v. United Mineworkers of Am.*, 330 U.S. 258, 320 n.6 (1947) (Frankfurter, J., concurring). See William E. Forbath, *The Shaping of the American Labor Movement*, 102 HARV. L. REV. 1109, 1155-57 (1989) (discussing "[t]he Origins of 'Government by Injunction' in Railway Strikes"). See generally Walter Nelles, *A Strike and Its Legal Consequences—An Examination of the Receivership Precedent for the Labor Injunction*, 40 YALE L.J. 507 (1931) (discussing role of federal judges in undertaking management of bankrupt railways).

<sup>205</sup> *Petrusch v. Teamsters Local 317 (In re Petrusch)*, 667 F.2d 297, 300 (2d Cir. 1981) (summarily affirming district court's reversal of bankruptcy court's strike injunction for lack of jurisdiction under

Nor is the potential for self-help in the face of rejection inconsistent with federal bankruptcy policy. Of course, where rejection constitutes a material breach of contract, the creditor is excused from continued performance under the agreement.<sup>206</sup> A debtor cannot both reject an executory contract and demand continued performance by the creditor.<sup>207</sup> The same logic has been recognized in collective bargaining. The possibility of self-help fosters agreements, as the Supreme Court concluded in unanimously overruling a strike injunction in a nationwide strike of all railroads.<sup>208</sup> In the *United* bankruptcy the Seventh Circuit recognized that the possibility of self-help fostered ALPA's eventual agreement to revised terms with that bankrupt carrier.<sup>209</sup> In sum, there is nothing in section 1113

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NLGA). See *Elsinore Shore Assocs. v. Local 54, Hotel Employees*, 820 F.2d 62, 66-67 (3d Cir. 1987); *Briggs Transp. Co. v. Int'l Bhd. of Teamsters*, 739 F.2d 341, 343 (8th Cir. 1984) ("[T]he parties have cited us to nothing in the Bankruptcy Code or its legislative history indicating a congressional intent to lift the jurisdictional restrictions of the Norris-LaGuardia Act . . ."); *Crowe & Assocs. V. Bricklayers & Masons Union Local No. 2 (In re Crowe & Assoc., Inc.)*, 713 F.2d 211, 214-15 (6th Cir. 1983) (citing *Petrusch* and holding that NLGA bars issuance of strike injunction notwithstanding automatic stay as "Congress would not have silently decided to alter its anti-injunction policy"); *Lehman v. Quill (In re Third Ave. Transit Corp.)*, 192 F.2d 971, 973 (2d Cir. 1951) ("The well established power of the reorganization court to issue orders necessary to conserve the property in its custody must be exercised within the scope of a jurisdiction which is limited by the broad and explicit language of the [NLGA]."); *Int'l Bhd. of Teamsters, Local 886 v. Quick Charge, Inc.*, 168 F.2d 513, 516 (10th Cir. 1948) ("There is nothing in the Norris-LaGuardia Act which exempts equity receiverships of any kind from its provisions. It prohibits injunctions in any case involving or growing out of any labor dispute. It provides that, 'No court of the United States shall have jurisdiction to issue (such injunction).';" *Anderson v. Bigelow*, 130 F.2d 460, 462 (9th Cir. 1942) ("However, it has been suggested elsewhere that employers can escape the provisions against enjoining peaceful striking or picketing if their enterprises can be brought within a federal receivership. We can find no case supporting such an interpretation of the Norris-LaGuardia Act. It prohibits injunctions 'in any case involving or growing out of any labor dispute.' It provides that 'No court of the United States shall have jurisdiction to issue' such injunctions. There is no exception of 'any case' or 'any labor dispute' in receivership proceedings.") (footnotes omitted).

<sup>206</sup> See, e.g., *Adelphia Bus. Solutions, Inc. v. Abnos*, 482 F.3d 602, 606 (2d Cir. 2007) ("Rejection of an unexpired lease . . . is treated as a breach of the lease."); *Med. Malpractice Ins. Ass'n v. Hirsch (In re Lavigne)*, 114 F.3d 379, 387 (2d Cir. 1997); *Bear, Stearns Funding, Inc. v. Interface Group-Nev., Inc.*, 361 F. Supp. 2d 283, 291 (S.D.N.Y. 2005) ("A fundamental principle of contract law provides that the material breach of a contract by one party discharges the contractual obligations of the non-breaching party.").

<sup>207</sup> See 11 U.S.C. § 365(a) (2006) (providing trustee can either assume or reject executory contracts of debtor); *In re Tabernash Meadows, LLC*, No. 03-24392 SBB 2005 WL 375660, at \*14 (Bankr. D. Colo. Feb. 15, 2005) (explaining debtor may not "demand payment from the non-debtor party while unable, or refusing, to perform its own obligations"); Theresa J. Pulley Radwan, *Limitations on Assumption and Assignment of Executory Contracts by "Applicable Law"*, 31 N.M.L.J. REV. 299, 302 (2001) ("Rejection of a contract serves as a court-approved breach of contract and terminates both parties' rights to demand further performance under the contract.").

<sup>208</sup> See *Burlington N.*, 481 U.S. at 451-53; see also Richard A. Posner, *Some Economics of Labor Law*, 51 U. CHI. L. REV. 988, 997 (1984) ("[T]he union and employer can deal only with each other and a refusal to deal, by imposing costs on the other party, makes him more likely to come to terms. The strike imposes costs on both parties: on the employer, by forcing him to reduce or cease production, and on the workers, by stopping their wages. The balance of those costs will determine the ultimate settling point between the union's initial demand and the employer's initial offer.").

<sup>209</sup> *United Retired Pilots Benefit Protection Ass'n v. United Airlines, Inc. (In re UAL Corp.)*, 443 F.3d 565, 569-70 (7th Cir. 2006) ["*UALP*"] (recognizing ALPA, on behalf of United Airlines' active pilots [as opposed to retired pilots] received substantial consideration in return for giving up contractual right to pension plan, resolving pending 1113 motion, largely because "active pilots had a stick to use against United—the threat

that limits labor self-help in the face of contract rejection and nothing in bankruptcy policy that would support such a limitation. In the absence of a statutory obligation, there can be no basis to enjoin a strike given the NLGA.

*B. The Panel's Expansive and Insupportable Construction of Section 2 (First)*

The Supreme Court has held that the jurisdictional limits of the NLGA may be overcome to enforce a clear mandate of the RLA.<sup>210</sup> Both the majority and concurring *AFA* opinions attempted to find that mandate in section 2 (First) of the RLA, but for inconsistent reasons. Neither opinion can be squared with the Supreme Court's holdings on section 2 (First), or even the Second Circuit's prior decisions, even assuming, *arguendo*, that section 2 (First)'s duty to "make and maintain agreements" somehow continued to bind *AFA* but not Northwest.

A court may enter a strike injunction to enforce the RLA's duty to bargain in narrowly limited circumstances: "[e]ven when a violation of a specific mandate of the RLA is shown, '[c]ourts should hesitate to fix upon injunctive remedy . . . unless that remedy alone can effectively guard the plaintiff's right.'"<sup>211</sup> The Supreme Court has instructed that section 2 (First) must not be used as "a cover for freewheeling judicial interference in labor relations of the sort that called forth the [NLGA] in the first place."<sup>212</sup> The *AFA* majority nowhere discusses those limitations or justifies its injunction as the sole remedy available to compel *AFA* to bargain in good faith (even assuming contrary to the unmentioned factual findings of the bankruptcy court that *AFA* had not already done so). Striking is not *per se* inconsistent with bargaining in good faith, as the majority acknowledged.<sup>213</sup> Northwest conceded and

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of a strike—that the retirees didn't have."); see also *In re UAL Corp.*, 468 F.3d 456, 461 (7th Cir. 2006) ["*UAL II*"] (citing *UAL I* and emphasizing threat of a pilot strike and that pilot unsecured claim was received by pilots "in exchange for surrendering the leverage that they enjoyed—United needs pilots to fly its planes").

<sup>210</sup> See *Burlington N.*, 481 U.S. at 445 (explaining importance of complying with RLA mandates); see also *Int'l Ass'n of Machinists v. S. B. St.*, 367 U.S. 740, 772 (1961) ("We have held that the Act does not deprive the federal courts of jurisdiction to enjoin compliance with various mandates of the Railway Labor Act."); *Virginian Ry. Co. v. Sys. Fed'n No. 40*, 300 U.S. 515, 607 (1937) ("Norris-LaGuardia Act can affect the present decree only so far as its provisions are found not to conflict with those of . . . the Railway Labor Act.");

<sup>211</sup> *Burlington N.*, 481 U.S. at 446 (quoting *Int'l Ass'n of Machinists v. S. B. St.*, 367 U.S. 740, 773 (1961)).

<sup>212</sup> *Chicago & N. W. Ry. Co. v. United Transp. Union*, 402 U.S. 570, 583 (1971). See *Regional Airline Pilots Ass'n v. Wings West Airlines, Inc.*, 915 F.2d 1399, 1402 (9th Cir. 1990) (noting that language of section 2, First through Fourth, gives "impression that the federal courts' obligation is to oversee the broad structure of the process and prevent major deviations, not to be involved in particulars of the bargaining process"). See generally 29 U.S.C. § 158(d) (2007) (clarifying and limiting obligation to bargain collectively).

<sup>213</sup> See *Nw. Airlines Corp. v. Ass'n of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 172 (2d Cir. 2007) (stating that unions generally have right to strike even if airline carrier breached but did not violate RLA); see also *NLRB v. Insurance Agents*, 361 U.S. 477, 493 (1960) (stating that strike is not a refusal to bargain in good faith); *Pan Am. World Airways, Inc. v. International Brotherhood of Teamsters*, 894 F.2d 36, 398 (2d Cir. 1990) ("The RLA, however, does not include a time limit within which either

the bankruptcy court found that AFA bargained in good faith, which the *AFA* majority and concurrence both overlook. The majority's view that AFA violated section 2 (First) because it might have done more to gain ratification,<sup>214</sup> is inconsistent with settled law that section 2, First does not require a union to recommend a TA for ratification (which AFA actually did here).<sup>215</sup> The majority thus provides no guidance to the lower courts on the scope of the duty in section 2 (First) that it for the first time—and contrary to precedent—concludes bars a strike under these circumstances.<sup>216</sup>

The concurrence ventures no analysis of what more is required of AFA by section 2 (First) (other than to capitulate to Northwest's demands). Its view that there can be binding status quo obligations in the absence of mutual agreement is inconsistent with settled law (including precedent in the Second Circuit) that an RLA status quo must be consensual.<sup>217</sup> And its conclusion that the status quo obligation that bars a union from striking continues to bind the union post-rejection—while the carrier is excused from the RLA's commands—is inconsistent with the integrated, bilateral RLA process. As the majority notes, the RLA's "explicit status quo provisions are equal and mutual."<sup>218</sup> *Shore Line* teaches that the major dispute process is "an integrated, harmonious scheme for preserving the status quo . . . ."<sup>219</sup> Under this integrated, harmonious RLA scheme, self-help by an employer and union who have a contractual history are linked together: the times when a carrier imposes new terms are also the times when a union may engage in self-help.

Because the RLA's status quo obligations are reciprocal, if during the major dispute negotiation process a carrier violates the RLA status quo provisions by unilaterally imposing its own desired terms or conditions of employment, then the union can immediately engage in self-help. Thus in *Telegraphers*,<sup>220</sup> the Court held that a strike injunction was properly denied where the carrier had breached the RLA's major dispute provisions in the face of the continued obligation to "make and maintain" agreements in section 2 (First).<sup>221</sup> In *Shore Line*, the Court noted that if, prior to completion of negotiations, the "carrier resort[s] to self-help, the union

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party must use or lose its right to self-help."). See generally *Bhd. of R.R. Trainmen v. Jacksonville Terminal Co.*, 394 U.S. 369, 378-79 (referring to the "ultimate right of the disputants to resort to self-help").

<sup>214</sup> *In re Nw. Airlines*, 483 F.3d at 175 (stating that AFA had not yet fulfilled its duty to exhaust dispute resolution process).

<sup>215</sup> See *Chicago, Rock Island & Pac. R.R. Co. v. Switchmen's Union*, 292 F.2d 61, 70 (2d Cir. 1961) (finding good faith bargaining by union despite failure to recommend a settlement).

<sup>216</sup> The *AFA* majority faults the *ALA* for not seeking the NMB's assistance. *In re Nw. Airlines*, 483 F.3d at 175; however, the NMB's participation began before the bankruptcy. Of course, there is no provision for NMB intervention in the section 1113 process.

<sup>217</sup> *Pan Am*, 894 F.2d at 39 ("The essential ingredient of a status quo that can be disturbed only after exhaustion of the 'major dispute' procedures is a resolution of disputed issues accepted by each side. No such resolution exists here.").

<sup>218</sup> *In re Nw. Airlines*, 483 F.3d at 172.

<sup>219</sup> *Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union*, 396 U.S. 142, 152 (1969).

<sup>220</sup> *Order of R.R. Telegraphers v. Chicago & N. W. R. Co.*, 362 U.S. 330 (1960) (*rehearing denied*).

<sup>221</sup> *Id.* at 359-60.

cannot be expected to hold back its economic weapons, including the strike.<sup>222</sup> There is no basis for the majority's view that courts may "pick and choose" status quo obligations. Thus, neither opinion can be squared with section 1113 or the RLA and both do violence to the bankruptcy and labor relations schemes.

### III. SQUARING THE CIRCLE: THE PROPER ACCOMMODATION OF SECTION 1113 AND THE RLA

Application of section 1113 and the RLA in the case of contract rejection must begin from the fact that as the later and more specific enactment, section 1113 displaces the RLA's major dispute provisions when a debtor seeks to reject a CBA.<sup>223</sup> Congress established in section 1113 a mandatory and exclusive process for rejection of a CBA.<sup>224</sup> "The language of the statute indicates that Congress intended section 1113 to be the sole method by which a debtor could terminate or modify a collective bargaining agreement."<sup>225</sup> As the Second Circuit earlier concluded, Congress provided for a comprehensive bargaining process to balance federal labor and bankruptcy policies:

Section 1113 governs the means by which a debtor may assume, reject or modify its collective bargaining agreement. 11 U.S.C. § 1113(a), (b) and (c) (1988). It ensures that the debtor attempt to negotiate with the union prior to seeking to terminate a collective bargaining agreement. § 1113(b). In the event such negotiations fail, it delineates the standard by which an application by the debtor to terminate the collective bargaining agreement is to be judged by

<sup>222</sup> *Shore Line*, 396 U.S. at 155. The Second Circuit reached the same result. *See* *Rutland Ry. Corp. v. Bhd. of Locomotive Eng'rs*, 307 F.2d 21, 41 (2d Cir. 1962) *cert. denied*, 372 U.S. 954 (1963) ("If in fact the [carrier] has failed to take the steps required of it by the [RLA], it is not entitled to injunctive relief against the strike of its employees."); *see also* *CSX Transp. Inc. v. United Transp. Union*, 879 F.2d 990, 996 (2d Cir. 1989) (holding parties may resort to economic self-help only after parties fail to negotiate, mediate, and arbitrate and after a thirty-day cooling off period); *Local 553 v. E. Air Lines, Inc.*, 695 F.2d 668, 674 (2d Cir. 1982) ("Once the parties have exhausted the Act's mediation process, however, either may resort to self-help by unilaterally changing working conditions or striking, as the case may be.")

<sup>223</sup> *See* *Basic v. United States*, 446 U.S. 398, 406 (1980); *Greene v. United States*, 79 F.3d 1348, 1355 (2d Cir. 1996).

<sup>224</sup> *See* *ALPA v. Con'l Airlines (In re Con'l Airlines)*, 125 F.3d 120, 137 (3d Cir. 1997) ("The provision outlines the procedure that a debtor or appointed trustee must follow to successfully reject a collective bargaining agreement . . ."); *Shugrue v. ALPA (In re Ionosphere Clubs, Inc.)*, 922 F.2d 984, 989-90 (2d Cir. 1990) ("The language of the statute indicates that Congress intended § 1113 to be the sole method by which a debtor could terminate or modify a CBA . . ."); *In re Kitty Hawk, Inc.*, 255 B.R. 428, 432 (Bankr. N.D. Tex. 2000) (stating section 1113 "outlines an exclusive process by which a debtor may seek to modify or reject a collective bargaining agreement"); *In re Alabama Symphony Ass'n*, 155 B.R. 556, 571 (Bankr. N.D.Ala.1993) ("[N]o other provision of the Code may be used to allow a debtor to bypass the requirements of Section 1113.")

<sup>225</sup> *In re Ionosphere Clubs*, 922 F.2d at 989-90.

the bankruptcy court and establishes a time frame in which this determination is to be made. 11 U.S.C. § 1113(c), (d) (1988).<sup>226</sup>

As the more recent and specific provision, the section 1113 process necessarily supplants the bargaining process mandated by the RLA. Section 1113 does not reference the RLA's major dispute provisions, and the section 1113 process is drastically different from the "almost interminable" RLA bargaining process.<sup>227</sup>

The conclusion is inescapable that Congress displaced the RLA process in section 1113. Indeed, in sections 1167 and 103(h) of the Code, Congress made clear that the section 1113 process, and not the RLA major dispute provisions, would govern when a bankrupt air carrier, as opposed to a bankrupt rail carrier, seeks rejection. Section 1167, in Subchapter IV of chapter 11, provides that "neither the court nor the trustee may change the wages or working conditions of employees of the debtor established by a collective bargaining agreement that is subject to the [RLA] except in accordance with section 6 of such Act . . . ."<sup>228</sup> Under section 103(h), "Subchapter IV of chapter 11 of this title applies only in a case under such chapter concerning a railroad."<sup>229</sup>

Thus, a carrier availing itself of section 1113 is not barred by section 2 (Seventh) from implementing revised terms and conditions of employment as section 1113 does not incorporate the RLA's contract modification process. But because the status quo provisions of the RLA are reciprocal, "an *integrated, harmonious scheme* for preserving the status quo,"<sup>230</sup> there is no basis to apply only one part of that integrated scheme—section 2 (First)—to bar union self-help once the section 1113 process is exhausted either. When Congress chose to supplant the RLA bargaining process in airline bankruptcy—without imposing limits on the use of self-help once that mandatory bargaining process was exhausted and rejection approved—it eliminated any basis to enjoin labor self-help.

#### CONCLUSION

The Second Circuit's *ATA* decision is a 21<sup>st</sup> century return to the type of strike-breaking judicial legislation that led to the loss of public trust in the judiciary and the enactment of the sweeping provisions of the NLGA. Faced with the reciprocal nature of the RLA's status quo obligations, the majority created out of whole cloth the novel bankruptcy theory that a CBA is abrogated upon rejection under section 1113. By doing so it sought to shoehorn the case into the framework of its earlier

<sup>226</sup> *Id.* at 989. See *Century Brass Prods. Inc. v. Int'l Union (In re Century Brass Prods., Inc.)*, 795 F.2d 265, 272 (2d Cir. 1986) (observing Congress undeniably overturned procedural prong of *Bildisco* when it enacted section 1113); *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 88 (2d Cir. 1987) (reaffirming *Century Brass* panel's discussion of section 1113's substantive requirements).

<sup>227</sup> *Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union*, 396 U.S. 142, 149 (1969).

<sup>228</sup> 11 U.S.C. § 1167 (2006).

<sup>229</sup> 11 U.S.C. § 103(h) (2006).

<sup>230</sup> *Shore Line*, 396 U.S. at 152.



decisions limiting the right to self-help prior to the negotiation of a first CBA.<sup>231</sup> The Court's unprecedented, "peculiar" holding in what it described as a "peculiar" corner of the law is inconsistent with the classical constructions of each of the three statutes at issue and should collapse from its own inconsistencies.<sup>232</sup>

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<sup>231</sup> *Nw. Airlines Corp. v. Assoc. of Flight Attendants (In re Nw. Airlines Corp.)*, 483 F.3d 160, 173 (2d Cir. 2007).

<sup>232</sup> *See id.* at 164.

## ATTACHMENT 3

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## Collective Bargaining Agreements in Corporate Reorganizations

by

Andrew B. Dawson\*

*Congress enacted § 1113 to the Bankruptcy Code in 1984 in order to establish a standard for the rejection of Collective Bargaining Agreements. But the statute's ambiguous language has caused a split between the Second and Third Circuits, and has precipitated a lengthy academic debate largely centered on the interpretation of one word: "necessary." This debate has focused on proper statutory interpretation as well as deeper concerns regarding the policy goals behind the Bankruptcy Code. The present study reports data that indicate that the different interpretations are irrelevant in practice. No matter how "necessary" is defined, the result is always the same: debtors are able to reject their collective bargaining agreements. This article concludes that § 1113's ambiguities need to be clarified such that courts have a clearer standard as to what "necessary" means and how that necessity is to be measured.*

### INTRODUCTION

Bankruptcy scholars have long debated the proper treatment of collective bargaining agreements in corporate reorganizations. Collective bargaining agreements (CBAs) are typically short-term contracts between employers and their labor unions, setting forth basic terms of employment such as wages and benefits. While employers are not required to enter into CBAs with their unions, once a CBA is adopted it is an unfair labor practice for the employer to unilaterally change any of these core employment terms. In bankruptcy, however, debtors may reject these CBAs under terms specified in 11 U.S.C. § 1113.

The interpretation of § 1113 has spurred a debate concerning the treatment of CBAs in corporate reorganizations. Some commentators have feared that an overly pro-debtor interpretation of this statute would allow debtors to use bankruptcy as a "union-busting" tool. In contrast, an overly labor-friendly interpretation might prevent debtors from successfully emerging from bankruptcy. This debate has taken concrete form thanks to a split be-

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tween the Third and Second Circuits. Thus, scholarship has largely divided as to which court has the better interpretation. Underlying this debate is an assumption that the difference in legal standards actually makes a difference in application.

This article presents data from an empirical study to test the above assumption. Based on data from every large publicly traded company bankruptcy between 2001 and 2007,<sup>1</sup> the present study reveals that the outcome of § 1113 motions was the same regardless of the legal standard applied: the court granted the debtor's motion to reject its CBA. This article argues that this result is the inevitable outcome of having an ambiguous pro-labor union standard in a pro-reorganization Bankruptcy Code. While the statute attempts to ensure that debtors can only reject their CBAs when rejection is truly necessary, Congress failed to define what "necessary" means or how courts are to make this determination. Consequently, Bankruptcy Courts implementing a Bankruptcy Code designed to facilitate the rehabilitation of debtors have little choice but to find rejection to be necessary.

This paper begins by presenting the language and background of § 1113. Part II then discusses the different interpretations of § 1113 in both the Third and Second Circuits, and reviews commentary regarding the merits of each interpretation. Part III describes the data collection methodology for the study reported in this article. Part IV lays out the findings of this study and presents analysis arguing that the difference in legal standards has no real impact on legal outcomes. And finally, Part V concludes.

## I. BACKGROUND OF § 1113 OF THE BANKRUPTCY CODE

Collective bargaining agreements are short term contracts<sup>2</sup> between employers and labor unions specifying such core employment issues as "wages, hours, and other terms and conditions of employment."<sup>3</sup> Since the enactment of the National Labor Relations Act in 1935, federal labor laws have sought to promote industrial peace by encouraging collective bargaining between

<sup>1</sup>Database of these cases was provided by Lynn LoPucki's Bankruptcy Research Database, available at [http://lopucki.law.ucla.edu/bankruptcy\\_research.asp](http://lopucki.law.ucla.edu/bankruptcy_research.asp).

<sup>2</sup>See Kevin J. Murphy, *The Determinants of Contract Duration in Collective Bargaining Agreements*, 45 INDUS. & LAB. REL. REV. 352, 357 (1992) (reporting results from an empirical study of collective bargaining agreements that "[t]he mean length of contracts signed during the sample period is 32.8 months. The standard deviation and the range of the data are 7.96 months and 4 years, respectively.")

<sup>3</sup>29 U.S.C. § 158(d). This section further describes the duty to bargain collectively:

For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party . . . .

employers and employee representatives.<sup>4</sup> The role of the government in this legal scheme is to allow workers the freedom to organize and bargain through representatives.<sup>5</sup> If the parties reach agreement on these terms, the law then serves to provide enforcement of the CBA.<sup>6</sup> If the employer modifies the terms of the CBA before its expiration without following the guidelines set forth in the act, it commits an "unfair labor practice" that will result in a claim before the National Labor Relations Board.<sup>7</sup>

This policy favoring collective bargaining in labor relations runs into direct conflict with bankruptcy policy when a unionized debtor files for bankruptcy under Chapter 11. Chapter 11 promotes the reorganization of businesses in order to preserve their going concern value.<sup>8</sup> And one of the primary tools for reorganization is the ability to reject burdensome contracts.<sup>9</sup> The Bankruptcy Code, as enacted in 1978, did not contain any special provision for CBAs, and most courts treated these agreements as executory contracts, such as sales contracts and leases.<sup>10</sup> Nonetheless, as the Supreme Court explained in *NLRB v. Bildisco & Bildisco*, courts treated CBAs differently due to their "special nature":

<sup>4</sup>See 29 U.S.C. § 151 ("It is hereby declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization, and designation of representatives of their own choosing, for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection.")

<sup>5</sup>*NLRB v. American Nat. Ins. Co.*, 343 U.S. 395, 401-2 (1952) ("The National Labor Relations Act is designed to promote industrial peace by encouraging the making of voluntary agreements governing relations between unions and employers. The Act does not compel any agreement whatsoever between employees and employers. Nor does the Act regulate the substantive terms governing wages, hours and working conditions which are incorporated in an agreement. The theory of the Act is that the making of voluntary labor agreements is encouraged by protecting employees' rights to organize for collective bargaining and by imposing on labor and management the mutual obligation to bargain collectively.")

<sup>6</sup>29 U.S.C. § 158(a) and (d) (making it an unfair labor practice to unilaterally change the terms in a CBA) and 29 U.S.C. § 185(a) (providing jurisdiction in federal district courts for suits for violations of CBAs); see *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448, 451 (1957) (29 U.S.C. § 185(a) "is more than jurisdictional . . . it authorizes federal courts to fashion a body of federal law for the enforcement of these collective bargaining agreements.")

<sup>7</sup>*NLRB v. Katz*, 369 U.S. 736, 747-48 (1962) ("Unilateral action by an employer without prior discussion with the union does amount to a refusal to negotiate about the affected conditions of employment under negotiation . . . . It follows that the Board may hold such unilateral action to be an unfair labor practice in violation of §8(a)(5), without also finding the employer guilty of over-all subjective bad faith.")

<sup>8</sup>*NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) ("The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.")

<sup>9</sup>11 U.S.C. § 365.

<sup>10</sup>Douglas Bordewick and Verne Countryman, *The Rejection of Collective Bargaining Agreements by Chapter 11 Debtors*, 57 AM. BANKR. L. J. 293, 294 (1983) ("courts now routinely hold that a collective bargaining agreement is an executory contract which may be rejected in a bankruptcy proceeding.")

Although there is no indication in § 365 of the Bankruptcy Code that rejection of collective-bargaining agreements should be governed by a standard different from that governing other executory contracts, all of the Courts of Appeals which have considered the matter have concluded that the standard should be a stricter one . . . . We agree with these Courts of Appeals that because of the special nature of a collective-bargaining contract, and the consequent "law of the shop" which it creates, a somewhat stricter standard should govern the decision of the Bankruptcy Court to allow rejection of a collective-bargaining agreement.<sup>11</sup>

Despite this agreement that CBAs merited special treatment in corporate reorganizations, courts disagreed regarding what this special treatment should be.<sup>12</sup> *Bildisco* clarified this question by stating that Bankruptcy Courts would allow debtors to reject their CBAs only "if the debtor can show that the collective-bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."<sup>13</sup>

On the same day as the Supreme Court issued its decision in *Bildisco*, a bill was introduced in the House of Representatives to overrule it.<sup>14</sup> This legislative initiative eventually resulted in the adoption of § 1113 of the Bankruptcy Code. While the impetus for the bill was a pro-labor reaction to *Bildisco*, the final law that emerged was a compromise between labor and business interests and did not represent a clear victory for either side.<sup>15</sup> While § 1113 overruled *Bildisco*'s most controversial holding—that a debtor could unilaterally reject a CBA upon filing for bankruptcy—it codified the general structure laid out in that decision: a debtor must first negotiate with its unions before seeking court-ordered rejection of a CBA.<sup>16</sup>

<sup>11</sup>*NLRB v. Bildisco & Bildisco*, 465 U.S. at 523-524 (internal citations omitted).

<sup>12</sup>See Bruce H. Charnov, *The Uses and Misuses of the Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 925, 934 (1989) (describing the pre-*Bildisco* caselaw: "The circuit courts employed at least three distinctly different standards before allowing rejection of a collective agreement in a Chapter 11 proceeding.")

<sup>13</sup>465 U.S. at 526.

<sup>14</sup>See *In re Century Brass Products, Inc.*, 795 F.2d 265, 272 (2d Cir. 1986) ("In fact, on the same day *Bildisco* was decided, Congressman Rodino introduced H.R. 4908 to 'clarify the circumstances under which collective bargaining agreements may be rejected.' H.R. 4908, 98th Cong., 2d Sess., 130 Cong. Rec. H 809 (daily ed. February 22, 1984).")

<sup>15</sup>Michael St. Patrick Baxter, *Is There a Claim for Damages from the Rejection of a Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code?*, 12 BANK. DEV. J. 703, at 721-22 (1993) ("What started as a pro-labor bill in the House turned into a compromise bill among various interest groups when it emerged from the Conference Committee. . . . Thus, the enactment of section 1113 cannot be considered an unqualified victory for either labor or management. Accordingly, it would be inappropriate to construe section 1113 with either a pro-labor or a pro-management bias.")

<sup>16</sup>*NLRB v. Bildisco & Bildisco*, 465 U.S. at 526 ("Before acting on a petition to modify or reject a

Section 1113 imposes both procedural and substantive restrictions on the bargaining process.<sup>17</sup> The procedural requirements are relatively straightforward—the debtor must meet with the union representative, make a proposal, and provide the information necessary to evaluate the proposal. The substantive provisions, on the other hand, are rather ambiguous and have sparked controversy among commentators and the split among Circuit Courts. For example, some scholars have considered what it means for the union to refuse the debtor's proposed modifications "without good cause."<sup>18</sup> Meanwhile, others have examined whether a labor union receives a claim for damages from a rejected CBA.<sup>19</sup> But the bulk of this commentary has focused on the meaning of "necessary."<sup>20</sup>

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collective-bargaining agreement, however, the Bankruptcy Court should be persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution. The NLRA requires no less. Not only is the debtor-in-possession under a duty to bargain with the union under § 8(a)(5) of the NLRA, 29 U. S. C. § 158(a)(5) . . . but the national labor policies of avoiding labor strife and encouraging collective bargaining, § 1, NLRA, 29 U. S. C. § 151, generally require that employers and unions reach their own agreements on terms and conditions of employment free from governmental interference.")

<sup>17</sup>11 U.S.C. § 1113, which states in relevant part:

- (b)(1) Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall—
  - (A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
  - (B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.
- (2) During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.
- (c) The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that—
  - (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1);
  - (2) the authorized representative of the employees has refused to accept such proposal without good cause; and
  - (3) the balance of the equities clearly favors rejection of such agreement.

<sup>18</sup>For a discussion of the "good cause" element, see Marc. S. Kirschner, Willis J. Goldsmith, Lawrence P. Gottesman, Deena B. Jenab, and Jay G. Swardenski, *Tossing the Coin Under Section 1113: Heads or Tails, the Union Wins*, 23 SETON HALL L. REV. 1516 (1993).

<sup>19</sup>Baxter, *supra* note 15, at 721-2.

<sup>20</sup>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 reorganiza-

Section 1113 requires that, prior to seeking rejection, the debtor must propose to its union "those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably."<sup>21</sup> Congress did not define what makes a modification "necessary" nor what it means for the modifications to be "necessary to permit" reorganization, and commentators immediately focused on this ambiguity.<sup>22</sup> They noted that not only is the statute ambiguous, but that the legislative history provides little to no guidance. With no House or Senate Report concerning § 1113, attempts at discerning the legislative intent have depended on a series of inconsistent statements from Congressional representatives.<sup>23</sup>

As predicted, this statutory ambiguity caused divergent outcomes among Bankruptcy Courts and then among Courts of Appeals. Notably, the two most prominent corporate Bankruptcy Courts in the country soon found themselves on opposing sides of this debate, as discussed below.

## II. THIRD CIRCUIT VS. SECOND CIRCUIT

Congress used the word "necessary" twice in drafting § 1113: "the debtor-in-possession . . . shall make a proposal . . . which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor."<sup>24</sup> The interpretation of "necessary" has thus posed two interpretative questions. First, "how necessary?" And second, "necessary for what?"<sup>25</sup> That is, must the modifications be "essential" or something more akin to "helpful"? And must the modifica-

tion."); Christopher D. Cameron, *How "Necessary" Became the Mother of Rejection: An Empirical Look at the Fate of Collective Bargaining Agreements on the Tenth Anniversary of Bankruptcy Code Section 1113*, 34 SANTA CLARA L. REV. 841, 869 (1994) ("Exactly what 'necessary' means has been the subject of vigorous judicial and academic debate.")

<sup>21</sup>11 USC 1113(b)(1)(A) (emphasis added).

<sup>22</sup>See e.g. James J. White, *The Bildisco Case and the Congressional Response*, 30 WAYNE L. REV. 1169, at 1197 (1984) ("What will be the consequence of the enactment of section 1113? Because the language is purposefully ambiguous and because it plays upon a vast and varied landscape, one cannot be sure. Surely it makes the law measurably less certain; it will make the trial judge's decision more discretionary and speculative; it will introduce greater guesswork into the lives of those who must advise management and unions about their rights.")

<sup>23</sup>Bruce H. Charnov, *The Uses and Misuses of the Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 923, 1002 (1989) (concluding that "other than this general desire to achieve a better policy reconciliation [between bankruptcy and labor law], little is dispositive in the legislative history."); see also Daniel S. Ehrenburg, *Rejecting Collective Bargaining Agreements under Section 1113 of the 1984 Bankruptcy Code: Resolving the Tension between Labor and Bankruptcy Law*, 2 J. L. & POL'Y 55, at 71 (1994) ("As a result, no definitive legislative history exists and legislative intent can only be inferred from inconsistent statements by various Congress-persons contained in the Congressional Record.")

<sup>24</sup>11 U.S.C. § 1113(b)(1)(A) (emphasis added).

<sup>25</sup>See Cameron, *supra* note 20, at 869.

tions prevent the debtor from entering liquidation, or is it enough that they facilitate the reorganization?

The Third Circuit answered these questions in *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America* by finding that the modifications must be essential in order to prevent the debtor's liquidation.<sup>26</sup>

The Second Circuit, in *Truck Drivers Local 807 v. Carey Transportation, Inc.*, found that the modifications need not be essential and that they must facilitate the reorganization: "the necessity requirement places on the debtor the burden of proving that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully."<sup>27</sup>

Even though the Second Circuit's interpretation has been more widely accepted among the other circuits,<sup>28</sup> commentators continue to debate which court has the better interpretation, as discussed below. Each side advances both policy and statutory arguments in favor of its position. And each side argues that its interpretation of "necessary" will have a drastic impact on corporate reorganizations.

Those in favor of the Third Circuit's interpretation argue that it better balances bankruptcy's pro-reorganization policy with the labor policy of resolving disputes through collective bargaining.<sup>29</sup> They argue that by re-

<sup>26</sup>*Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074, 1088 (3d Cir. 1986) ("The 'necessary' standard cannot be satisfied by a mere showing that it would be desirable for the trustee to reject a prevailing labor contract so that the debtor can lower its costs. Such an indulgent standard would inadequately differentiate between labor contracts, which Congress sought to protect, and other commercial contracts, which the trustee can disavow at will . . . . We reject the hypertechnical argument that 'necessary' and 'essential' have different meanings because they are in different subsections. The words are synonymous."); and at 1089 ("While we do not suggest that the general long-term viability of the Company is not a goal of the debtor's reorganization, it appears from the legislators' remarks that they placed the emphasis in determining whether and what modifications should be made to a negotiated collective bargaining agreement on the somewhat shorter term goal of preventing the debtor's liquidation, the mirror image of what is 'necessary to permit the reorganization of the debtor.'")

<sup>27</sup>*Truck Drivers Local 807 v. Carey Transportation, Inc.*, 816 F.2d 82, 90 (2d Cir. 1987).

<sup>28</sup>Anne J. McClain, *Bankruptcy Code Section 1113 and the Simple Rejection of Collective Bargaining Agreements: Labor Loses Again*, 80 GEO. L.J. 191, 206 (1991) ("The majority of courts, however, have rejected the Wheeling-Pittsburgh interpretation of the necessity element and have imposed a more liberal interpretation."); Hon. William T. Bodoh and Beth A. Buchanan, *Ignored Consequences—The Conflicting Policies of Labor Law and Business Reorganization and its Impact on Organized Labor*, 15 AM. BANKR. INST. L. REV. 395, 409 (2007) ("the Second Circuit approach . . . is the approach most widely adopted by courts.")

<sup>29</sup>See e.g. Gary M. Roberts, *Bankruptcy and the Union's Bargain: Equitable Treatment of Collective Bargaining Agreements*, 39 STAN. L. REV. 1015, 1047 (1987) ("Courts should strictly construe the necessity requirement, allowing only those contract modifications that must be made to avoid liquidation. Only through such strict construction can the courts establish in bankruptcy the balance of power in labor-management negotiations that approximates the relative strengths established by Congress in the NLRA."); Babette A. Ceccotti, *Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code*, 15 AM. BANKR. INST. L. REV. 415, 431 (2007) ("Viewed under *Carey*, the rejection standard tilts decidedly towards a bankruptcy-centered consideration about the pros-



quiring debtors to propose only those bare minimal modifications to avoid liquidation, the decision in *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America* respects the balance of power between labor and management created by the NLRA.<sup>30</sup> At the same time, the Third Circuit still permits debtors to reject burdensome CBAs when doing so is necessary to prevent liquidation—and to avoid the job losses that would result. Proponents of the Third Circuit approach argue that to define “necessary” as less than “essential” would allow debtors to use the Chapter 11 process as a “collective bargaining weapon,” as any company in bankruptcy can easily establish that the cutting of labor costs would help to increase profits.<sup>31</sup>

Supporters of the Second Circuit’s interpretation argue that Congress actually used the word “essential” in another part of § 1113, and that it is therefore internally consistent to interpret “necessary” as something less than essential.<sup>32</sup> Additionally, they argue that to interpret “necessary” as “essential” would frustrate the duty to bargain in good faith. In this spirit, *Truck Drivers Local 807 v. Carey Transportation, Inc.*, held as follows:

Because the statute requires the debtor to negotiate in good faith over the proposed modifications, an employer who initially proposed truly minimal changes would have no room for good faith negotiating, while one who agreed to any substantive changes would be unable to prove that its initial proposals were minimal.<sup>33</sup>

Policy-wise, commentators have argued that the Second Circuit interpretation is more likely to permit successful reorganizations—thus avoiding liquidations and consequent job losses. They contend that because the debtor needs some breathing room to survive unforeseen events, a successful reorganization requires that the debtor be allowed to make more than minimal

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pects for a long-term reorganization and away from a labor policy frame of reference (for example, the degree to which proposed cuts invade the expectations reflected in the collective bargaining agreement or are modulated by snap-backs or other compensatory features of interest to the union).”).

<sup>30</sup>Roberts, *supra* note 29, at 1047.

<sup>31</sup>McClain, *supra* note 28, at 207 (“[The Carey] rationale is self-fulfilling. Since a Chapter 11 debtor is in severe financial straits, any proposed cost reduction would likely help its reorganization and would, therefore, be ‘necessary.’ The court’s analysis in *Carey Transportation* supports this conclusion.”).

<sup>32</sup>Charnov, *supra* note 23, at 1003 (“Even if the legislative history is discounted, the textual and pragmatic good faith arguments raised in *Allied Delivery* point to the interpretation offered by the *Carey Transportation* court as being more accurate. Interpreting section 1113(b)(1)(A)’s necessity requirement as less than the essential standard employed for interim modifications under section 1113(e) avoids the rigidity ascribed to the REA Express standard of labor contract rejection.”); Steven Kropp, *Collective Bargaining in Bankruptcy: Toward an Analytical Framework for Section 1113*, 66 TEMP. L. REV. 697, 710-11 (1993) (“Finally, as commentators have noted, Congress used the term ‘essential’ in subsection (e), which authorizes emergency relief (interim) changes, but used ‘necessary’ in subsection (b)(1)(A). Congress must therefore have intended a distinct and lower threshold where it used the word ‘necessary.’”)

<sup>33</sup>*Carey*, 816 F.2d at 20.

modifications.<sup>34</sup> In addition, by allowing more than minimal changes to the CBA, the debtor can cut more costs, thus resulting in a greater payout to the other general unsecured creditors whose vote may be critical to confirmation of a plan.<sup>35</sup> Finally, proponents of the Second Circuit's approach argue that it enhances the debtor's long term financial health and is more consistent with the Bankruptcy Code's goal of approving plans that will ensure the emerging company's survival.<sup>36</sup>

These arguments about whether the Third or Second Circuit has properly interpreted the word "necessary" each assume that the difference in legal standards actually matters. That is, they assume that debtors will have greater success rejecting their CBAs in the Second Circuit than in the Third. A secondary assumption is that the difference in legal standards would impact a unionized debtor's decision of where to file for bankruptcy. Large corporations can effectively forum shop their bankruptcy filings, due in part to the Bankruptcy Code's venue provisions and to the nature of corporate groups.<sup>37</sup> Presumably, therefore, the difference in legal standards would make it more likely that a unionized debtor would file for bankruptcy in the Second Circuit than in the Third.<sup>38</sup>

To assess whether the difference in legal standards actually impacts cor-

<sup>34</sup>See Carlos J. Cuevas, *Necessary Modifications and Section 1113 of the Bankruptcy Code: A Search for the Substantive Standard for Modification of a Collective Bargaining Agreement in a Corporate Reorganization*, 64 AM. BANKR. L.J. 133, 191 (1990).

<sup>35</sup>Keating, *supra* note 20, at 533 ("The *Carey* standard of 'necessary,' which allows greater cuts in union wages than merely those absolutely necessary to avoid liquidation, is more likely to lead to a confirmed plan of reorganization. The reason that the *Carey* standard will have this effect is that the *Carey* definition of 'necessary' is more likely to allocate at least some of the gains of the debtor's going-concern surplus to the unsecured creditors who must vote on the debtor's plan of reorganization.")

<sup>36</sup>This is known as the "feasibility" requirement for the confirmation of a plan of reorganization, found in 11 USC § 1129 (a)(11) ("Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."); Cuevas, *supra* note 34, at 192 ("The feasibility requirement of section 1129 must be borne in mind in determining whether the proposed modifications to the collective bargaining agreement are necessary to permit reorganization. It is vital to examine the proposed modifications to a collective bargaining agreement in terms of the long-term financial stability of the debtor.")

<sup>37</sup>The Bankruptcy Code's venue requirements, 28 U.S.C. § 1408, allow a debtor to file for bankruptcy at the (1) location of the debtor's residence, (2) location of principal place of business, (3) location of the principal assets, or (4) the location of a chapter 11 case involving an "affiliate, general partner, or partnership." As noted by Professor LoPucki, a large corporate debtor can use this last option as a "venue hook" to file for bankruptcy almost anywhere. LYNN LOPUCKI, *COURTING FAILURE: HOW THE COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY SYSTEM* 37 (2005) ("A venue hook enables a corporate group to pull itself into any court in which any of its constituent corporations can set the hook. For large corporate groups, that can include almost any bankruptcy court in the United States.")

<sup>38</sup>This assumption led many to predict that Chrysler and General Motors would choose to file their bankruptcies in the Southern District of New York, within the Second Circuit, instead of in Delaware, within the Third Circuit. Cf. Barbara Kiviat, "GM's Potential Bankruptcy: Shopping for a Venue," April 9, 2009, <http://www.time.com/time/business/article/0,8599,1890171,00.html>.

porate reorganizations, it is necessary to look not only at the outcomes in bankruptcies in each circuit but also at the practice of forum shopping. Prior to the present study, data has been insufficient to answer these questions. Although this is not the first empirical study on § 1113 motions, it is the first to gather a large enough sample to analyze the impact of the different legal standards.

The first study of § 1113 was conducted in 1994 by Professor Christopher Cameron.<sup>39</sup> He focused on thirty-eight Bankruptcy Court decisions<sup>40</sup> between the years 1984 and 1993.<sup>41</sup> Although he gathered data on the location of the bankruptcy filings,<sup>42</sup> he did not analyze the impact of the different legal standards on outcomes. Instead, he tested three different hypotheses: (i) § 1113 has led to fewer rejected CBAs since its passage in 1984;<sup>43</sup> (ii) § 1113's procedural steps are more important than the substantive ones;<sup>44</sup> and (iii) courts are more willing to reject a CBA if the debtor bargains but fails to reach a negotiated agreement.<sup>45</sup> By comparing the percentage of decisions in his study that resulted in a rejected CBA with a similar "rejection rate" reported by Professor James White in a pre-§ 1113 study, Cameron concluded that § 1113 had a pro-labor impact.<sup>46</sup> He found that after the

<sup>39</sup>Cameron, *supra* note 20.

<sup>40</sup>*Id.* at 886-87 ("The study examined forty-six reported bankruptcy court decisions in which a debtor filed at least one section 1113 application: thirty-eight decisions in which complete contract rejection was sought under section 1113(c), and twenty in which interim modification of the contract was sought under section 1113(e). Applications for rejection rather than modification of collective bargaining agreements draw more critical fire, so the study focused on the thirty-eight decisions under section 1113(c).")

<sup>41</sup>*Id.* at 878 ("The study examined every bankruptcy court decision reported between July 10, 1984 and July 10, 1993 in which the debtor-employer filed an application for relief from the obligations of a collective bargaining agreement under section 1113."); and at 879 ("For purposes of the study, the term 'reported,' when used in referring to reported bankruptcy court decisions, has two dimensions. First, it includes all section 1113 bankruptcy court decisions published or otherwise made available through the facilities of the Bureau of National Affairs, Commerce Clearing House, Matthew Bender Company, Mead Data Corporation, and West Publishing Company. It was assumed that West's *Bankruptcy Reporter* was the most widely relied-upon reporting service. Consequently, the study examined the version of every decision reported there and used the other services to examine additional decisions not reported by West. Second, 'reported' includes all un-reported bankruptcy court decisions for which there were related reported appellate decisions (by district courts, bankruptcy appellate panels, and circuit courts of appeal, where applicable) providing significant data about what happened below when the bankruptcy court was presented with a section 1113 application.")

<sup>42</sup>*Id.* at 890 ("Close to two-thirds of the decisions were reported by bankruptcy courts in the Second, Sixth, and Seventh Circuits, which may reflect the financial distress suffered by residents of the industrial Midwest and Northeast during the 1980's. By contrast, no section 1113(c) decisions at all were reported by bankruptcy courts in the First, Fourth, or District of Columbia Circuits during the study period.")

<sup>43</sup>*Id.* at 892.

<sup>44</sup>*Id.* at 904.

<sup>45</sup>*Id.* at 909.

<sup>46</sup>*Id.* at 895-96 ("In sum, the study shows that the rate of rejection has declined about nine percentage points since the enactment of the statute—from about sixty-seven percent during the period 1975-1984 to about fifty-eight percent during the period 1984-1993. This is a substantial, if not radical, improvement in

enactment of §1113, debtors were able to reject their CBAs in 58% of all cases, compared to 67% of the cases prior to 1984.<sup>47</sup> Examining the relative importance that courts seemed to place on each of § 1113's requirements, he concluded that courts put the most emphasis on the "necessary" standard.<sup>48</sup> Finally he found that courts were more likely to grant rejection when debtors participated in a greater number of bargaining sessions.<sup>49</sup>

The United States Government Accountability Office (GAO) later performed a study on Chapter 11 bankruptcies to measure the impact of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act and the Pension Protection Act of 2006 on corporate reorganizations.<sup>50</sup> This study examined all 115 publicly traded companies identified by the SEC as having filed for bankruptcy between 2004 and 2006.<sup>51</sup> It found that eight of the twenty-eight, or 29%, of the debtors with CBAs sought to reject the labor agreements in bankruptcy, and that these § 1113 motions generally resulted in negotiated modifications.<sup>52</sup> While this GAO report presents a census of Chapter 11 cases with § 1113 motions, as opposed to Professor Cameron's study, it did not examine where these cases were filed. Additionally, this study involved a small sample of only eight cases with § 1113 motions.

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the prospects for the survival of collective bargaining agreements in Chapter 11.") (comparing his results with those of Professor James White in *The Bildisco Case and the Congressional Response*, 30 WAYNE L. REV. 1169 (1984)).

<sup>47</sup>Cameron, *supra* note 20, at 895-96.

<sup>48</sup>*Id.* at 906-7 ("Therefore, it can safely be concluded that the idea shared by so many commentators is correct: the single most important step that a debtor must climb to secure rejection under section 1113(c) is establishing that his or her proposed modifications are 'necessary' to permit reorganization. Or, stated another way, in the average bankruptcy court decision regarding a section 1113(c) application, step three is the most important of all the steps in the decision-making process.")

<sup>49</sup>*Id.* at 911-12 ("The data suggest a strong relationship between unsuccessful bargaining and the likelihood of rejection after three or more bargaining sessions. Of the nineteen decisions in which rejection was granted and for which data were available, thirteen involved three or more unsuccessful bargaining sessions. By contrast, of the eleven decisions in which rejection was denied and for which data were available, just three involved three or more such sessions. The conclusion: bankruptcy courts 'reward' debtors who have engaged in actual bargaining sessions that do not produce contract settlements by granting their applications for rejection.")

<sup>50</sup>U.S. GEN. ACCOUNTING OFFICE, MANY FACTORS AFFECT THE TREATMENT OF PENSION AND HEALTH BENEFITS IN CHAPTER 11 BANKRUPTCY (2007), available at <http://www.gao.gov/new.items/d071101.pdf>.

<sup>51</sup>*Id.* at 11 ("Reviewed publicly available court documents of the 115 public companies identified by the Securities and Exchange Commission (SEC) as having filed for chapter 11 bankruptcy in the years before and after BAPCPA's general enactment date—October 17, 2005, (76 companies before, 39 after), including motions to change benefits, such as defined benefit (DB) plans, retiree health benefits, and those protected by collective bargaining agreements (CBA). We also reviewed whether employers sought approval to continue benefit programs. The scope of analysis was limited to public companies due to data limitations and is not generalizable to all companies in bankruptcy.")

<sup>52</sup>*Id.* at 34 ("Eight of the 28 employers that reported union representation sought to modify or reject their CBAs. Generally, employers and unions negotiate the changes to the CBA. Negotiations often include wage and benefit cuts.")

These two previous studies present important insights into the use of § 1113 in corporate reorganizations, but they do not provide sufficient data to analyze the importance of the differing legal standards in the two most important corporate reorganization courts. The study reported in this article, as described below, seeks to contribute the necessary data to address this issue.

### III. DATA

The study reported in this article is based on data from every Chapter 11 filing of large publicly traded companies between 2001 and 2007, as identified through Professor Lynn LoPucki's Bankruptcy Research Database.<sup>53</sup> This database provided certain basic facts about each case, including the date of filing, the district in which it was filed, and whether the case was "forum shopped"—meaning that it was filed in a district other than where the debtor had its headquarters.

Building on Professor LoPucki's data, this study coded each filing for the presence of a unionized labor force. This information was gathered in three ways: (1) by examining the debtors' last pre-bankruptcy SEC Form 10-K for statements indicating that its employees were represented by labor unions;<sup>54</sup> (2) by examining the bankruptcy docket report for debtors' motions to reject a collective bargaining agreement;<sup>55</sup> and (3) by examining news reports after the bankruptcy filing.<sup>56</sup> Finally, each case was coded for the presence of motions to reject a CBA. This was done principally by searching the bankruptcy case docket for such motions, either as motions pursuant to § 1113 or simply motions to reject a CBA.<sup>57</sup> The search was supplemented with news searches for collective bargaining agreements in bankruptcy.<sup>58</sup>

<sup>53</sup>Database of these cases was provided by Lynn LoPucki's Bankruptcy Research Database, available at [http://lopucki.law.ucla.edu/bankruptcy\\_research.asp](http://lopucki.law.ucla.edu/bankruptcy_research.asp).

<sup>54</sup>An examination of the latest 10-K for the year prior to filing bankruptcy was performed, and included a review of the subsection "Employees." The company was coded as having no collective bargaining agreements if the 10-K made no mention of labor unions or CBAs, or if the company specifically said that it was not subject to any collective bargaining agreements, that its employees were not unionized, or that only a very small minority of the employees was unionized. The company was coded as having a collective bargaining agreement if it said that its employees were unionized (unless it said this group was a small minority).

<sup>55</sup>Dockets were accessed from PACER, either through Bloomberg's docket search or directly from the PACER website itself.

<sup>56</sup>A search of news source was performed in two databases on Bloomberg, both the labor union news and bankruptcy news databases. A search was performed in the bankruptcy news database for "collective bargaining." A search in the labor database was performed for "bankrupt\*" and "collective bargain\*."

<sup>57</sup>If the docket, as accessed on PACER, had a motion to reject the collective bargaining agreement, this was coded as a yes. Motions for interim relief from collective bargaining agreements were not counted. To search for motions, a word search was performed for the words "1113" (for a § 1113 motion), "collective" (for collective bargaining), and "union" (for any mention of labor unions.)

<sup>58</sup>*Supra* note 56.

Data were collected as to how many CBAs were affected by motions in each of the subject cases. In some instances, the debtor tried to reject as many as ten or more of its CBAs. In others, the debtor only attempted to reject one. For each of the affected CBAs, the name of the union involved and the outcome of the motion were recorded.

This study contributes to the previous studies by providing a complete census of large Chapter 11 filings over seven years in a recent time span. The census provides a broader picture of the CBAs in bankruptcy—not only the rejection rate, but also how often these motions are filed and how often they settle. In addition, this study contributes data about each individual CBA affected by these motions.

The data in this study do pose a limitation, however. They represent only a thin sliver of all Chapter 11 filings during this time period, as large corporate bankruptcies are the exceptions more than the norm.<sup>59</sup> The outcomes in these big cases may not be representative of the treatment of labor contracts in all Chapter 11 cases. It is possible that smaller companies are better able to negotiate with their unions—perhaps because they have fewer unions with whom to negotiate. It is also possible that courts may treat larger cases differently due to the added pressure of trying to keep large companies afloat through the bankruptcy process. Something akin to the “too big to fail” mentality may impact outcomes, as courts may feel additional pressure to keep these large companies out of Chapter 7 liquidation.

Despite the above limitations, the data present the complete picture of large Chapter 11 filings during the covered period. And partially *because* of this limitation, the data carry even greater weight. If courts do indeed feel an additional pressure when handling these larger cases, this present analysis will provide a stress test of § 1113’s ability to balance the bankruptcy and labor policies inherent when a debtor seeks to reject a CBA.

#### IV. FINDINGS

Even though the debate concerning the appropriate interpretation of the necessity requirement has assumed that the different legal standards in the Third and Second Circuits would produce different outcomes, this study finds that courts granted every motion under § 1113 without regard to the applicable legal standard.<sup>60</sup> This finding suggests that the difference in legal standards made no difference in practice. The outcome was “debtor-friendly”

<sup>59</sup>Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 609 (2009) (“In the 2002 sample [of Chapter 11 filings], 15% are tiny cases, with less than \$100,000 in assets, while at the other end of the spectrum 6% involve over \$100 million in assets.”)

<sup>60</sup>Only once, in the Southern District of New York, did a court deny a debtor’s motion—but the court then granted the debtor’s renewed motion. *In re Delta Air Lines*, 342 B.R. 685 (Bankr. S.D.N.Y. 2006)

whether the Bankruptcy Court applied the "pro-labor" or "pro-debtor" interpretation of "necessary."

This section first presents an overview of the use of § 1113 motions and finds that about 20% of unionized debtors filed a § 1113 motion. Presenting data concerning Chapter 11 filings in Delaware and the Southern District of New York, this study finds no significant difference except with respect to the settlement rate of motions. Not only did the difference in legal standards fail to make a difference in litigated motions, but it also did not appear to impact debtors' venue selection. An almost equal number of debtors filed § 1113 motions in New York as in Delaware. This section then concludes that the two legal standards have converged in practice, and that they have done so in a way that makes the necessity requirement effectively meaningless.

#### A. OVERVIEW: SECTION 1113 MOTIONS TO REJECT CBAs

In this study of large Chapter 11 bankruptcies, 136 of 316 companies had unionized workforces. The debtor filed at least one motion to reject a CBA in thirty of these cases (representing 22% of the unionized debtors), a percentage not far from the 29% reported in the GAO study.<sup>61</sup> In the vast majority of cases, the debtor did not need to avail itself of § 1113. It may not have needed to modify its CBAs—perhaps because it could restructure without modifications, because the Chapter 11 filing may have resulted in a liquidation of the business, or because the debtor may have been able to negotiate modifications out of court.

These thirty debtors that sought to reject a CBA involved a total of 103 different § 1113 motions. The majority of these motions were settled. The debtor and the labor unions reached settled agreements for 62 of these 103 CBAs. For nine other CBAs, the § 1113 motions were never ruled on because the debtor failed to reorganize. All of the remaining thirty-two CBAs were rejected. Only once did a court deny a debtor's § 1113 motion, and even then the debtor was able to reject the CBA upon filing a second motion.<sup>62</sup>

#### B. SECOND CIRCUIT VS. THIRD CIRCUIT

Although conventional wisdom holds that the Second Circuit case law is more pro-management while the Third Circuit is more pro-union, every litigated motion allowed the debtor to reject its CBA, regardless of whether the case was filed in the Southern District of New York or Delaware. As men-

(denying the debtor's § 1113 motion) and 351 B.R. 67 (approving the debtor's renewed motion three months later.)

<sup>61</sup>U.S. GEN. ACCOUNTING OFFICE, *supra* note 50, at 34.

<sup>62</sup>This involved *In re Delta Airlines*, as stated *supra* note 60.

tioned above, only once did a court deny even an initial § 1113 motion, and that was in the Delta Airlines restructuring in the “pro-debtor” Southern District of New York.<sup>63</sup> While these results do not indicate that the difference in legal standards was entirely irrelevant, they do indicate that the difference in legal standards did not affect the ultimate outcome: every litigated motion resulted in a rejected CBA.

Not only were debtors successful in rejecting their CBAs regardless of legal standard, but the difference in legal standards does not appear to have driven more unionized debtors to file in the Southern District of New York. In fact, more unionized debtors shopped into Delaware than into New York. Of the sixty-two unionized debtors that shopped into either New York or Delaware, thirty-seven filed in Delaware and twenty-five in New York. And among these unionized debtors that shopped into Delaware and New York, five New York debtors filed § 1113 motions compared to six in Delaware.<sup>64</sup>

If one accepts the assumption that large publicly traded companies have virtually limitless options on where to file—and all the debtors in this study are of this sort—then it does not appear that the difference in legal standards promoted forum shopping. Thus, the difference in legal standards does not appear to have affected either the outcome of litigated motions or debtors’ forum selection decision.

The one significant difference between the cases filed in the Southern District of New York and those filed in Delaware concerns the settlement rate of § 1113 motions. In the five New York cases, the debtors filed a total of twenty § 1113 motions. In the six Delaware cases, the debtors filed a total of twelve such motions. Nearly 85% of the New York motions were settled, compared to only 58% of the motions in Delaware.<sup>65</sup> (see Figure 1).

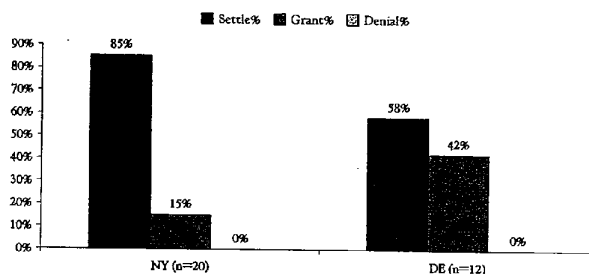
<sup>63</sup>See *supra* note 60 and text at note 62.

<sup>64</sup>The following debtors filed in the Southern District of New York: Dana Corporation (Docket No. 06-10354), DPH Holding Corp., at al. (Docket No. 05-44481), Delta Air Lines, Inc. (Docket No. 05-17923), Northwest Airlines Corporation (Docket No. 05-17930), and Tower Automotive Inc. (Docket No. 05-10578). The following filed in Delaware: Muma Services, Inc. (Docket No. 01-0926), Advanced Glassfiber Yarns, LLC (Docket No. 02-13615), Rouge Industries, Inc. (Docket No. 03-13272), American Class Voyages Co. (Docket No. 01-10954), Kaiser Aluminum Corporation (Docket No. 02-10429), and Trans World Airlines, Inc. (Docket No. 01-0056).

<sup>65</sup>Seventeen of the twenty § 1113 motions in New York were settled, compared to seven of the thirteen motions in Delaware. This difference is statistically significant with  $\chi^2 = 3.86$ ,  $p = .05$ .



Figure 1: Outcomes of § 1113 Motions on CBAs, in New York and Delaware Cases



## C. ANALYSIS

The different legal standards regarding the rejection of CBAs in the Second and Third Circuits has made little difference in application, despite the difference in settlement rates. Even though the Second and Third Circuits continue to apply different standards, the results of § 1113 motions indicate that these standards have effectively converged.

The higher settlement rate in motions filed in New York may indicate that the different legal standards have impacted the parties' perception of their bargaining leverage. Labor unions may be more inclined to settle when negotiating in the shadow of the Second Circuit's standard.<sup>66</sup> In addition, although not verifiable by the data here, it is possible that the different legal standards affected not only the rate of settlements but also the terms of those settlements.

The impact upon settlement rates suggests that labor unions and their debtor-employers perceive the applicable legal standard as relevant. Nonetheless, the outcome of the litigated motions—resulting in ultimate victory for the debtor in every case—suggests that the legal standards are actually irrelevant. As between the Second and Third Circuits, different interpretations of § 1113 produce the same results. In effect, their different legal standards have converged.

Convergence in legal standards might generally represent a positive development, especially in a field like bankruptcy that involves a uniform code. In

<sup>66</sup>See Linda Babcock, Henry S. Farber, Cynthia Fobian, and Eldar Shafir, *Forming Beliefs about Adjudicated Outcomes: Perceptions of Risk and Reservation Values*, 15 INT'L REV. L. & ECON. 289, 290 (1995) ("In negotiations where impasses are resolved via a dispute resolution mechanism in which a third party makes a binding decision (e.g., the court system, arbitration), beliefs about a potential adjudicated outcome are central in determining the negotiating environment."); cf. Mnookin and Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 978 (1979).

this case, however, the convergence of legal standards regarding § 1113 has resulted in one-sided, pro-debtor outcomes that are inconsistent with the statutory intent. This bankruptcy code provision was intended to provide some extra protection for CBAs. As discussed above, the precise level of protection is unclear. But the fact that every large corporate debtor during a seven year period was able to reject its CBAs suggests that the statute has provided very little protection at all. Section 1113 may have imposed additional costs on debtors seeking to reject their CBAs, but it has not kept any debtor from rejecting a CBA. In essence, § 1113's requirements were to serve as a gatekeeper for motions to reject CBAs, but the data reported here indicate that the gatekeeper has let everyone through.

This convergence in legal standards with decidedly pro-debtor results should also cause concern because it is alarmingly consistent with the fears of forum shopping scholars.<sup>67</sup> Because large corporate groups can forum shop their reorganizations, these scholars fear that in order to attract these cases, Bankruptcy Courts will adopt pro-debtor procedures and interpretations that will gradually result in a "race to the bottom."<sup>68</sup> While the data in this paper cover too short a time span to indicate any trends indicating a race to the bottom, the data are consistent with these theories, especially when compared with the results of Professor Cameron's 1994 study reporting that some motions were denied.

Even though the data in this study are consistent with the court competition theory, this article suggests that a better explanation for the collapsing of the legal standards is § 1113's ambiguous language. By failing to define "necessary" or to provide any guidance for measuring necessity, courts are left with little choice but to ultimately find that all proposed modifications are necessary and to grant these motions.<sup>69</sup> Granting these motions is not only consistent with the bankruptcy policy of promoting reorganizations, but it also represents the less risky choice for courts. If a court grants the debtor's motion, wages will be cut and some jobs will be lost, but the debtor will more likely survive. In contrast, if a court denies a motion for rejection, the debtor may be forced into liquidation and *everyone* will lose employment. Absent more direct language in the statute telling courts what is required to

<sup>67</sup>See LYNN LOPUCKI, *COURTING FAILURE: HOW THE COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY SYSTEM* (2005).

<sup>68</sup>*Id.* at 123-35; see also Theodore Eisenberg & Lynn M. Lopucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 1002-3 (1999).

<sup>69</sup>Judge Hardin, in his opinion denying Comair's motion to reject its CBA, described § 1113 as "surely [ ] one of the most unusual provisions in the Bankruptcy Code or any other statute because of the remarkable degree of subjective discretion which a bankruptcy court must exercise in order to carry out its mandate." *In re Delta Air Lines*, 342 B.R. 683, 691 (Bankr. S.D.N.Y. 2006).

prove "necessity," rational decision making compels courts to allow debtors to reject their CBAs.

Clarification to § 1113 should not only define "necessary," but should also provide objective means for measuring necessity. The data reported here suggest that merely defining "necessary" to mean "essential" or "important" would not effect any change in outcome. Instead, this provision needs to include some sort of objective requirements for measuring necessity. One such provision, as has been proposed to Congress, would be to require that proposed modifications be of a limited duration.<sup>70</sup> Such duration limits would provide some assurance that the proposed changes would apply only during the debtor's financial difficulty.

Alternatively, Congress could amend § 1113 to ensure that labor unions have a claim for damages resulting from a rejected CBA, in the same way that a landlord would have a claim for damages under § 365 for rejection of its lease. Currently, the Code is silent on the union's right to receive such damages.<sup>71</sup> If § 1113 clarified this—and provided a means for measuring these damages—the statute could provide another way to balance bankruptcy and labor policies.

By clarifying not only the standard for rejecting CBAs but also both how to determine if that standard is met and what the consequences of rejection should be, Congress could not only provide courts with more guidance, but it could also alter the bargaining process between employers and their unions.

## V. CONCLUSION

Even though § 1113 contains ambiguous language and has no definitive legislative history, its text clearly indicates that Congress preferred the outcome of negotiated settlements to labor disputes. This preference may reflect a belief that settlements are more consistent with federal labor policy, which seeks to promote collective bargaining and, more generally, to remove government presence from labor relations. Nonetheless, § 1113 does more than encourage negotiation. It also creates the substantive law that provides the parameters for that negotiation. And that substantive law is defectively ambiguous.

Legal scholars have argued about what has been perceived as the major point of ambiguity: what does § 1113 mean when it requires debtors to propose only necessary modifications? These scholars were rightly concerned about the impact of the substantive law on outcomes, and indirectly, on nego-

<sup>70</sup>See e.g. *Hearings before the H. Comm. on the Judiciary, Subcomm. on Commercial and Administrative Law*, 111th Cong. (Dec. 16, 2009)(statement of Marshall Huebner, co-chair of Insolvency and Restructuring Department at Davis, Polk & Wardwell LLP), 2009 WL 4829091.

<sup>71</sup>See Baxter, *supra* note 15.

tiations. However, the study reported in this paper suggests they overestimated the significance of the competing interpretations of "necessary." Not only did the different interpretations produce the same outcomes, but the necessity requirement had no impact on the outcomes.

While the necessity requirement of § 1113 needs clarification, the statute must also provide a means for determining if a debtor's proposals meet that standard. In addition, § 1113 needs clarification concerning the consequences of a rejected CBA. By providing these clarifications, Congress would create greater uniformity in the Bankruptcy Code. In turn, such uniformity would promote more effective labor negotiations. Until Congress enacts such clarifications, courts will have little choice but to continue to err on the side of encouraging corporate reorganization, and employers and unions must continue to negotiate in the shadow of a pro-debtor law.

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Mr. COHEN. Our second witness is Captain John Prater. Captain Prater is the eighth President of the Air Line Pilots Association, ALPA, since 2006.

As ALPA's chief executive administrative officer, Captain Prater oversees daily operation of the association, presides over meetings with ALPA's governing body and serves as chief spokesperson for the union. Captain Prater currently serves as a Boeing 767 captain and knows the importance of on-time takeoffs and finishing his statement in 5 minutes.

Captain, would you begin your testimony.

**TESTIMONY OF JOHN PRATER, CAPTAIN,  
AIR LINE PILOTS ASSOCIATION, INTL.**

Mr. PRATER. Good morning, Chairman Cohen, Ranking Member Franks, and Members of the Subcommittee. I will keep my PAs fairly short and, I hope, make some key points.

I am pleased to represent the nearly 53,000 pilots of the Air Line Pilots Association. Since our founding in 1931, ALPA members have delivered safely to their destination millions of passengers and millions of tons of cargo. ALPA pilots have helped our companies thrive in good economic times. We have also repeatedly sacrificed to help save our airlines in bad times, and we deserve to be treated fairly in bankruptcy process.

Despite the original intent of Congress, section 1113 of the U.S. Bankruptcy Code today fails to protect workers or serve as the mechanism of last resort to save a failing business. Instead, it has been exploited as a business model of the first resort for companies to gain long-term economic concessions by gutting the wages and working conditions of airline and other employees. The 1113 process allows employers to unilaterally impose contract changes through the court and outside of the normal collective bargaining process.

Recent court decisions have significantly loosened the standards that employers must meet before forcing unnecessary economic concessions from workers and have greatly limited employee recourse when it does happen.

As a result, employers are now able to breach their employees' contracts with impunity. Workers have lost critical leverage in the process, removing any incentive for management to bargain in good faith during bankruptcy, which has yielded grossly unfair results.

In just the last 10 years, more than two dozen U.S. airlines declared bankruptcies, with workers at nearly all of them taking severe wage cuts.

Attached to my written testimony is a series of slides that illustrates the carnage that the bankruptcy process has brought to our industry, and to pilots in particular. This data shows the nearly \$30 billion in wage concessions that pilots have given up and the nearly 50 percent overall decrease in pilot wages that has occurred at carriers filing Chapter 11. The data also shows that over 135,000 good American jobs have been lost from their industry.

I will reiterate just one example. After the travesty of 9/11, a typical pilot at United Airlines endured two rounds of concessions that included a 30 percent pay cut, followed by a 12 percent cut in pay, harsher work rules, less job security, and a terminated pension

plan. Thousands of United pilots were laid off. In 2009, the pilots who remained recaptured all of 1.5 percent of their lost wages. In the face of this, the airline's CEO received a total compensation package worth more than \$40 million.

Now United is adding insult to injury by attempting to outsource significant trans-Atlantic flying based upon the job security concessions that were forced upon the United pilots during the bankruptcy process. This gross abuse is just one of many examples that I have detailed in my written testimony.

This miscarriage of justice is bad for pilots at these individual airlines, bad for our profession. It is also bad for the U.S. airline industry and our economy.

After 9/11, many airline managements not only used the 1113 process to eviscerate employees' contracts, they also misused it to cut staff to the bone, with deteriorating customer service as just one of the outcomes.

ALPA supports this legislation because it clarifies that bankruptcy courts must only permit concessions that are truly necessary, rather than those that are simply desired by management. It also directs courts to weigh in their deliberations the ramifications that a reorganization plan will have for all workers, and ensure that employee sacrifices are fair and proportional to those of other stakeholders, including the corporate executives.

In summary, this legislation will restore balance to the bankruptcy processes and, with it, an incentive for management to bargain in good faith. It reestablishes collective bargaining as the primary means to make changes to a labor contract. It clarifies that a union may seek damages from the employer or strike if there are forced changes to a collectively bargained agreement.

These critical reforms will promote bargaining, help restore battered employee morale and trust, and make labor a more effective partner in rebuilding the long-term financial health of airlines. This bill will also make certain that working families are not forced to deeply sacrifice, while CEOs reward themselves with lavish bonuses. This bill will level the playing field and share the pain of bankruptcy, rather than leaving workers to unfairly shoulder the burden.

We urge Congress to swiftly pass this comprehensive reform legislation. Thank you. I would be more than willing to take any questions.

Mr. COHEN. Thank you, Captain. Another on-time arrival.

[The prepared statement of Mr. Prater follows:]

PREPARED STATEMENT OF JOHN PRATER

**STATEMENT OF  
CAPTAIN JOHN PRATER, PRESIDENT  
AIR LINE PILOTS ASSOCIATION, INTERNATIONAL  
BEFORE  
THE COMMERCIAL AND ADMINISTRATIVE LAW  
SUBCOMMITTEE  
OF  
THE COMMITTEE ON THE JUDICIARY  
US HOUSE OF REPRESENTATIVES  
WASHINGTON, D.C.**

**May 25, 2010**

**THE URGENT NEED TO ENACT  
THE PROTECTING EMPLOYEES AND RETIREES  
IN BUSINESS BANKRUPTCIES ACT OF 2010**

**Air Line Pilots Association, International  
1625 Massachusetts Avenue, N.W.  
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(202) 797-4033**

CAPTAIN JOHN PRATER, PRESIDENT  
AIR LINE PILOTS ASSOCIATION, INTERNATIONAL  
BEFORE  
THE COMMERCIAL AND ADMINISTRATIVE LAW  
SUBCOMMITTEE  
OF  
THE COMMITTEE ON THE JUDICIARY  
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**THE URGENT NEED TO ENACT  
THE PROTECTING EMPLOYEES AND RETIREES  
IN BUSINESS BANKRUPTCIES ACT OF 2010**

May 25, 2010

Good morning Mister Chairman and members of the Subcommittee. I am Captain John Prater, President of the Air Line Pilots Association, International. ALPA is the largest pilots' union in the world, representing nearly 53,000 professional pilots who fly for 38 airlines in the United States and Canada. On behalf of our members, I want to thank you for the opportunity to testify today about the urgent need to enact the Protecting Employees and Retirees in Business Bankruptcies Act of 2010. This comprehensive bill would greatly improve protections for employees when their employers file bankruptcy cases. In my testimony today, I will focus primarily on the proposed changes to section 1113 of the Bankruptcy Code, which governs labor agreements in bankruptcy. The amendments would restore balance and basic fairness to the



Section 1113 process where an employer seeks to reject a labor agreement under Chapter 11 of the Bankruptcy Code.

In the aftermath of the events of Sept. 11, 2001, ALPA and other labor unions faced continuous efforts by airlines to use the bankruptcy process as a razor-sharp tool to strip away working conditions and living standards that were built over decades of collective bargaining. Airline workers have borne far more than their fair share of the pain to save their airlines, as massive pay cuts, lost pensions and other deep concessions clearly attest. Section 1113 of the code has been applied by the bankruptcy courts, at management's instigation, in a manner far removed from the original intent of these provisions. The 1113 process has not been the mechanism of last resort to save a failing business, but has often been used by employers as a business model to gain long-term economic advantage by unfairly gutting the wages and working conditions of airline and other employees. Instead of protecting employees, as the 1113 process was meant to do when it was enacted in 1984, it has been repeatedly used by employers as a means to severely tilt the playing field in management's favor to the detriment of the legitimate economic security of airline workers and their families. Indeed, many of these same employers also used the current bankruptcy law to rubber stamp multimillion dollar bonuses and other rewards for the corporate executives who perpetrate these abuses on workers, the same kind of unconscionable excess on the part of corporate leadership that has been rightly the subject of severe criticism in the recent financial meltdown.

After 9/11, many airline managements used the 1113 procedures to not only gut employee wages and working conditions; they also exploited the bankruptcy process to cut staff to the bone. Both of these factors have combined to make piloting a far less desirable job than it

used to be, contributing to increased pilot frustration, attrition and turnover at a number of airlines. Added to the understandable employee frustration and anger, these additional, related problems make the implications of failing to restore balance to the bankruptcy process more serious than just failing to end the immorality of this situation. The current imbalance has created a poisoned environment that has greatly undermined labor relations and employee goodwill in the airline industry, which are critical to the efficient operation of our essential national air transportation system.

ALPA has seen that airline managements' successful efforts through Section 1113 to turn back the clock decades on workers' pay, rights and benefits have far exceeded any legitimate shared economic sacrifices that might have been necessary for the economic survival of the airlines. For example, a typical pilot at United Airlines endured two rounds of concessions that included an initial 30 percent pay cut, a second pay cut of 12 percent, harsher work rules, less job security, and a terminated pension plan. Thousands of United pilots were furloughed, and in 2009, the remaining pilots only recaptured 1.5% of their lost wages. Additionally, over the past three years over 1400 United pilots who originally lost their jobs were recalled and furloughed a second time, and this does not count the thousands that suffered job demotions. The remaining pilots are not scheduled to receive any additional pay increases, either this year or for the foreseeable future, while they struggle to negotiate a new contract past the amendable date of the bankruptcy contract. As harsh a reality as that is, imagine that United pilot's disbelief and outrage upon learning that the airline's CEO received a total compensation package worth over \$40 million dollars after exiting bankruptcy. Further compounding the anger and resentment is the fact that under the changes in job security provisions that the United pilots were forced to accept in the bankruptcy, the Company is now attempting to outsource significant trans-Atlantic

and perhaps other international flying to foreign carriers. The dilution in bankruptcy of the United pilots' job security guarantees have also led to the loss of nearly one-third of United's total domestic flying. The contrast of many unionized airline employees losing up to half of their pay, work rules, and the majority of their decades-old pension benefits, and as we now see, perhaps even their jobs to foreign pilots, as a result of bankruptcy concessions, while outrageous executive compensation and benefits programs are approved for airline managers, is more than enough by itself to show that the current Section 1113 process is unbalanced, grossly abused, and in need of urgent reform.

Similar horror stories exist among the thousands of pilots flying for other airlines, as managers departed the scene with golden parachutes, leaving behind employees who now struggle mightily to take care of their families while delivering millions of their passengers safely day after day. Distressing tales of employee suffering wrought by the 1113 process are all too familiar throughout the industry.

As the Subcommittee knows, the Section 1113 procedures are the mechanism by which employers can seek judicial permission to reject and thereby breach collectively-bargained obligations to their employees, and impose in their place dictated pay and working conditions. This Section 1113 process was originally intended to prevent employers from using the Chapter 11 process as an "escape hatch" to simply wipe away with a bankruptcy filing the binding, long and hard-fought pay and working condition achievements of workers secured by their collective bargaining agreements.

Prior to its enactment, in 1984 the Supreme Court ruled in the *Bildisco* case that an employer could walk away from binding collective bargaining agreements after a bankruptcy

filing without first making any showing of necessity as to the need to reject the terms of the agreement. In response, the Congress, at the urging of ALPA and other unions, acted swiftly to establish procedures that sought to protect the rights of employees in bankruptcy to prevent such results. The so-called 1113 process was inserted into the bankruptcy code to require a stringent showing of necessity for proposed modifications to labor agreements and further proof that, prior to seeking the court's intervention, the employer engaged in good-faith bargaining with a labor union in order to obtain necessary concessions. Failing such a consensual agreement, a company could impose dictated terms and conditions on its employees after court process only if those concessions were determined by the court to be truly necessary to its survival.

Since that time, the employee-protective purpose of Section 1113 has been turned on its head by the bankruptcy courts and subverted by employers to achieve precisely the contract-destroying, worker-bashing results that Congress originally sought to prevent. ALPA has seen the requirements of Section 1113 repeatedly ignored or misapplied, without due regard for the financial security interests of airline employees and their families. The most extreme examples of the one-sided nature of the current process are in recent court decisions which allow management to reject binding collective bargaining agreements and impose working conditions with impunity, holding that such rejection is not considered a breach of contract in the case of a labor agreement, even though, for all other contract parties, rejection by a debtor is considered a breach, entitling that party to a claim for rejection damages and excusing the aggrieved party from further performing under the rejected contract. In sharp contrast to the way other bankruptcy stakeholders are treated, unionized airline employees were therefore dealt two devastating blows in these court decisions: they put into question whether their union could seek damages claims for a breach of their labor agreement and prohibited the employees from

withdrawing their services under those rejected agreements. Airline employees have therefore been unfairly discriminated against and singled out in a way that puts them at a severe disadvantage in a way that no other creditors have been by these rulings. These flawed court decisions alone justify Congressional action. This corrective legislation is urgently needed to restore the original intent and purpose of these Section 1113 provisions, and to restore balance and basic fairness to the bankruptcy process as it impacts honest workers called upon to sacrifice to help save their employers.

ALPA believes that the proposed legislation appropriately overhauls the Section 1113 process by: (1) returning to their original intent the standards governing when management can unilaterally reject their contractual obligations to workers, so that a breach of a collective bargaining agreement can be permitted only when truly essential; (2) prohibiting the employer from singling out employees for cuts in pay and benefits and seeking a host of contract changes that, while the employer may find desirable or convenient to seek while in bankruptcy, are not truly essential to the company's ability to emerge from bankruptcy; (3) ensuring that, when an employer seeks concessions from its employees, the company's executives are not reaping the rewards of bonuses and other excessive compensation packages, lining their own pockets while their employees disproportionally sacrifice to help save the company; and (4) making it clear that, if a consensual agreement between the parties cannot be reached, employers breach collective bargaining agreements if they reject them in bankruptcy and that employees have the right to seek damages and strike in response to such breach. This latter clarification in particular is desperately needed in light of the recent distorting court cases I have mentioned so as to restore the incentive for management to negotiate in good faith with unions in the 1113 process

and thereby enhance the prospects for reaching a superior, mutually acceptable labor-management solution to the company's financial problems.

All of these changes are urgently needed to restore some semblance of a level playing field in collective bargaining between workers and management, and to deter employers from ever again using the bankruptcy process as a business strategy to extort widespread, unjustified and abusive concessions from workers. These reforms will, in our view, also help fulfill the purpose and ensure the success of Chapter 11 in our industry by increasing the long-term chance of successful reorganizations of airlines by promoting rather than weakening the collective bargaining process and limiting excessive management compensation packages, thereby strengthening the relationship between management and labor rather than continuing to destroy it, as the current 1113 process does today. By doing so, these critical reforms will help restore battered employee morale and trust, and make labor a more effective partner in rebuilding the long-term financial health of airlines, which so heavily depend upon the goodwill of their employees to successfully serve the travelling public.

I will now describe a number of additional examples which show what has gone wrong with the current administration of the 1113 process, both in the corporate boardrooms and in the courts, and illustrate why such legislation is so urgently needed to correct the employer abuse which has flourished unchecked in the current environment.

**I. The Bankruptcy Courts Have Allowed Employers To Use The Section 1113 Process As Leverage To Gut Labor Contracts Without Requiring Employers To Show That The Concessions Are Necessary Or Fair.**

The courts, egged on by opportunistic employers, have progressively undermined the "necessity" standard for granting employer relief in Section 1113. As I have alluded to, this

standard was intended to be applied strictly and allow only essential changes in wages and working conditions that are truly “necessary to permit the reorganization” of the employer. “Necessary” unfortunately has come to mean “desirable to management” and this has turned the bankruptcy process into a tool to leverage draconian wage and benefit cuts. These scorched-earth tactics of using the 1113 procedures to extract concessions that are not truly necessary for the company’s survival or otherwise achievable in consensual bargaining have led to widespread tension and resentment among employees, creating lasting damage to labor relations.

ALPA’s experience has shown that circumstances where consensual solutions reached by the parties in a process guided by labor relations professionals have led to far superior outcomes for airlines, their pilots and the flying public than forced and distorted negotiations or imposition of terms under the auspices of a bankruptcy court. Congress needs to pass this legislation to level the playing field and restore support for truly consensual negotiations in such circumstances. Both employers and the bankruptcy courts need to be reined in to ensure that the numerous recent abuses of the 1113 process are never repeated.

In fact, ALPA has seen profitable airlines use Section 1113 as a bargaining lever to wrest employee concessions to either facilitate a sale or other transaction or just to improve the competitive position or profitability of the carrier. In the case of the bankruptcy of Hawaiian Airlines, pilots faced a Section 1113 motion by a *profitable* company after having made pre-petition concessions demanded to avoid a Chapter 11 filing. All this after management approved a self-tender of the airline’s stock at a substantial premium to market value, *following* September 11 and *before* the bankruptcy filing. Hawaiian is still profitable today, and just weeks ago, some

four and a half years after the 2005 bankruptcy concessions, finally reached a new consensual agreement with ALPA that appropriately recognizes the pilots' sacrifices.

In the case of Delta Airlines, even after many months of litigation before the bankruptcy court, management continued to demand drastic concessions. Only after the parties agreed to a special arbitration process before a panel of industry experts, which took the matter out of the hands of the bankruptcy court which was not familiar with the industry, did management finally sufficiently reduce its extreme demands and, in response to ALPA's demands, offer the pilots an appropriate bankruptcy claim in exchange for their substantial concessions. After a consensual agreement was reached on this basis, the Company completed its successful reorganization, returned to profitability, eventually merged with Northwest Airlines, and as everyone knows, the new Delta is now the largest airline in the world.

ALPA believes that the bargaining agreement resolution at Delta, which took place largely outside of the bankruptcy court process, shows that bankruptcy courts with judges focused solely on the debtor's concerns are not the best place to resolve differences between labor and management. The best place to do that is at the bargaining table, and ALPA believes this legislation will promote superior collectively-bargained solutions.

The warped pressures of the bankruptcy process were also clearly exposed in the Comair bankruptcy. There, pilots were forced by management into Section 1113 litigation because the operation was simply deemed *not profitable enough* to the corporate parent Delta.



Under the diluted “necessity” standard, the Company was emboldened to make demands for a 22% pay cut that would qualify some full-time pilots for federal welfare assistance. In response to testimony from a pilot whose family would qualify for federal food stamps were he to work full-time under the Company’s demands, the bankruptcy judge indicated that he would not be persuaded by these facts of employee hardship and suffering, because he viewed the issue purely in terms of the purported “need” for relief for the debtor. The impact the Company’s 1113 proposal would have on the pilot group and its families was irrelevant in the court’s view. A concessionary agreement was only reached after the airline effectively moderated its demands by offering the pilots meaningful “upside” benefits.

In the case of Mesaba Aviation, the bankruptcy court approved as “necessary” a wage cut of almost 20% that would have lasted for 6 years, within a structure that did not envision any reversal or mitigation of the cuts during that lengthy period. After the district court agreed with ALPA that such overreaching amounted to bad-faith conduct and an abuse of the bargaining process, ALPA still had to accept a concessionary agreement even though the Company reorganized under a plan that provided a 100% recovery for all creditors, including interest. Again, ALPA believes that the warped necessity standard effectively puts a gun in management’s hands in concessionary negotiations. Again, we submit that the best way to reach a sustainable future for a carrier is through the collective bargaining process, not the bankruptcy courts, and the legislation before you, by limiting employer abuse and providing incentives for management to negotiate in good faith in the Section 1113 process, does that.

As this review shows beyond doubt, the current 1113 process has repeatedly failed to fulfill Congress’ purpose – protecting employees from those employers that view Chapter 11 as a

way to simply rid itself of collectively bargained pay, pension and working condition obligations. Because Section 1113 does not currently impose effective limits on the scope of employer concession demands, it is prone to management abuse and grants inappropriate leverage for employers to often extract unwarranted concessions from employees. Simply put, an employer can now easily use the current 1113 process to magnify the severe duress employees are already under during Chapter 11 – just the opposite of what Congress intended. These examples also show that consensual solutions to financial crises are always superior to the imposed alternatives. The current 1113 process undermines consensual, legitimate solutions to financial crises. The necessary modifications to that process that are contained in this bill correct these imbalances and support superior consensual solutions.

The legislation before you would ensure, for example, that an employer would not be permitted to initiate the 1113 process seeking court permission to reject a collective bargaining agreement unless there has been good-faith bargaining over proposed modifications to the agreement for a reasonable period of time, and until the company can further show that negotiations are not likely to produce agreement. The legislation also sets more specific limits on the scope of concessions that can be extracted from a particular labor group, and requires the company to present a plan of workforce and non-workforce cost savings, including savings in management personnel costs, if it seeks cost cuts from a particular labor group. The legislation would, by adopting tighter necessity standards for rejection, also help prevent the abuse of employers “locking in” long-term drastic concessions which go beyond what is needed for recovery in the short term, such as occurred at United and other airlines, where labor concessions were left in place long after the exit from bankruptcy while other stakeholders had received their recoveries and moved on. The legislation also appropriately requires the bankruptcy court to

consider whether alternative proposals from the union would be sufficient to permit successful reorganization. Additionally, the bankruptcy court would be required under the legislation to consider the effect of the proposed cuts on the workforce, the employer's ability to retain a qualified workforce, and the effect on the enterprise's overall labor relations if there was a rejection of a binding collective bargaining agreement. All of these changes are essential to ensure that the sacrifices extracted from employees are truly fair, proportionate and necessary, and to end employers' abuses of the current 1113 process.

**II. The Legislation Would Also Prevent the Continuation of the Current Double Standard Under Chapter 11: Deep Sacrifice For Workers, Huge Payouts For Those At The Top.**

Just as important, the legislation would require that the economic relief sought from employees not be disproportionate in kind or amount, or in comparison to the treatment of executives. This legislation would therefore require the court to consider whether corporate executives are being asked to sacrifice as well in a proportional manner, so that employees and their families are not shouldering the burden unfairly. These changes are urgently needed to restore basic fairness and credibility to the 1113 process. The current system has led to outrageous unfairness, with workers absorbing at the same time huge, long-term cuts in pay, work rules, and health and retirement benefits, while management executives have enjoyed huge payouts which appear to be nothing more than rewards that are directly tied to the level of pain they have inflicted on the employees. These are the same kind of executive abuses that have outraged the public during the recent financial meltdown and bailouts. For example:

- Pilots at United Airlines, who took concessions of 40% or more in pay, lost numerous important work rules, had their defined benefit pension plan terminated in multiple Section 1113- induced concessions, and many of whom lost their jobs outright because of furloughs, were locked into a nearly seven-year deeply concessionary agreement, but saw the injustice of the United Board raising the total compensation

- Northwest Airlines' pilots were also forced to accept huge wage cuts of nearly 40%, as well as accept numerous rollbacks to their quality of life by losing key protective working conditions. By contrast, the CEO was rewarded with an immediate \$1.6 million in salary and bonus payments. The revelation that he was also rewarded with more than \$26 million in stock-related compensation under a court-approved management equity plan further demonstrates the basic unfairness and abuse of the 1113 process.

There are egregious flaws in a 1113 process that today permits employers to revoke their agreements with employees, slashing paychecks and essential benefits to the bone, in some cases below the poverty line, on the basis of alleged necessity, and then turn around and reward executives with multi-million dollar paydays. The legislation therefore also includes reforms that would require that compensation paid to corporate officers and directors be subject to much more stringent oversight by the court as part of the employer's emergence from bankruptcy. The court would be required to determine that proposed executive compensation is not excessive or disproportionate in light of concessions made by employees during bankruptcy.

These reforms would also appropriately provide especially careful review of requests for employee concessions in Section 1113 proceedings if the employer has implemented an executive compensation program either during bankruptcy or within six months prior to bankruptcy. If such a program has been implemented, a presumption would be created that the employer has not met the requirement that the proposed cuts not overly and disproportionately burden the affected employee group. These changes are urgently needed to stop any future court-assisted looting of employees by greedy executives of the type that has already occurred.

**III. More Unfairness: Deep Concessions Are Extracted From Employees, While Other Stakeholders Suffer Few Or No Adverse Consequences.**

The legislation before you is also needed to level the playing field because employees have also suffered extreme unfairness at the hands of the 1113 process compared to other stakeholders and participants in the bankruptcy process. For example:

- Pilots at Hawaiian Airlines and Mesaba faced demands for concessions despite plans of reorganization that paid unsecured creditors in full.
- Professional advisors, banks, economic experts, financial managers and executives who participate in the Section 1113 process on behalf of airlines do not share in the sacrifices. Instead they earn lucrative fees and even “success” bonuses with the approval of the bankruptcy court, while the workers’ pay, work rules and pensions are allowed to be gutted.

The legislation would appropriately require the bankruptcy court to conclude, before it can allow an employer to reject a collective bargaining agreement, that the forms of economic relief sought from employees not be disproportionate in type or amount to the treatment of other stakeholder groups. This is not the case today, and represents a basic flaw of the current system needing urgent correction.

**IV. Even More Unfairness: Airlines Use Section 1113 To Avoid Binding Obligations To Employees, But Have Convinced Some Courts That The Bankruptcy Laws Immunize Them From Facing Any Employee Self-Help Or Breach Damages Claims In Response.**

The last item that I wish to bring to the Subcommittee’s attention is what I perceive to be the most egregious of the many aspects of unfairness that exists in the current administration of the Section 1113 system that I have highlighted today. As I have explained, airlines have used the Section 1113 process as leverage to obtain what they could never obtain in consensual bargaining – deep, lasting and unfair changes to avoid the binding commitments that they made

to their employees in collective bargaining agreements, but that has not been enough for them. They have gone to the bankruptcy and federal courts and asked them to declare that airline employees do not have the right to respond to these unilateral, fundamental breaches of their collective bargaining agreements by pursuing bankruptcy claims for breach of agreements – like any other creditor -- or by withholding services, as common sense, fairness and the basic tenets of labor law dictate. In fact, two bankruptcy courts, a federal district court, and the Second Circuit Court of Appeals, have ruled that airline employees can be forced to accept the utter destruction of their fundamental rates of pay and working conditions in binding collective bargaining agreements, but cannot withhold their services in response. Without any basis in the statute these decisions unjustly discriminate against, and single out, airline employees – as all other creditors are allowed to withdraw their services or refuse to continue to provide goods or services to the debtor when the debtor rejects a contract.

A split panel of the Second Circuit Court of Appeals vastly magnified the damage to workers by justifying this highly inequitable result with the fiction that management is not actually breaching a collective bargaining agreement when it obtains judicial permission to reject a labor contract through the Section 1113 process, a notion also wholly at odds with settled bankruptcy doctrine and completely inconsistent with Section 1113. Thus only employees under collective bargaining agreements are left without a claim if their contract is rejected in bankruptcy. This aspect of the court's decision vastly compounds the imbalance that has come to exist under Section 1113. This outrageous situation puts at grave risk, if not precludes outright, the few inadequate claims that employees have been able to obtain to date in exchange for negotiating concessionary agreements under the threat of contract rejection.

The willingness of the courts to enjoin a strike and effectively preclude a breach claim by employees in response to management imposition of unilateral terms under Section 1113 has effectively taken away any incentive for airlines to negotiate rather than dictate terms in bankruptcy. Airline employees have a right under the Railway Labor Act to strike after a bankruptcy court grants a motion to reject a collective bargaining agreement under Section 1113 and management imposes new inferior rates of pay, benefits, job security and/or working conditions. We believe that under the Norris-LaGuardia Act (which was enacted in the 1930's to bar injunctions against strikes) bankruptcy judges and U.S. District Court judges do not have jurisdiction to issue injunctions against such strike activity when management has acted to change the status quo and tear up a binding labor contract outside of the established labor law negotiations process.

It is essential that the right of airline employees to strike after a Section 1113 contract rejection be preserved and this legislation does precisely that. If the rule were otherwise, as some courts have concluded, management would be allowed to impose conditions without having to face the prospect of a strike – and possibly not even a rejection breach damages claim. Such blatant inequity allows management free reign to impose conditions without any check on the kind of overreach and abuse that has occurred to date. This legislation is needed to restore the economic balance contemplated in the anti-strike injunction mandates of Congress in the Norris-LaGuardia Act, which the Supreme Court found “was designed primarily to protect working men in the exercise of organized, economic power, which is vital to collective bargaining.” Balance will be restored and management will be forced to act responsibly and fairly in bankruptcy towards its employees *only if* it is faced with the real possibilities of a responsive strike and a significant damages claim.

**V. These Urgently Needed Reforms Will Promote Superior Collectively-Bargained Solutions to Financial Crises And Help Restore A Mutually Respectful Labor-Management Relationship, Increasing The Likelihood of Successful, Long-Term Reorganization.**

In sum, while ALPA recognizes that substantial economic sacrifices are sometimes inevitable where employers face severe economic disturbances, and our union in fact has repeatedly acted in a leadership role to help many airlines survive the ravages of the post 9/11 environment, management and the courts have moved the 1113 process far from its original intent to protect workers. Today, it is an extreme, one-sided process that often destroys the lives of workers and their families and creates deep and lasting scars in labor-management relations in a customer-service industry heavily dependent upon employee morale. ALPA believes that this corrective legislation is urgently needed to fix the misinterpretation and abuse of the 1113 process that has snowballed in the last decade. The Congress must act to restore Section 1113's original intent to protect employees from unfair, dictated sacrifices of the type that have been recently forced upon them while the corporate chieftans reap huge payoffs.

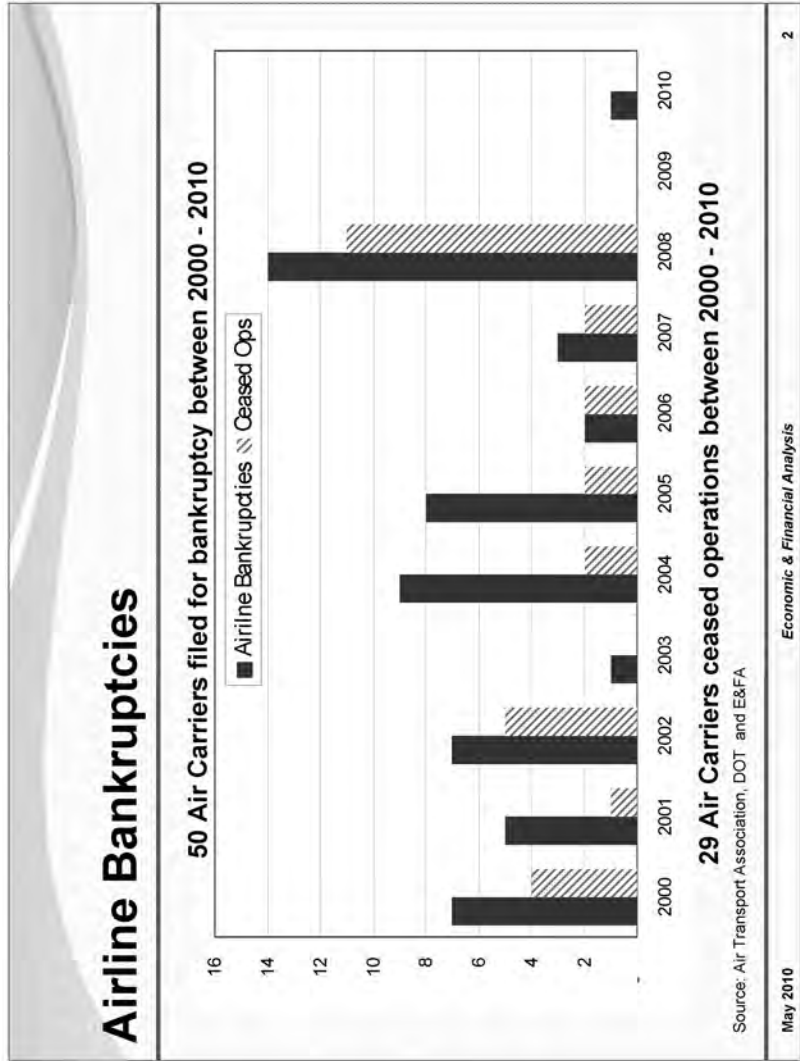
By enacting these reforms to promote rather than undercut collectively-bargained solutions to financial crises, and to ensure basic fairness by limiting excessive executive compensation and clarifying that employees may seek breach damage claims or withdraw their services if their binding working agreements are rescinded, Congress will help fulfill Chapter 11's purpose to successfully reorganize debtors on a long-term basis by restoring a sustained relationship of mutual trust and shared sacrifice between workers and their employers. Only if this critical relationship is returned to one of respectful, equitable partnership rather than one-



sided abuse, as exists today, will carriers' long-term health truly be assured for the benefit of the travelling public.

Mister Chairman, I appreciate the opportunity to testify here today, and I would be happy to answer any questions the Subcommittee may have.

## **Results of Bankruptcy on Air Line Pilots Association**



## Airlines That Have Declared Bankruptcy or Ceased Operations Since 2000

Airline Name	Filed Airline Name	Filed Airline Name	Filed
Tower Air	2/29/2000 Hawaiian	3/21/2003 Gemini Air Cargo	3/15/2006
Kitty Hawk Air cargo	5/1/2000 Great Plains Airlines	1/23/2004 Traveland	3/17/2007
Pro Air	9/19/2000 Atlas Air/ Polar Air Cargo	1/30/2004 Kitty Hawk Air cargo	10/15/2007
Fine Air Services	9/27/2000 Piedmont	9/12/2004 MAXjet Airways	12/24/2007
Legend Airlines	12/3/2000 PSA	9/12/2004 Bfg Sky	1/7/2008
Reeve Aleutian Airways	12/5/2000 US Airways	9/12/2004 Skyway	1/16/2008
National Airlines	12/6/2000 American Trans Air	10/26/2004 Champion	3/31/2008
Allegiant Air	12/13/2000 Pan American Airways/ Bosfor	11/1/2004 Aloha Airlines	3/31/2008
Trans World Express	1/10/2001 Southeast Airlines	12/1/2004 American Trans Air	4/2/2008
TWA	1/10/2001 Aloha Airlines	12/31/2004 Skybus Airlines	4/7/2008
Midway	8/14/2001 Westward Airways	7/1/2005 Frontier Airlines	4/11/2008
Midway Commuter	8/14/2001 Delta	9/27/2005 Eos Airlines	4/26/2008
Emery Worldwide	12/5/2001 Comair	9/27/2005 Gemini Air Cargo	6/18/2008
Sun Country	1/2/2002 Northwest Airlines	9/27/2005 Air Midwest (Mesa Air Group)	6/30/2008
CCAir	7/1/2002 TransMeridian Airlines	9/29/2005 Vintage Props & Jets	7/18/2008
Vanguard Airlines	7/30/2002 Mesaba	10/13/2005 Zoom Airlines	9/3/2008
Piedmont	8/11/2002 Fly-I Independence Air	11/7/2005 Sun Country	10/6/2008
PSA	8/11/2002 Era Aviation	12/28/2005 Primaris Airlines	10/15/2008
US Airways	8/11/2002 Florida Coast Airlines	2/21/2006 Mesa Air Group	1/5/2010
United Airlines	12/9/2002		

Shaded carriers filed twice during 2000-2010

Source: Air Transport Association, DOT and E&FA

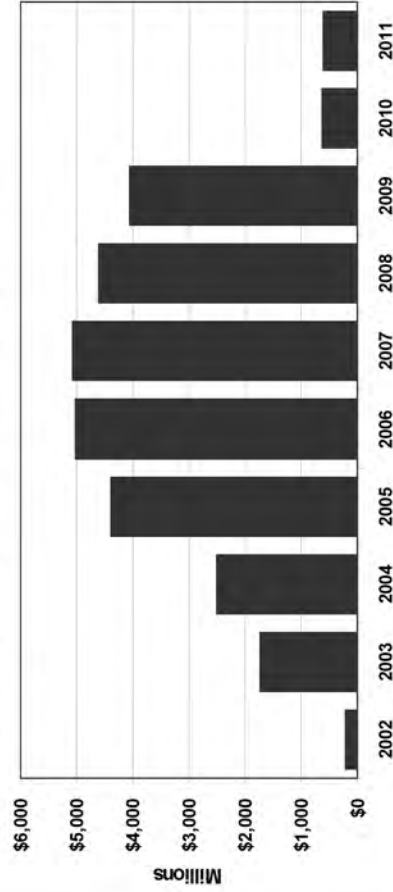
May 2010

Economic & Financial Analysis

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## Pilot Concessions 2003-2011

Pilots **alone** conceded nearly \$30 billion to airlines between 2002 and 2011, *not including* lost retirement benefits of nearly \$5.5 billion.



Source: Company press releases, ALPA E&FA. Includes amounts for ALK, AMR, CAL, DAL, NWA, UAL, US Air, Aloha, ATA, Comair, HAL, Mesaba.

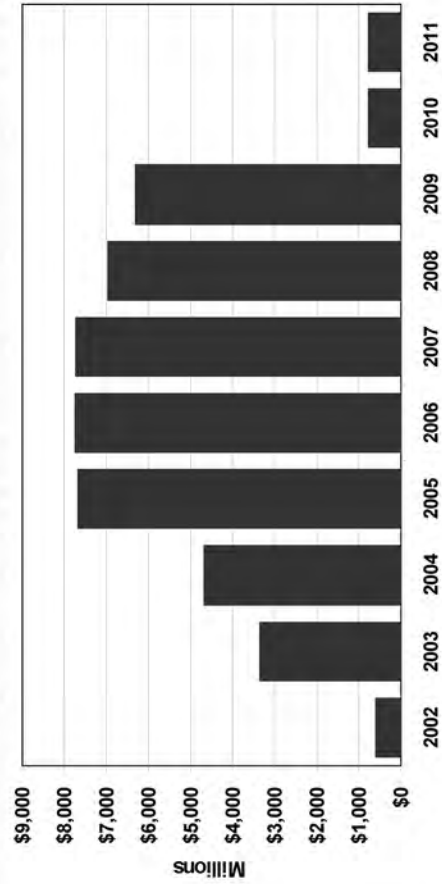
May 2010

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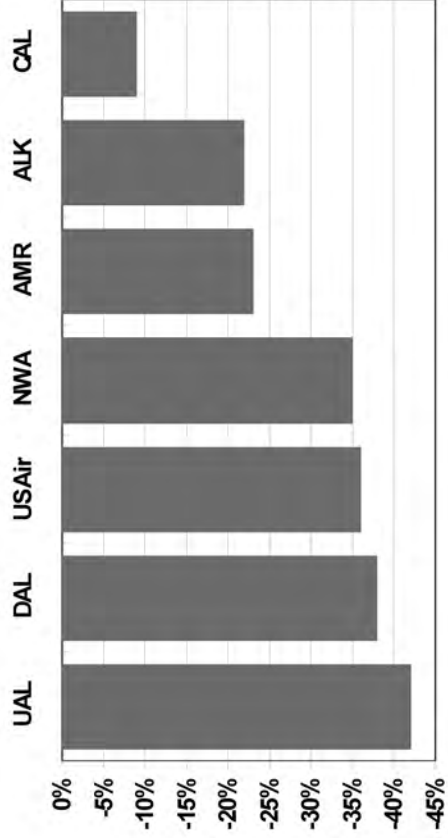
## Other Labor Concessions 2003-2011

Other labor groups conceded nearly \$47 billion to airlines between 2002 and 2011.



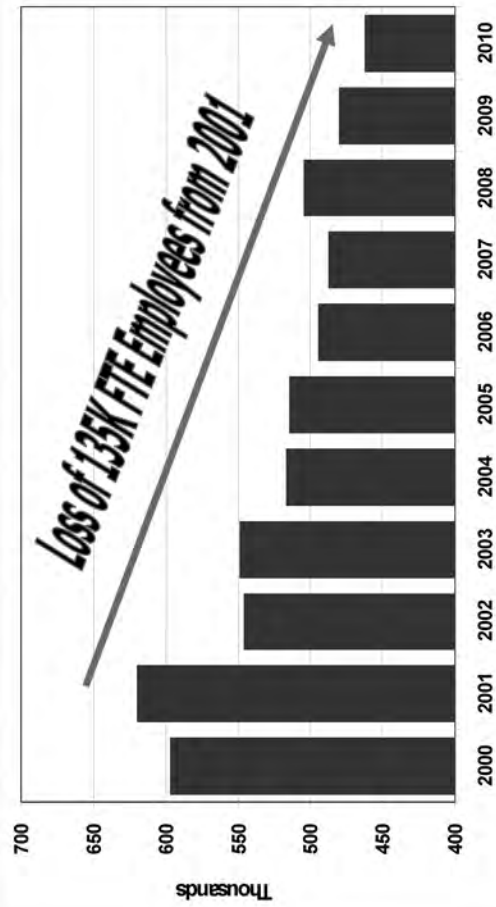
Source: Company press releases, ALPA E&FA. Includes amounts for ALK, AMR, CAL, DAL, NWA, UAL, US Air.

## Pilot Contract Hourly Pay Rate Cuts 2001-2007



Source: Company press releases, ALPA E&FA. Includes amounts for ALK, AMR, CAL, DAL, NWA, UAL, US Air,

## Employment Drastically Reduced At Airlines



Source: BTS Number of Airline Employees

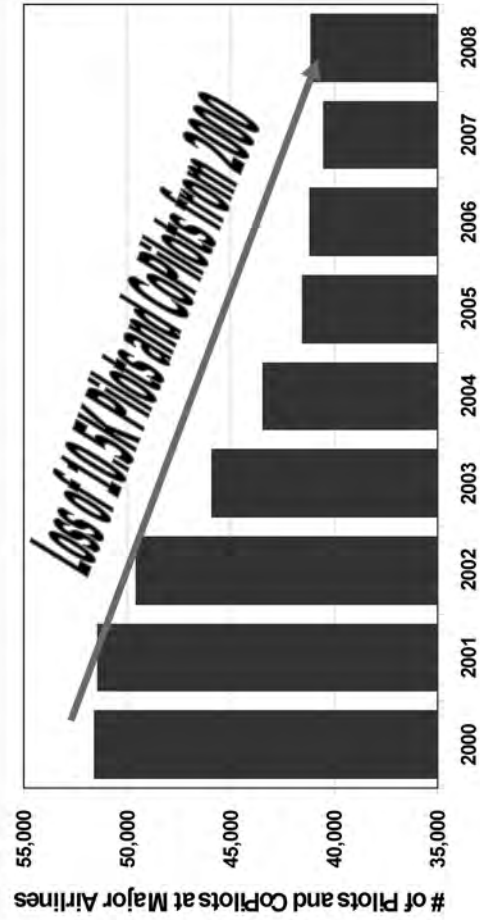
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## Overall fewer pilots at Major Airlines



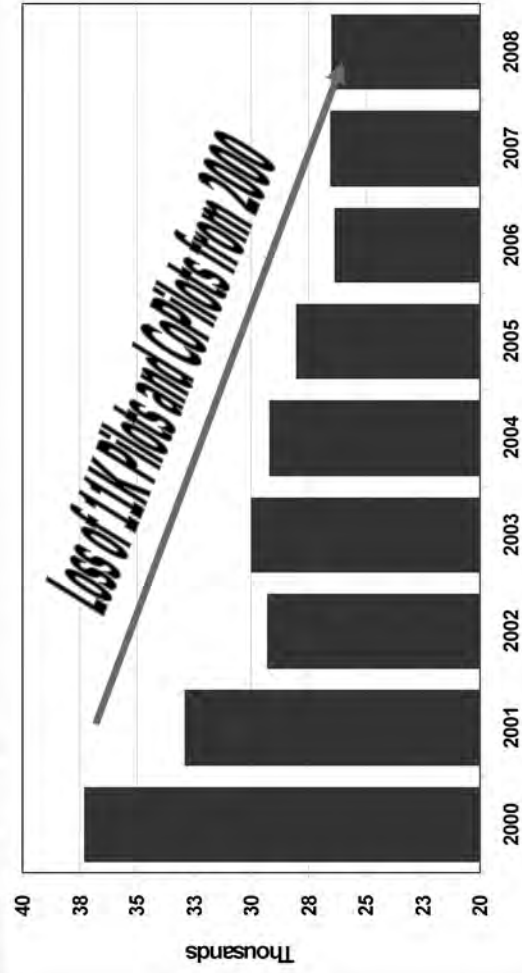
Source: BTS P10 Data for AMR, ALK, ATA, CAL, DAL, NWA, SVA, UAL, US Airways. 2009 data unavailable until July 2010.

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## Pilot Numbers At Carriers that Have Filed Bankruptcy

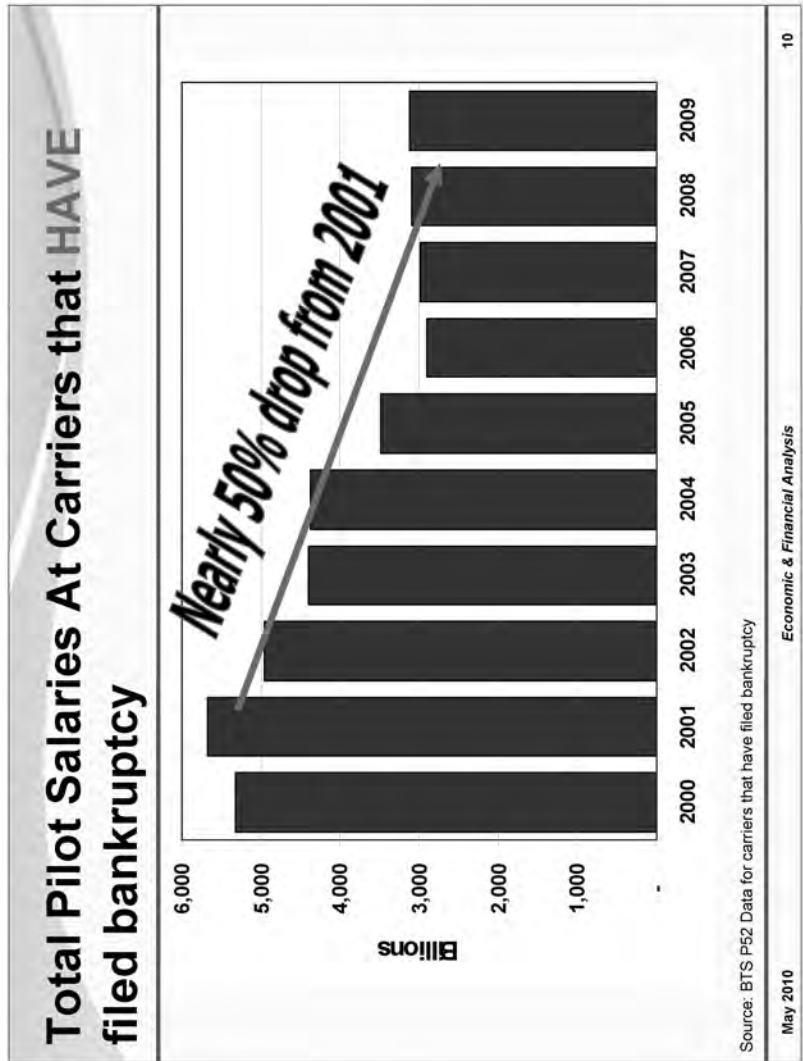



Source: BTS P10 Data for airlines that filed bankruptcy during 2000-2010. Data for 2009 unavailable until July 2010.

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	<p><b>Notes and Sources:</b></p> <ul style="list-style-type: none"> <li>• Data on concessions from press releases and E&amp;FA estimates</li> <li>• Data on employment from BTS</li> <li>• Pilot employment numbers from BTS, Schedule P10</li> <li>• Pilot Salary information from BTS, Schedule P52. Not all carriers are required to file P52. Of those carriers that filed, the data was segregated if the carrier had filed bankruptcy during the 2000-2010 time period.</li> <li>• General Management Salary information taken from BTS, Schedule P6. As with the P52 schedule, not all carriers are required to file.</li> <li>• P6 data is not collected by aircraft as the P52 data is collected.</li> </ul>
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Mr. COHEN. Our third witness is Mr. James Sprayregen. Mr. Sprayregen is a restructuring partner in the Chicago and New York offices of Kirkland and Ellis. Mr. Sprayregen has extensive experience representing U.S. and International companies in and out of court, as well as buyers and sellers of assets in distressed situations. He also has extensive experience advising boards, in general representing domestic and international debtors and creditors, and insolvency restructuring workout in bankruptcy matters, handle matters for clients in industries as varied as manufacturing, technology, transportation, energy, media and real estate.

He returned to Kirkland and Ellis in December 2008 after nearly 3 years with Goldman Sachs. Prior to joining Goldman Sachs—

Mr. ISSA. Mr. Chairman, I couldn't quite hear you. Could you repeat that for the record?

Mr. COHEN. Mr. Sprayregen has spent 16 years at Kirkland and Ellis where he has led bankruptcy cases for United Airlines and Consec, among many others.

Mr. Sprayregen, please begin your testimony.

**TESTIMONY OF JAMES H.M. SPRAYREGEN,  
KIRKLAND AND ELLIS LLP**

Mr. SPRAYREGEN. Mr. Chairman and Members of the Subcommittee, I thank you for inviting me to testify today in connection with this proposed bill. As noted, I am a senior partner at the law firm of Kirkland and Ellis and run our restructuring and bankruptcy group. We primarily represent large- and middle-market companies in a wide variety of bankruptcy and insolvency situations.

I have personally represented many international and U.S. companies in these types of situations, including TWA in their third bankruptcy, United in its bankruptcy, and currently Japan Airlines—the U.S. aspects of that.

I offer my testimony from the perspective of the debtor company. We have somewhat of an asymmetrical situation in that there are not many prospective debtor companies that will come and testify before you and give their perspective on what they think will happen if they go bankrupt in the future, so it is left to folks like me who are generally in the industry representing companies like this in their situation.

I would note that while this legislation seems to be very well intended, I believe that, if passed, it will have severe, and I mean severe, unintended consequences. It will be counterproductive. I believe it will, unfortunately, contrary to the goals of the legislation, result in less jobs, less money for employees, there being less employees, retirees being less protected, and more liquidations of companies that have large employee bases of industrial companies in America.

Why do I say that? Unfortunately, the bankruptcy system is, by definition, used for companies that are unable to comply with their promises that they have made to a number of stakeholders, including employees. And in those situations, there needs to be, to be able to fix the company, compromise from all of the stakeholders in the situation: the creditors, union employees, nonunion employees, secured creditors, et cetera. This legislation would tilt that balance that has been carefully crafted in the 1978 Code and a number of amendments that have been made to the Code since then and some court-imposed, U.S. Supreme Court-imposed elaborations on the Code and those amendments.

And there being no free lunch, to the extent that this legislation were to pass, we are going to have a situation where secured creditors and lenders in the capital markets will look at this legislation, evaluate the prospects of a company continuing to exist and making it through a bankruptcy, and decide whether to lend to that company or not. Both out-of-bankruptcy and before there ever is a

bankruptcy, that type of thing is evaluated; and once there is a bankruptcy, the lifeblood of a bankruptcy is debtor-in-possession financing, and debtor-in-possession financing is only available for companies that the lender believes can actually be reorganized.

Many of the amendments that are contained in the legislation will make it much more costly for a company to reorganize; will make it harder for the company to reorganize; and will set a standard for what compromises can be made by the court, or can be agreed to, that is only what is necessary for reorganization in a 2-year time period.

Now, again, that is something that sounds good; but in the fullness of time, lenders look at whether there is a 5-year business plan for a fix of a company. If the changes that can be made to a labor agreement are only those related to what is absolutely necessary to avoid liquidation, and only for a period of 2 years, I submit that, unfortunately, lenders will not be lending to companies on debtor-in-possession financing basis, or to be able to exit the bankruptcy itself, and that will cause a situation which again is counterintuitive and counterproductive and not the intent of this legislation. But that is where it will take us.

I am highly sensitive to all of the pain taken by many of the employees and the people that represent those employees sitting with me at the table. But I will tell you, many of the cases that they are citing were very close calls, not as to whether these companies would do those difficult things to their employees, but whether those companies would reorganize at all and whether they would liquidate.

We talked about TWA, we talked about United. There are other companies that we talked about. If we move the balance a little bit here, we are going to put companies in a situation where they may not be able to survive the Chapter 11 process. And that would be unfortunate, because I agree with the intent that has been stated by the two previous witnesses and the upcoming witnesses that it is intended to save jobs and reorganize the company and share the sacrifice.

I submit that is exactly what has been going on, and this is not something that is broke in this legislation. With all due respect, it is unnecessary. Thank you for hearing me.

Mr. COHEN. You are welcome, Mr. Sprayregen, and I appreciate your testimony and allowing me to not have the right pronunciation and to help me with that, your name.

Mr. SPRAYREGEN. It happens all the time.

[The prepared statement of Mr. Sprayregen follows:]

PREPARED STATEMENT OF JAMES H.M. SPRAYREGEN

**Hearing on H.R. 4677:  
The “Protecting Employees and Retirees in  
Business Bankruptcies Act of 2010”**

**Before the Subcommittee on Commercial and  
Administrative Law**

Statement of:

James H.M. Sprayregen, P.C.  
Partner  
Kirkland & Ellis LLP  
300 N. LaSalle  
Chicago, IL 60654

May 25, 2010

**Prepared Statement of James H.M. Spravregen, P.C.**

Mr. Chairman Conyers and members of the Subcommittee, thank you for inviting me to testify at your hearing on H.R. 4677, the “Protecting Employees and Retirees in Business Bankruptcies Act of 2010.” My name is James H.M. Spravregen. I am a senior partner at the law firm of Kirkland & Ellis LLP and co-head of the firm’s Restructuring Group.<sup>1</sup> Though Kirkland’s Restructuring Group primarily represents large and mid-market companies in a wide variety of insolvency, bankruptcy, and restructuring matters, our practice also includes the representation of equity holders, creditors, committees, investors, and other parties. I have represented numerous U.S. and international companies across various industries, including manufacturing, technology, transportation, energy, media, and real estate in connection with both in- and out-of-court restructuring matters and in connection with matters involving the intersection of labor and bankruptcy law.

For example, some of my more recent and significant engagements include representing affiliates of General Growth Properties, Inc., Japan Airlines Corporation, Visteon Corporation, Lear Corporation, YRC Worldwide, Inc., UAL Corporation (the parent company of United Airlines) (“United”), Consecro, Inc., and Trans World Airlines, Inc. in its sale to American Airlines. Certain of these engagements, United in particular, presented unique issues both with respect to the application of sections 1113 and 1114 of the Bankruptcy Code and with respect to the sometimes difficult task of balancing the policy of protecting employees and retirees with the underlying policies of the Bankruptcy Code.

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<sup>1</sup> The views expressed herein are solely those of the author, and do not necessarily represent the views of my firm or any of its clients.



In addition to my client representations, I have lectured and spoken frequently and published a number of articles on insolvency, fiduciary duties, and distressed and international transactions. I also have served as an Adjunct Professor at the University of Chicago Booth School of Business and the New York University School of Law.

I offer my testimony from the perspective of the debtor/company. The debtor's perspective is different than the others testifying today because the debtor is charged with the responsibility of weighing the interests of creditors, employees, retirees, and consumers, among many others.

**I. Executive Summary.**

H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010," would modify a number of the provisions of the Bankruptcy Code dealing with the treatment of collective bargaining agreements ("CBAs"), the insurance benefits of retired employees, employee claims, and executive compensation in Chapter 11. Contrary to the laudable desire to protect employees and retirees, the proposed modifications would have a number of negative effects on a company's ability to utilize Chapter 11 to reorganize, including, but not limited to, undermining the network of checks and balances originally put in place to enable a company to reorganize while protecting the interests and rights of various stakeholders.

As an initial matter, the proposed modifications would disrupt the well-established and successful negotiating process that bankruptcy judges, practitioners, lenders, labor unions, and authorized representatives have developed since the introduction of sections 1113 and 1114 into the Bankruptcy Code. The changes will negatively alter the negotiating dynamics at the bargaining table such that a consensual deal through which all parties are forced to share some sacrifice for the benefit of all stakeholders may be unobtainable. As a consequence, the proposed modifications would make it more difficult for a company to manage and rationalize its

labor and retiree benefit obligations. Without the ability to reduce all of its costs (not just labor and retiree costs), a company may be unable to raise new capital in the market, likely forcing the company into liquidation, a result that would be detrimental to all of the company's stakeholders, most notably its employees and retirees.

With respect to employee compensation, H.R. 4677 will make it more burdensome, in an already difficult situation, to retain or recruit key employees necessary to guide a company through a successful reorganization. Experienced personnel are not only necessary to help a company navigate the Chapter 11 process, but are necessary to provide comfort to financiers looking to invest in the company. The proposed modifications limit the ability of a company to offer employees market-based compensation where a company obtains relief under sections 1113 or 1114. To have a chance at a successful reorganization, a company must have the concomitant flexibility to attract or retain employees with the requisite skills to lead the company through Chapter 11 and the ability to reduce burdensome and above-market costs.

Finally, the proposed modifications force a company to include additional, and possibly quite burdensome, post-reorganization costs and liabilities in its post-Chapter 11 capital structure. Creating additional post-reorganization claims does not enhance a company's ability to generate cash going forward, nor does it increase a company's value. Instead, these claims simply put at risk a company's long-term viability and make it difficult for the company to raise capital and demonstrate that its plan of reorganization is feasible. Such a result undermines the primary tenet of Chapter 11: maximization of value for all stakeholders.

## **II. Collective Bargaining Rights Outside Bankruptcy.**

Since the 1930s and the enactment of, among other laws, the National Labor Relations Act (the "NLRA") and the Railway Labor Act, it has been recognized that an employee's right to bargain collectively deserves special protection. In other words, an employee's freedom of

association should be safeguarded with a concomitant imposition on employers to refrain from interfering with an employee's choice in that regard. It also has been well-recognized, however, that federal laws should not impose substantive obligations upon these parties. Rather, the parties should be required only to meet and negotiate; the federal government should have no role in determining the specific terms of any agreement, nor oblige the parties to reach an agreement.

### **III. CBAs and Retiree Benefits in Bankruptcy.**

Generally, companies that enter Chapter 11 have made certain promises and taken on certain obligations that they are incapable of satisfying in full. With a limited amount of value to distribute, it is important to consider how changes to the Bankruptcy Code will affect the recovery all of stakeholders.

As initially conceived and, in my opinion, properly brought to fruition in the form of the Bankruptcy Reform Act of 1978, as codified in Title 11 of the United States Code, a primary tenet of Chapter 11 is to allow a company to restructure its debt in a way that maximizes value for all parties with an interest in the company. To accomplish this, Chapter 11 establishes an elegant set of checks and balances to ensure that no single party accumulates too much leverage or power in the reorganization process.<sup>2</sup> For instance, on the one hand, once a company files for bankruptcy, Chapter 11 provides the tools necessary for the now “debtor in possession” to reorganize its operations, if necessary, restructure its balance sheet, and emerge from bankruptcy as a going-concern for the benefit of creditors, equity holders, employees, and consumers. On

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<sup>2</sup> The importance of these checks and balances in a bankruptcy system cannot be underestimated. Indeed, the recent enactment of the new bankruptcy laws in China—which closely track the U.S. Chapter 11 structure—was delayed because of a philosophical debate concerning priority levels of secured creditor and employee claims. It was finally determined, approximately two years later, that giving priority to secured debt claims is better for the long-term viability of the company and, therefore, its employees, by encouraging the development of a market for secured debt.

the other hand, Chapter 11 provides certain protections to various parties in interest, such as section 1129(a)(7) of the Bankruptcy Code, otherwise known as the “Best Interest Test,” requiring a debtor to show that every creditor or equity interest holder will recover as much under the proposed Chapter 11 plan than such party would recover in a hypothetical liquidation under Chapter 7 of the Bankruptcy Code. Put simply, allowing a debtor to reorganize effectively under Chapter 11 of the Bankruptcy Code ensures that all stakeholders, including secured debt holders, suppliers, customers, and employees, are not harmed more than necessary by the Chapter 11 process.

There is an inherent policy conflict between the Bankruptcy Code and the labor statutes. For example, prior to the enactment of sections 1113 and 1114, section 365 of the Bankruptcy Code governed the treatment of CBAs and retiree benefits. Section 365 allows generally for the unilateral rejection/termination of executory contracts, *i.e.*, a court-approved breach of certain contracts based on a debtor’s business judgment with respect to whether rejection is appropriate. In contrast, employers cannot reject or modify CBAs under the NLRA before their natural expiration and the parties to a CBA are subject to a detailed process of negotiating and resolving labor disputes. Thus, while the Bankruptcy Code provides a company with tremendous leverage in negotiating with contract counterparties, the labor statutes force management to “break bread” with organized labor and prohibit an employer from “refusing to bargain collectively with the representative of his employees.”<sup>3</sup>

In 1984, the Supreme Court in *In re Bildisco* issued an opinion holding that a debtor could reject a CBA unilaterally without thereby committing unfair labor practice.<sup>4</sup> The Supreme

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<sup>3</sup> NLRA § 8(a)(5).

<sup>4</sup> *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).

Court set forth additional guidelines prior to rejection: a court must find that reasonable efforts to achieve voluntary modification were made, an accord was not likely, and an inability to reach agreement will impede reorganization.

Congress reacted swiftly to the *Bildisco* opinion, enacting section 1113 of the Bankruptcy Code to prohibit a company's unilateral rejection of CBAs by establishing certain procedural requirements that the parties must follow before rejection a CBA is proper. Congress subsequently enacted section 1114 in 1988 to protect vested retiree medical benefits, putting into place procedural mechanisms that are substantially similar to those included in section 1113. Indeed, the proposed modifications to sections 1113 and 1114 are substantially similar and generally can be analyzed by reference only to section 1113.

Section 1113 balances the need to reorganize the company, encourages collective bargaining, and reconciles the goals of Chapter 11 with the framework established by the labor statutes to protect the interests of employees in preserving, among other things, their wages and benefits. Indeed, in many ways, section 1113 attempts to mirror the forced negotiation process under federal labor statutes.

In general, section 1113 allows a bankruptcy judge to exercise discretion when evaluating the proposed termination of CBAs. This flexibility, as opposed to a one-size-fits-all approach, is necessary to allow parties to negotiate freely and develop a consensual deal that (1) requires all parties to make a sacrifice, (2) permits a company to cut costs and preserve going-concern value, and (3) protects, to the maximum extent possible, the rights and interests of labor unions (and retirees under section 1114).

Under section 1113, before presenting a bankruptcy judge with a motion seeking rejection of a CBA, a debtor must make a proposal to the union. Between the proposal and

hearing on a motion to reject the CBA, a debtor must provide unions with relevant information and meet at reasonable times. Upon the filing of a motion to reject, a bankruptcy court must schedule a hearing within 14 days, and notice must be provided to interested parties at least 10 days before the hearing. The bankruptcy court may then continue the hearing for not more than 7 days, and the hearing may be continued further if the debtor and unions agree. After the first day of the hearing, the bankruptcy court has 30 days to rule on the motion, and, again, the debtor and unions can agree to extend the time for the ruling. If no ruling is made, the debtor may terminate or modify the CBA pending a ruling by the bankruptcy court.

Section 1113 covers three basic areas: (1) the need for cost reductions to permit reorganization; (2) the fairness of the proposed reductions; and (3) the propriety of the bargaining process, including its timing, the sharing of information, and the parties' good faith. Within these three areas are nine requirements for rejecting CBAs:

1. the debtor in possession must make a proposal to the union to modify the collective bargaining agreement;
2. the proposal must be based on the most complete and reliable information available at the time of the proposal;
3. the proposed modifications must be necessary to permit the reorganization of the debtor;
4. the proposed modifications must assure that all creditors, the debtor, and all of the affected parties are treated fairly and equitably;
5. the debtor must provide to the union such relevant information as is necessary to evaluate the proposal;
6. between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union;
7. at the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement;

8. the union must have refused to accept the proposal without good cause; and
9. the balance of the equities must clearly favor rejection of the collective bargaining agreement.

In addition, courts have identified other considerations for determining whether to allow termination of a CBA, including, but not limited to, the good faith of the parties during the negotiation process, the amount saved through rejection versus other means of cost-cutting, the possibility that the employees may strike after rejection, and the impact the rejection damages claim may have on plan feasibility.

With respect to the third enumerated requirement above, the Circuit Courts of Appeals are split over the interpretation of the word “necessary.” On one hand, the Third Circuit in *Wheeling Pittsburg Steel Corp. v. United Steelworkers of Am.*, concluded that Congress intended the word “necessary” to be construed strictly and suggested that use of the word equated to “essential” and that rejection under section 1113 was to be used only when necessary to prevent liquidation.<sup>5</sup> On the other hand, the Second Circuit in *Truck Drivers Local 807 v. Carey Transp. Inc.* applied a less stringent standard, concluding that “necessary” means the debtor has the burden of proving that its proposal is made in good faith and that the proposal contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully.<sup>6</sup> Irrespective of jurisdiction or interpretation of “necessary,” however, in practice courts generally impose a high burden on debtors to satisfy the various procedural requirements of section 1113.

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<sup>5</sup> *Wheeling-Pittsburg Steel Corp. v. United Steelworkers of Am.*, AFL-CIO-CLC, 791 F.2d 1074, 1088 (3d Cir. 1986).

<sup>6</sup> *Truck Drivers Local 807 v. Carey Transp. Inc.*, 816 F.2d 82, 89–90 (2d Cir. 1987).

As mentioned above, Congress designed section 1113 to balance the conflicting policies underlying the Bankruptcy Code and the labor statutes. Considering the difficulty in accomplishing this task, it is my belief that the extant version of section 1113 appropriately balances the interests of protecting employees' interests with fostering a reorganization of the company for the benefit of all parties. Not only has Congress required parties to come to the bargaining table to negotiate the terms of their CBAs, courts have further enforced this requirement by holding the parties' feet to the fire to make a proper showing that they have engaged in good faith negotiations. This requirement both provides cover to unions to negotiate with debtors on necessary wage and work rule concessions and ensures that the potential rejection by a debtor of its CBAs will be held to a high burden. Indeed, at hearings on section 1113 motions, courts typically require extensive testimony and the proffer of substantial evidence regarding the extent and course of negotiations, the details of the proposed terms, and the amount of information exchanged. Moreover, in most cases courts require substantial evidence regarding the extent of the reduced labor costs and how these reductions will affect the debtor's ultimate bottom line. Section 1113 also gives the bankruptcy judge the power to order the parties back to the negotiating table if it is believed that further negotiations are likely to be successful.

The forced negotiation process in sections 1113 and 1114 means that the termination and modification provisions of sections 1113 and 1114 become operative only when the parties are unable to reach a consensual deal. The power of these sections, therefore, lies in their effects on the out-of-court negotiation process. At bottom, altering these sections in the manner outlined by H.R. 4677 will only serve to make it harder to get deals done.



#### **IV. The Proposed Modifications of H.R. 4677.**

The modifications to the Bankruptcy Code proposed by H.R. 4677 would, in my opinion, upset the delicate balance of stakeholder interests enforced in Chapter 11 and thereby impede a company's ability to reorganize in Chapter 11. Labor and retiree interests are, of course, important and absolutely deserving of protection, as recognized by Congress in its original enactment of sections 1113 and 1114. The proposed modifications, however, alter significantly the leverage points between the debtor, labor, retirees, and other stakeholders, tilting the scale significantly in favor of labor and retirees.

For example, provisions such as the one that prevents a bankruptcy judge from granting stronger cost-cutting measures than those requested by a debtor in its last offer removes the litigation downside that parties normally consider when negotiating. With the elimination of this litigation risk, labor unions, for example, would lack the incentive to make a deal if the worst result would be the last offer proposed by the company. Additionally, the proposed modifications include an explicit authorization for "self help" remedies, *e.g.*, a labor strike, in the event that a court authorizes rejection of a CBA. This would undermine any incentive a labor union has to negotiate because it could always turn to the threat of a strike knowing that the court is prevented from issuing an injunction, even where necessary to preserve the company's chances for reorganization.

These changes to the leverage points will alter the dynamics of negotiations that occur outside the purview—but within the shadow—of the Bankruptcy Code, as well as the dynamics of the negotiations that take place once a company seeks Chapter 11 relief. In my view, these changes will diminish the chance that parties will consummate deals and will ultimately stand in the way of a debtor successfully reorganizing. And, to be clear, failure to reorganize may force

the debtor to liquidate, thereby harming all constituencies. Thus, enactment of H.R. 4677 likely would be detrimental to the very interests it is aimed at protecting.

Together with the changes to the leverage points, the proposed modifications alter what types of modifications a debtor can propose and change the standard for determining what is “necessary” for successful reorganizations. For example, the proposed modifications permit a bankruptcy court to approve termination of CBA or changes to vested retiree benefits only if, among other things, the relief is “not more than the minimum savings essential to permit the debtor to exit bankruptcy,” such that the confirmation of a plan is not likely to be followed by liquidation or further financial restructuring of the debtor in the “short-term.” This standard goes further than the already restrictive standard articulated in *Wheeling-Pittsburg* by explicitly limiting the time period courts can consider when evaluating what is “necessary.” By applying these restrictions on a debtor’s ability to terminate CBAs or modify vested retiree benefits, a debtor is forced to propose only what is the bare minimum required to stave off an immediate liquidation or imminent restructuring. Moreover, these limitations make it more difficult for debtors to meet the “feasibility” requirement under section 1129(a)(11), which does not permit a debtor to look only to the “short-term” viability of the reorganized company. Instead, as a majority of courts have held, a debtor should be able to propose modifications that will help to ensure the long-term viability of the debtor’s business, which further supports the overall policy of the Bankruptcy Code. In contrast to H.R. 4677, which would force the company to limp out of Chapter 11 without being fully competitive, the current framework affords sufficient flexibility to a company to fix its business properly with a view towards lasting survivability, thereby creating more value for the business ultimately inuring to the benefit of all stakeholders.

Further limiting a company's flexibility, the proposed modifications in H.R. 4677 inextricably link the evaluation of a debtor-proposed compensation program for certain key employees with the evaluation of the propriety of terminating CBAs and/or modifying vested retiree benefits. In other words, if a company wants to provide its key employees with a certain type of compensation program, the proposed modifications would make it difficult to utilize sections 1113 and 1114 of the Bankruptcy Code to rationalize its labor and pension obligations. Thus, under this framework, to preserve its right to section 1113 and 1114 relief, a company is forced to consider whether to offer below-market compensation to its current key employees or, for that matter, new talent.

Offering below-market compensation is problematic because it makes it harder to attract or retain key employees. Key employees, for example, senior executive officers and managers, are "at will" employees, unlike those employees subject to a CBA. In my experience, once a company becomes financially distressed and begins to consider Chapter 11, it is more often than not the case that the key employees a company wants and needs to retain (or recruit) are those that are most likely to leave for (or go to) financially stable companies that are paying market-based compensation. It is incumbent, therefore, upon a debtor to make an effort to retain or recruit the best and brightest managers who would be willing to work at will for a company operating in the complex and sometimes unpredictable universe of Chapter 11. Companies also must consider that potential financiers may be reticent to invest in a company if they are not comfortable that their investment will be managed by individuals with the requisite experience and know-how. The resulting limited access to financing could have negative effects on a company's chances for reorganization.

To attract the necessary talent in the environment leading up to and during Chapter 11, a company must be willing to offer market-based compensation. Indeed, the most desired managers with the greatest ability to lead a company through Chapter 11 likely will demand such compensation. A company's ability to offer market-based compensation is not without its limits and excessive compensation, especially for executive level employees, is a concern as it is not in the company's interest to pay above-market compensation. In the current regime, Congress already polices inappropriate compensation under the restrictions contained in section 503(c) of the Bankruptcy Code and various other clawback provisions. However, to ensure the Bankruptcy Code's objectives of successful long-term rehabilitation, preservation of going-concern value, and the emergence of a streamlined debtor ready to compete in its respective industry, a debtor must have the ability to rationalize its labor and retiree obligations while at the same time compete, within reason, for employees who have the skill-set necessary to usher the debtor through the Chapter 11 process. Hamstringing a company in this regard simply puts at risk a company's ability to manage the Chapter 11 process as well as the likelihood that a company will be able to raise funds in the capital markets to finance a successful reorganization process that ultimately results in the preservation of jobs.

In addition, the proposed modifications assume that specific and detailed facts are unimportant in determining the propriety and/or extent of management cuts. Bankruptcy judges must have the discretion to analyze these facts. For example, the Bankruptcy Code requires that any modifications to a CBA not be disproportionately burdensome to employees covered by a CBA. H.R. 4677 goes one step further and puts in place a mechanism by which compensation can be recovered from a director equaling the percentage diminution in value of the company's obligations effectuated by sections 1113 or 1114. Though forcing the constituencies of a debtor

to share the sacrifice is a fair and necessary concept, legislating the removal of a bankruptcy judge's discretion to tailor relief in a specific set of circumstances may cause unnecessary harm.

Because at will employees and employees covered by a CBA may not be starting from a level playing field in terms of compensation, judicial discretion is necessary to ensure just and appropriate relief. For instance, a company can address costs related to employees at will both in and out of Chapter 11. Conversely, outside of Chapter 11, a company cannot adjust its obligations under a CBA without the consent of its employees. Thus, leading up to a bankruptcy filing, a company may have and likely effectuated certain employee cost reduction programs that negatively affected wages and benefits of at will employees. Forcing a company to make proportionate reductions to already reduced payments would, therefore, result in at will employees shouldering a disproportionate cut in wages. As I explained above, offering market-based compensation is important to the overall restructuring of the company. Limiting a company's ability to offer this type of compensation (*i.e.*, by tying a bankruptcy judge's hands), makes liquidation a more likely outcome. This result is detrimental to all parties' interests and runs contrary to the well-settled policies behind Chapter 11.

Finally, the proposed modifications create additional post-reorganization costs and materially alter and amend the current priority scheme in Chapter 11. For example, the proposed modifications create administrative priority for prepetition severance pay obligations and WARN Act damages. In addition, under the proposed section 1113(g), a company would be required to pay the fees and expenses incurred by a labor union. Because these priority claims could be substantial and must be paid in full before a debtor can emerge from Chapter 11, the costs of Chapter 11 could increase significantly. Moreover, lenders considering whether to finance the Chapter 11 process (*e.g.*, in the form of "DIP financing") or whether to finance the company

once it exits from Chapter 11 will consider the effect of these increased post-reorganization liabilities on the company's capital structure when evaluating whether and on what terms to lend funds to the company. Such financing generally is necessary for debtor companies to fund their restructuring; making this financing less available and more expensive may prevent some debtors from reorganizing successfully.

By the same token, increasing priority claims for one constituency has the necessary effect of decreasing the recovery for another constituency. Put another way, increasing the obligations of a debtor to pay employees may, in fact, reduce the recoveries for certain taxing authorities and quasi-governmental agencies (*e.g.*, Pension Benefit Guaranty Corporation), trade vendors, customers, or tort victims.

#### **V. Conclusion.**

It is important to consider H.R. 4677 in the context of the principal goal of Chapter 11—to reorganize the debtor and maximize value for all stakeholders. In my view, the proposed modifications undercut this principal goal.

As I discussed above, bankruptcy judges, practitioners, lenders, labor unions, and authorized representatives have adapted to the particular provisions of sections 1113 and 1114 and have been operating within its framework for approximately 25 years. It is important not to tip the balance disproportionately in favor of one party over another such that the dynamics of negotiations are altered. The bankruptcy judge must be able to, and currently has the power to, ensure that neither party utilizes either procedural or substantive leverage to affect the outcome of negotiations. The proposed modifications curtail the discretion of the bankruptcy judge.

More to that point, bankruptcy courts need flexibility to implement workable solutions for distressed companies. It is a well-recognized principle that the exigencies of bankruptcy require bankruptcy judges to retain flexibility to deal with the unique or particular issues that

may arise in a specific case. The limited discretion afforded to bankruptcy judges under the current forms of sections 1113 and 1114 is the specific corollary to this principle within the context of negotiations related to collective bargaining obligations. Including provisions such as the ones described above that eliminate litigation risk and authorize “self help” remedies creates perverse incentives and negatively affects the deal dynamics, possibly undermining the entire negotiation process, which as I have discussed, ultimately harms both the company and its stakeholders.

Loss of jobs and decreased wage and benefit packages for employees, while certainly the less-preferred alternative, may be an economic reality for certain companies, and it certainly is more preferable than liquidation and a complete loss of jobs and wages. A company’s decision to undertake the dramatic step of filing for bankruptcy is likely the result of the company’s inability to obtain painful but necessary cost reductions outside the bankruptcy process. Restricting a company’s ability to take full advantage of the panoply of tools the Bankruptcy Code provides only will force more companies to liquidate under Chapter 7 of the Bankruptcy Code. This will harm all stakeholders, especially the employees, who, in the event of liquidation, will be employees no longer. Not only will employees lose their jobs in such an event, but sections 1113 and 1114 are inoperative under Chapter 7, offering zero protection to employee interests. Thus, these interests will be better-served in the long-run by a financially healthy and operationally viable employer that is competitive in the global marketplace. Unfortunate as it may be to resort to section 1113 and 1114 to cut costs, the Honorable Bankruptcy Judge Eugene R. Wedoff has observed that bankruptcy generally “involves choosing the least bad among a number of unfortunate choices.”<sup>7</sup>

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<sup>7</sup> Hearing Testimony, May 10, 2005, *In re UAL Corp.*, Case No. 02-48191 (Bankr. N.D. Ill. 2005).

Finally, in my experience, companies do not take the strictures of sections 1113 and 1114 lightly. The procedural and substantive requirements of sections 1113 and 1114—overseen and enforced by an actively involved bankruptcy judge—require companies to consider carefully all options before beginning the process of termination or modification. And, once this process has begun, sections 1113 and 1114 provide significant, meaningful opportunities for the parties to reach a consensual resolution prior to the rejection of a CBA or modification of vested retiree benefits.

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Mr. COHEN. Our fourth witness is Ms. Janette Rook. Ms. Rook was hired as a flight attendant by Northwest in July 1998. In 2006 she was elected the Detroit Local Council Representative of the American Flight Attendants Union. Ms. Rook was elected to the Master Executive Council Vice President in May 2008, and has served as President from March 2009 to the present.



Thank you, Ms. Rook, and will you proceed with your testimony.

**TESTIMONY OF JANETTE ROOK, ASSOCIATION OF  
FLIGHT ATTENDANTS-CWA**

Ms. ROOK. Good morning and thank you, Chairman Cohen and Members of the Subcommittee, for holding this important hearing. My name is Janette Rook. I am the Master Executive Council President of the Association of Flight Attendants-CWA at Northwest Airlines, now Delta Airlines. I am also here on behalf of AFA-CWA's 55,000 members at 22 airlines around the country.

In July 1998, I became a flight attendant with Northwest Airlines. A union contract negotiated since the mid-1940's was handed to each and every one of us. That contract provided decent pay, benefits, and working conditions, and was our admission to the great American middle class. I put my trust in that agreement with the knowledge that government institutions and the laws of the land would protect my contract.

I testify today to tell a different story about how the laws of my country failed to protect airline employees during bankruptcy. My testimony is about my experience during bankruptcy at Northwest Airlines but, unfortunately, my story mirrors what occurred to thousands of airline workers at many airlines. The lives of so many airline workers and retirees have been devastated by the exploitation of our bankruptcy laws by airline management and their armies of outside lawyers, financiers, and consultants.

I witnessed how management uses the bankruptcy laws like a weapon to obliterate pay, pensions, health care, and the jobs of hardworking Americans.

Mr. Chairman, Northwest employees were told to pull things out of the trash, shop at thrift stores, and cut coupons as ways to manage the 40-percent pay and benefits cuts we experienced during bankruptcy. Meanwhile, our executives were paid bonuses of nearly \$400 million. This insult to the dignity of Northwest employees best exemplifies why Congress must enact H.R. 4677.

Congress must act to level the playing field so that bankruptcy is no longer a business strategy that transfers money to executives' pockets, while those with union contracts are forced by law to take drastic pay cuts, face devastated health care and retirement benefits, and the risk of outsourced jobs.

On September 14, 2005, Northwest Airlines filed for Chapter 11 bankruptcy protection in a New York court. Minutes before, in the same court Delta Airlines also filed. These filings set in motion drastic cuts in pay and slashed benefits at both airlines before the merger was announced in April 2008. It soon became clear that Northwest executives were poised to use bankruptcy laws to extract draconian pay and benefits cuts from employees and to abrogate our contract.

Ultimately, Northwest executives failed to succeed in ripping up our contract. But along the way, they exploited loopholes in bankruptcy laws to attempt to impose concessions on our group and deny us the greatest bargaining leverage we have: the right to strike.

The company filed a motion pursuant to section 1113 of the Bankruptcy Code that began an assault on our contract. This mo-

tion came with a message from management that negotiating was not an option. They intended to impose pay and benefits cuts on flight attendants with the stroke of a pen. Northwest executives also attempted to use the bankruptcy laws to outsource our work to the lowest bidder. We relied on remaining contractual protections and a public campaign to save our jobs. We thought that our country's bankruptcy laws protected workers but, instead, the laws were used against us at every turn.

Meanwhile at United, Mesaba, Aloha, ATA, Midwest, Delta and US Airways' corporate executives used the bankruptcy laws in the same manner as Northwest management. Across the industry, management had the green light from bankruptcy courts that it was open season on our careers.

When employees looked for protection in the laws of our land, we found no advocate.

At Northwest, management won a U.S. district court case that eliminated our right to strike during bankruptcy, even though our right to self-help was our only leverage to fight back. H.R. 4677 restores that right.

Northwest management also froze our pensions, as did other carriers in our bankruptcy. However, management's pension plan survived bankruptcy at many carriers. Bankruptcy judges ruled on executive compensation motions, they had sympathy for rank-and-file employees, but essentially said there was nothing they could do about it because the law did not give them the authority to second-guess management compensation.

H.R. 4677 levels the playing field by curbing excessive executive compensation during bankruptcy.

Mr. Chairman, my testimony, unfortunately, can be repeated in the near future if we don't act now. The airline industry is indeed volatile, and we know that events can spoil what looks like a hopeful recovery. Bankruptcy is not new to the airline industry. One hundred fifty airlines have filed for bankruptcy since the deregulation act of 1978, with 21 bankruptcies just since 9/11. We received a fresh reminder on January 5 when Mesa Airlines filed for Chapter 11.

Left unchecked, airline executives can once again use the laws of our land to destroy careers and cause chaos to family budgets. You can stop it by passing H.R. 4677.

Thank you. And I look forward to answering your questions.

Mr. COHEN. Thank you, Ms. Rook.

[The prepared statement of Ms. Rook follows:]

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PREPARED STATEMENT OF JANETTE ROOK

**Testimony Submitted To**  
**The House Subcommittee On Commercial**  
**and Administrative Law**  
**On**  
**H.R. 4677, the "Protecting Employees and**  
**Retirees in Business Bankruptcies Act of 2010**

**May 25, 2010**

**By**

**Janette Rook**

**President, Master Executive Council at**  
**Northwest Airlines / Delta Air Lines**  
**Association of Flight Attendants-CWA, AFL-**  
**CIO**

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Good morning, and thank you Chairman Cohen for holding this important hearing. We are truly fortunate to have someone like yourself and Chairman Conyers in the position to help shape a reform of corporate bankruptcy laws so that what I and too many workers around this country have faced the past several years does not happen again. My name is Janette Rook and I am the Master Executive Council President of the Association of Flight Attendants-CWA, AFL-CIO at Northwest Airlines, now Delta Air Lines. I am also here today on behalf of AFA-CWA's 55,000 members at 22 airlines around the country.

In July of 1998, I earned my wings to fly with Northwest Airlines, a carrier with an historic past and a promising future. A union contract, negotiated since the mid-1940's, was handed to each and every one of my graduating class and was, to me, just as important a part of my new career as the wings I had earned. The Northwest flight attendant union contract, like my airline, had its own proud past and provided good pay, benefits and working conditions. It was a legally binding agreement between the company I served and me and my co-workers. The contract contained signatures of company executives and flight attendant negotiators who all agreed to abide by the words contained in the contract. I put my trust in that agreement with the knowledge that government institutions were in place to protect those words on the paper and that the laws of the land provided assurances and protections that those written words would be honored. I also believed that company executives would honor their agreements and honor their word.

Mr. Chairman, I testify today to tell a different story about how the laws of my country failed to protect employees in the aviation industry, and allowed corporate executives and an army of outside consultants to plunder the assets of my company and to exploit the bankruptcy laws to enrich themselves at the expense of thousands of workers. My testimony today is about my experience at Northwest Airlines, but my experience, unfortunately Mr. Chairman, is an all too common story that occurred to thousands of aviation workers at many airlines.

The lives of so many airline workers and retirees have been devastated by the exploitation of corporate bankruptcy. I witnessed how management used the bankruptcy laws like a weapon to obliterate pay, pensions, healthcare and the jobs of hard-working Americans. The depth of my experience and the devastation experienced by the workers I represent will only be summarized in this testimony; there is simply too much to tell. But to put my testimony in the best context possible, there is something you should know.

Mr. Chairman, Northwest employees were told in an official company publication to pull things out of the trash, shop at thrift stores and cut coupons as a way to handle the 40 percent pay and benefits cuts we experienced during bankruptcy. This was their financial planning seminar for us, in short. While corporate executives and consultants were granted excessive pay packages by the bankruptcy court, my co-workers were told to accept hand-me-downs and contact local food pantries. This

insult to the dignity of Northwest employees best exemplifies why this hearing is so important today and why Congress must enact H.R. 4677.

Something must be done to level the playing field so that bankruptcy is no longer a “business strategy” that simply transfers money to executives’ pockets and the coffers of lawyers, bankers and financiers who profit during bankruptcy while those who have negotiated a fair wage and decent benefits and working conditions are forced, by law, to take drastic pay cuts, face devastated health care and retirement benefits and the risk of outsourced jobs. Some of my fellow co-workers were forced to file bankruptcy while executives received so-called performance bonuses and were issued stock in the reorganized company valued at millions.

On September 14, 2005, Northwest Airlines filed for Chapter 11 bankruptcy protection in the Southern District of New York. This was my airline’s first bankruptcy filing in its 79 year history and would be the last. Minutes before, and in the same court, Delta Air Lines filed for Chapter 11 bankruptcy protection. These filings set in motion, under the protection of bankruptcy law, drastic cuts in hourly pay of up to 40 percent and a series of other cuts in benefits for employees at both airlines.

When Delta and Northwest managements completed their slash and burn plan to employee wages and benefits, they announced a merger of the two carriers on April

14, 2008. My fellow flight attendants at Delta Air Lines did not have union contract protections during bankruptcy like we had at Northwest Airlines.

It soon became clear that Northwest executives were poised to use the bankruptcy process to extract draconian pay and benefit cuts on employees and those executives were going to exploit the bankruptcy laws to attempt an end run around our contract. Ultimately, Northwest executives failed to succeed in ripping up our contract, but along the way, they exploited loopholes in existing bankruptcy law to attempt to force concessions on our group and to deny us the greatest bargaining leverage we have - the right to strike.

Management's assault on our contract and the right to enforce our contract began when the company attempted to abrogate our agreement in bankruptcy court with a motion pursuant to Section 1113 of the Bankruptcy Code. This motion came with a message from management that negotiating a restructured agreement was not an option for them and they intended to impose draconian pay and benefit cuts on flight attendants with the stroke of a pen. The court implemented a tentative agreement reached between negotiators, but rejected by the members. Our small victory in court to limit pay and benefit cuts to the negotiated agreement was no consolation prize by any means. The cuts were deep and painful to flight attendants. Negotiators had reached a second tentative agreement that softened the concessions, but was still painful. The bankruptcy court denied our union's motion to impose that agreement.

Northwest executives also attempted to use the bankruptcy laws to outsource our work to the lowest bidder. We relied on remaining contractual protections and a public campaign to save our jobs. We thought that our country's bankruptcy laws protected workers, but instead, the laws were used against us at every turn. Mr. Chairman, this is another reason this Congress must pass H.R. 4677.

Meanwhile, at other carriers such as United, Mesaba, Midwest, Delta and US Airways, corporate executives at those carriers used the bankruptcy laws to impose drastic pay cuts and to destroy the pensions and health care protections for retirees. Across the industry, management had the green light from bankruptcy courts that it was open season on employee wages and benefits.

Management attempted to use the bankruptcy code to circumvent collective bargaining in order to destroy the voice of the hard-working people of the middle class by cutting union jobs and obliterating the protections and benefits negotiated and earned by union members. Management and their consultants convinced bankruptcy court judges that the only problem with the airline industry was that airline workers are paid too much, that the courts should impose the pay and benefit cuts and that negotiating face to face with their own employees was not an option. Their strategy – unfortunately for airline workers – was devastatingly effective. Airline employee wages, benefits and work rules across the industry were soon slashed to levels not seen in decades.



The story that unfolded at Northwest and Delta and other airlines in bankruptcy would have been difficult to imagine only ten years ago.

Bankruptcy is not new to the airline industry, Mr. Chairman. There have been over 150 airline bankruptcies since the industry was deregulated in 1978, with at least twenty-one since September 11. Unfortunately, we have a fresh reminder of airline bankruptcy with the Chapter 11 filing by Mesa Airlines on January 5, 2010. Mesa flight attendants ratified a new contract in February, 2010 after difficult negotiations. So far, management has not requested concessions.

This committee has the extraordinary opportunity now to send a message of hope to Mesa employees, and all workers who may soon fall victim to bankruptcy law exploitation, that Congress has heard the stories today in this hearing and that reform is coming.

As this Committee looks into whether the current bankruptcy system is fair to workers, I think you will agree that there was nothing fair about this process from the perspective of the workers. H.R. 4677 restores fairness, restores trust and provides the framework for an orderly restructuring and reorganization when a company, and most importantly its employees, face bankruptcy.

One hundred forty thousand airline workers have lost their jobs over the past eight years. Workers who were not forced out have lost pensions or had them frozen at levels that prevent a decent retirement and forcing workers to work years beyond their plans. We have seen our wages cut by as much as 20 to 40 percent. And that's just the beginning. Management has forced changes in work rules that cause us to work many more hours at reduced pay, and to be away from our homes and our families for more days every month. Meanwhile, our executives have reaped millions of dollars in compensation.

When employees looked for protection in the laws of our land, we found no advocate. Instead, we found that the odds were stacked against us and we discovered an industry-wide management strategy that systematically intended to ignore decades of collective bargaining history and precedent. Management no longer wanted to negotiate with workers and instead looked at their own employees as just another creditor in bankruptcy court.

At Northwest, they used the bankruptcy courts to deny workers a fundamental right to strike, under the process defined in the Railway Labor Act (RLA) and mediated by the National Mediation Board (NMB). Under the cover of bankruptcy laws, management won a U.S. District Court case that eliminated our right to strike when management attempted to impose pay and working conditions on us and attempted to abrogate our contract. Our appeal to the U.S. Court of Appeals for the Second Circuit was unsuccessful. We were left with no leverage to bargain for better

concessions. Management used the courts to eliminate the one threat that would have forced them to negotiate fairly. H.R. 4677 restores the right to self-help in the bankruptcy process. This is leverage that workers need to keep the company honest.

Many of our flight attendants – and many other airline workers – have had their lives destroyed by these bankruptcies, and by management’s use of the law to force devastating cuts on the employees.

These most recent rounds of bankruptcy have been especially devastating. One needs to look no further than the numbers. At several of the airlines represented by AFA-CWA, which have gone through bankruptcy, the slashing of union jobs has been dramatic. At ATA Airlines when the company entered bankruptcy on October 26<sup>th</sup>, 2004 the company had 1,946 active flight attendants and when the carrier ceased operations in April, 2008, there were just over 700 flight attendants at the airline. Aloha Airlines had 440 employed flight attendants on December 1, 2004. By April, 2007, Aloha employed just 386 flight attendants before ceasing operations in April 2008.

US Airways had 7,790 active flight attendants when they entered bankruptcy and almost five years later, their number of active flight attendants was down to 4,770. The nearly 12,000 flight attendant jobs cut at United Airlines is another chilling example. At the same time, there are more passengers traveling today than there

were in the year 2001 prior to these cuts, resulting in an unprecedented productivity increase.

Over a five year period between 2002 and 2006, annual flight attendant costs at ATA were reduced from \$62 million a year to \$38 million. At Northwest the costs went from \$631 million to \$533 million. US Airways went from \$623 million to \$267 million. At United the annual costs went from \$1.4 billion to \$945 million, and prior to the cuts the 27,000 flight attendants only comprised 7.1% of the total labor cost at our airline.

The painful cuts absorbed by the employees were repeated, numerous and stretched out over several devastating years of uncertainty. US Airways went through bankruptcy twice, with multiple rounds of concessionary bargaining each time.

Once again, Northwest management used the law and the threat that all benefits would be cut off as a hammer to beat drastic cuts out of the workers who had invested their entire working lives in the airline. The same anti-worker attack occurred at Delta Air Lines.

The bottom line, Mr. Chairmau, is that the law allowed management to do what they did. The bankruptcy court gave its blessing to almost each and every management request in court. A law designed to give extra protection had been turned on its head, and was now another weapon in management's arsenal.

As if the cuts in wages, work rules and medical benefits were not enough, Northwest management also froze our pensions, as did other carriers in bankruptcy. Still other major carriers struggled to protect their pension promises with help from Congress, but management at United and US Airways walked away from their promises and used the bankruptcy process to destroy pensions. AFA-CWA fought to save those pensions, using every legal avenue at our disposal. Unfortunately, in the end, tens of thousands of flight attendants found themselves facing an uncertain retirement as the bankruptcy court approved a legal maneuver by management that made an end run on the pension protections in the law. Congress never envisioned that bankruptcy laws and pension laws would be twisted into results like this.

United management, like the executives at other airlines, claimed the impact of the pension termination may be mitigated, assuming that United flight attendants work an extra nine years to recover the benefit levels they had in their defined benefit plan. Their analysis disregards the present value of money and also makes a number of highly unlikely financial assumptions. Especially ridiculous is their formula assumption that flight attendants would receive a four percent annual wage increase every year between the date of termination and the date of retirement, at the same time that wages were being cut an additional 9.5% in a second round of Section 1113 labor contract cuts. That simple statement, obviously misleading, is designed to confuse and mislead workers and others. Nevertheless, the self-serving

statement is typical of the assertions airline management makes on this specific issue as well as numerous others and all under the protection of the law.

Is there any fairness in the current law regarding termination of pension plans in bankruptcy? The only pension plans that survived bankruptcy at many carriers is management's pension plan. United Airlines CEO, Glenn Tilton, was careful to shield his own pension from termination. Prior to the bankruptcy he executed a legal maneuver, putting his \$4.5 million pension into a trust that successfully insulated it from the bankruptcy. Is it fair that the law allows this drastic disparity of treatment between employees of a bankrupt company? Obviously not.

Personal bankruptcies have become commonplace among airline workers and with good reason when earnings are slashed 20, 30 and even 40 percent. At Mesaba Airlines, management's demands for cuts in wages would have reduced some flight attendant's pay to less than \$10,000 per year *before* taxes. That is nothing short of corporate-induced poverty, shifting responsibility for a living wage from the company to the taxpayers.

Finally, no consideration of the fairness of the current bankruptcy process would be complete without mention of the issue of management bonuses and compensation. If the current system had any element of fairness it would not allow massive bonuses and incredible compensation packages for the very executives who took these

companies into bankruptcy in the first place, and who then inflicted massive pay cuts on the workers under color of law.

But, that is exactly what happens. A huge bonus for executives of a bankrupt corporation is simply wrong in light of the enormous sacrifices made by the workers during the course of the bankruptcy. They often give lip service to the concept of pay for performance, but the reality is much different: huge bonuses while workers take cuts. Management typically demands that the workers' concessions be locked in for four, five or even six years. But for management employees they steadfastly refuse to make any long-term commitment to such cuts, while making very modest up front cuts to give the appearance of fairness.

While airline employees have shouldered the heavy financial burden of the bankruptcy process, airline management has suffered incredibly little – if any at all – sacrifice. While the front line employees have seen their numbers slashed, pay drastically reduced, benefits eliminated and work rules destroyed, the upper management level employees reap unearned rewards.

Our experience with management compensation at Northwest, US Airways and United illustrates that management compensation in the bankruptcy process is simply out of control. Too many airline employees are obligated to work under four additional years of concessions following the date of exit from their carrier's bankruptcy. There is little to no evidence that airline executives have agreed to

make any sacrifices. To the contrary, 800 members of management at United and Northwest received a windfall in compensation during bankruptcy and cashed in on an excess of \$800 million in compensation packages. After destroying the careers of United employees, United's CEO alone reaped over \$40 million, 2000 times the pay of a first year flight attendant. The bonuses were awarded regardless of their past or future performance. When judges ruled on compensation packages they commented on union objections to those excessive packages and acknowledged our concerns, but essentially said there was nothing they could do about it because the law did not give them the authority to second guess management compensation, or a standard by which to determine "how much is too much." H.R. 4677 curbs excessive executive compensation during the bankruptcy process.

If the executives' interests were to be aligned with those of the workers they too would need to experience the grief associated with losing their home, losing their jobs, or not being able to make ends meet. At some point, the greed exhibited by corporate executives must be stopped. That time is now.

This profiteering comes predictably at the expense of the dedicated workers who strive daily to ensure our airlines' viability and success. The prospect of a select group of executives rewarding themselves at the expense of flight attendants and other employees adds fuel to a simmering fury and to a relationship void of trust. Companies with overly-generous salaries and very lucrative management profit sharing programs – far above any reasonable measure for a company in bankruptcy



– simply cannot pass the test of fairness in using the current law to force billions of dollars in annual concessions from employees.

In the beginning of most bankruptcy filings, airline management talks a good game about protecting employees and promotes that they intend to treat employees fairly in this process. Unfortunately, the record reflects an entirely different reality. In every instance, employees have been forced to make life-changing sacrifices while executives are richly rewarded. In light of the sacrifices made by the dedicated front-line workers whose commitment has been critical to the success of these airlines, these snatch-and-grab schemes by management not only evidence poor judgment, but also reflect downright avarice.

Mr. Chairman, my testimony, unfortunately, can be repeated in the near future if we don't act now. The airline industry is indeed volatile and events, such as oil price spikes, can spoil what looks like a hopeful recovery. Left unchecked, airlines can once again use the laws of our land to destroy careers and cause chaos to family budgets. You can stop it by passing H.R. 4677.

H.R. 4677 is entitled "*Protecting Employees and Retirees in Business Bankruptcies Act of 2010*" and I implore you, on behalf of thousands of AFA-CWA members, and tens of thousands of workers in the airline industry, and many more hundreds of thousands of workers in other industries: fix the bankruptcy law before there is any more devastation. Put an end to management abuses and their use of the

bankruptcy laws as just another business tactic to cut costs and line their own pockets. Level the playing field for the workers we represent. Enact this law that provides protection to employees during bankruptcy restructuring. Restore the value system that says a company must honor dedicated workers who are committed to the success of their companies and restore the balance and level playing field that occurs when parties engage in collective bargaining.

Again, thank you Chairman Cohen for the opportunity to testify today. I look forward to answering any questions that you or any members of this Committee may have.



## Preparing for a Financial Setback



Living on less is never easy, but with a little planning and a positive attitude, you should be able to weather most financial storms. NEAS, your employee assistance program, makes financial counseling and education available to you through BALANCE, a financial fitness program. BALANCE counselors can help you develop a savings and spending plan, manage your debt, review your credit history, take the necessary steps to buy a home or protect the one you've got, or set up a plan of action to reach your goals. So, take a deep breath, relax, and review the following tips that you can help make any setback smooth and (almost) painless.

For more information on how to access BALANCE and other services NEAS offers, call 1-877-464-4009 or log onto [www.neas.com](http://www.neas.com).

### PRAGMATIC PLANNING

- Now is the time to take stock of what you can do to avoid being hit with a financial shock later. Avoid the urge to procrastinate – Mark on your calendar the date that you will have to live on less.
- Anticipating a tax refund? If so, beat the rush and file your taxes as soon as possible so you don't have to wait for much-needed cash.
- Put money aside in a special "piggy bank" or savings account for the occasion.
- Start thinking about generating money by selling an asset. This can include everything from having a garage sale to selling stock (just beware of capital gains taxes for next year).

### BUDGETING BASICS

- Financial planning begins and ends with a realistic budget. If you haven't reviewed your goals, assets, income, expenses, and debt in a

while (or ever), now is the time to do it. Sit down and do the numbers crunch. It is worth the effort.

- Once you have an accurate idea of where your money is going each month, take a good, hard look at it. Are there areas you can reduce or eliminate? Just how important is the \$4 morning muffin and coffee? Five times per week will run you \$80 a month. This is your opportunity to analyze when and how you spend your money – and make positive decisions about what you may want to change.

- Track your expenses. It's a great habit to get into, and you may be able to prevent "money leakage" – the fast cash \$40 that seems to evaporate before you leave the ATM machine. By plugging the holes now, you can save more efficiently for the times when you will really need it.

### SAVVY SAVING

- Emergency savings are for times like this. If you have saved some money, pat yourself on the back – you deserve it. Take out only what you need and spend prudently.
- If you do not have a savings account to fall back on, don't despair. However, this is a good example of a situation where an emergency savings would be helpful, and may be the perfect motivation to start one. Ask your employer to have money deducted from your paycheck and deposited into a savings account. Three to six months of accessible expenses is standard.

### SMART SHOPPING

- Consider every purchase – Do you need it? Do you need it now? Can you get it for less somewhere else? Asking yourself these questions will help you become a savvy shopper in both flush and tough times.

- Buy in bulk – but only if you can afford it. It doesn't make sense to buy a 50 pound bag of cat food, even if it is a great deal, if you really only have enough for a box that will last the week.

- If there is a farmers market in your area, you can take advantage of the freshest produce for "dirt" cheap prices.

- Use coupons to save on food costs. But beware – you may be tempted into buying something you would never otherwise purchase simply because it seems like such a bargain. Do you really need four packs of triple A batteries, or orange-confetti cake frosting?

- Cut entertainment costs by renting videos rather than going to the movies. Or take advantage of the movies available on the cable or satellite service you already pay for.

- Eat at home rather than going to restaurants – even fast food is often more expensive than a home cooked meal. If you do go out, try eating at cheaper restaurants or take food out rather than eating in the restaurant to save on tips and drinks.

- Save on supplies – use sponges rather than paper towels, a multi-purpose cleaner instead of several specialized ones, and recycle newspapers, bottles and cans. You will help save the earth while saving money!

#### CREDIT CONTROL

- If you find you can't pay your bills, contact your creditors and explain your predicament – you may be able to avoid a late payment fee, particularly if your payment history has been consistent. A phone call is good, but a letter is better, as you will have tangible evidence of your efforts. Keep copies of all correspondence and maintain a log of telephone communications, complete with a representative's name and time of call.

- If you have credit card debt, pull out your most recent statements and check your present

annual percentage rates. Are they higher than you remembered? Or simply too high for you to be comfortable with? If so, it may be time to make some changes:

- Give your current creditors a chance. If you have been a good customer, remind them of it, and ask for an interest rate reduction. A five-minute phone call can make for huge savings.

- Consider transferring your balances to low interest cards or those with extremely low "teaser" rates. Be sure to evaluate the transfer offers carefully though – How long does the offer last? Is the APR 5.9% or 5.9% plus the prime rate of interest? How long is the grace period – you may not want to go from a 30 to a 20 day grace period. What is the punitive interest rate for late payments? They can be as high as 36% -- quite a jump from the original offer.

- Credit card debt is expensive. And frustrating. If you feel you have been treading water or watching the balance grow rather than plunge, go back to your budget and consider making changes. A \$2,000 balance with a 19% interest rate may take 30 years to repay if you just make the minimum payment – and that's if you never make another purchase on it!

- Debt consolidation may be an option. A Debt Management Plan is designed to help consumers repay their debt in three to five years by offering interest rate reductions (depending on the creditor), one monthly payment, and a commitment from you to not get into further debt. A BALANCE counselor can help you determine if the Debt Management Plan is appropriate for you.

Finally, remember that planning ahead is key to being prepared for tomorrow. BALANCE can help you understand your present and future financial options. If you need help with your budget, credit report, long term planning, consumer issues, or debt management, contact NEAS for a referral.

Keep reading for a list of quick money-saving tips.

1. Set your thermostat to 64 and turn it down to 60 at night.
2. Use the phone book instead of directory assistance.
3. Use coupons at the grocery store.
4. Carpool.
5. Ask for generic prescriptions instead of brand name.
6. Do your own nails.
7. Rent out a room or garage.
8. Replace 100 watt bulbs with 60 watt.
9. Make long distance calls at night and on weekends, instead of mid-day, mid-week.
10. Throw pocket change in a jar and take it to the bank when it's full.
11. Always grocery shop with a list.
12. Buy spare parts for your car at the junkyard.
13. Go to museums on free days.
14. Quit smoking.
15. Get hand-me-down clothes and toys for your kids from family and friends.
16. Meet friends for coffee instead of dinner.
17. Request to get interest on the security deposit for your apartment.
18. Take a shorter shower.
19. Write letters instead of calling.
20. Brown bag your lunch.
21. Make your own baby food.
22. Use public transportation.
23. Drop duplicate medical insurance.
24. Buy old furniture at yard sales and refinish it yourself.
25. Apply for scholarships and financial aid.
26. Exercise for free - walk, jog, bike, or get exercise videos from the library.
27. Form a baby-sitting cooperative with friends and neighbors.
28. Buy your clothes off season.

## 101 Ways To Save Money

29. Go to a matinee instead of an evening show.
30. Share housing with a friend or family member.
31. Hang clothes out to dry.
32. Do not use your calling card.
33. Volunteer two hours a month for reduced cost food through the Share Program (800-499-2506).
34. Change the oil in your car yourself regularly.
35. Get pre-approval from your medical insurance company before undergoing any procedures or tests.
36. Buy "no frills" vitamins.
37. Take a date for a walk along the beach or in the woods.
38. Make cards and gifts for friends.
39. Shop in thrift stores.
40. Have the water company do an audit so you are not charged sewage fees for water used in your garden.
41. Refinance your mortgage.
42. Grocery shop on double coupon days.
43. Trade down your car for a less expensive, lower maintenance one.
44. Convert your cash value life insurance to term.
45. Shop around for eyeglasses.
46. Don't be shy about pulling something you like out of the trash.
47. Recycle.
48. Move to a less expensive place to live.
49. Use low flush toilets or water saving devices in the tank.
50. Drop unneeded telephone services like call forwarding or caller ID.
51. Buy fruits and vegetables in season.
52. Avoid using your ATM card at machines that charge a fee.
53. Bicycle to work.
54. Shop around for auto insurance discounts for multiple drivers, seniors, good driving records, etc.
55. Ask your doctor for samples of prescriptions.
56. Borrow a dress for a big night out, or go to a

- consignment shop.
57. When you buy a home, negotiate the sales price and closing costs.
  58. Turn the hot water heater down and wrap it with insulation.
  59. Never grocery shop hungry.
  60. If you qualify, file for Earned Income Credit on your taxes.
  61. Shop around for prescriptions including mail order companies (Medi-Mail 800-331-1458, Action Mail Order Drugs 800-452-1976, and AARP 800-456-2277).
  62. If you pay for childcare, make use of the dependent care tax credit or your employer's dependent care flexible spending account.
  63. Buy, sell, and trade clothes at consignment shops.
  64. Shop around for the lowest banking fees.
  65. Caulk windows and doors.
  66. Iron your own shirts.
  67. Plan your weekly food menu before shopping.
  68. Buy a good used car instead of a new model car.
  69. Purchase all of your insurance from the same company to get a discount.
  70. Cut your cable television down to basic.
  71. Go to an optometrist for routine vision tests or to change an eyeglass prescription.
  72. Buy pre-owned toys and children's books at garage sales.
  73. Have potluck dinners with friends and family instead of going out.
  74. Use the library for books, video tapes, and music.
  75. Inspect clothing carefully before purchasing it.
  76. Don't use your dishwasher dry cycle; open the door and let them air dry all night.
  77. At the grocery store, comparison shop by looking at the unit price.
  78. Make your own coffee.
  79. Use old newspapers for cat litter.
  80. Shop at discount clothing stores.
  81. Skip annual full mouth X-rays unless there is a problem; the ADA recommends X-rays every 3 years.
  82. Water your garden at night or early in the morning.
  83. Shop around for long distance rates.
  84. Hand wash instead of dry cleaning.
  85. Grow your own vegetables and herbs.
  86. Shop around for auto financing.
  87. Donate time instead of money to religious organizations and charities.
  88. If you are leaving a room for more than five minutes, turn off the light.
  89. Shop at auctions or pawn shops for jewelry and antiques.
  90. Keep your car properly tuned.
  91. Request lower interest rates from your creditors.
  92. Trade in old books, records, and CDs at book and record exchanges.
  93. Pay bills the day they arrive; many credit card companies charge interest based on your average daily balance.
  94. Buy software at computer fairs.
  95. Search the internet for freebies.
  96. Compost to make your own fertilizer.
  97. If your car has very little value, you probably only need liability insurance.
  98. Cut the kids hair yourself
  99. Increase your insurance deductible.
  100. Buy in bulk food warehouses.
  101. If your income is low, contact utility companies about reduced rates.



For more information on BALANCE services, please contact NEAS at 1-877-464-4009, or log onto [www.neas.com](http://www.neas.com) (password: 1NWA).



May 12, 2006

Subject: Flight Attendant Tentative Agreement

Dear Flight Attendants:

As you know, the Company reached a Tentative Agreement with the PFAA on March 1, 2006, as part of its ongoing labor cost restructuring process and voting on that agreement is now underway.

Since the announcement and distribution of the TA, the Company has received hundreds of questions regarding its contents. While each Flight Attendant must decide how s/he will vote, it is important that accurate information is provided to aid in that decision-making process. As a result, the Company is taking the following actions:

- This communication briefly addresses the contents of the TA, and the ramifications should it fail.
- An email address ([TAQA@NWA.COM](mailto:TAQA@NWA.COM)) has been established for your use. Please send any questions you have regarding the proposed agreement to this address.

Questions and the answers will be communicated via CENTRY and posted to ATLAS frequently throughout the voting period. Persons submitting questions will not be identified.

While nobody welcomes wage and benefit reductions, the Company's position is different today from any point in history. We are operating in bankruptcy, and the Company's survival depends on successful restructuring. Reducing labor costs is one component of the broader restructuring plan. To date, each of our unions as well as our salaried employees has done its part to secure the future of the airline by reaching agreements that provide the necessary savings targeted as part of an overall labor cost reduction of \$1.4 billion. The implementation of each of these deals is contingent upon each of the others; if one group fails to provide the required savings, the Company cannot proceed with implementation of any of the agreements. Therefore, with ratified agreements with ALPA, IAM/COFPS, ATSA, NAMA and TWU, and a hearing on the motion to reject the IAM/ESSC Agreement scheduled for May 15, it is increasingly imperative that Flight Attendant savings be achieved now.

While providing \$195 million in annual savings, the pending Flight Attendant agreement will:

- a. Preserve international flying for PFAA-represented Flight Attendants and avoid approximately 800 additional furloughs otherwise required by the redirection of this flying to Foreign National Flight Attendants.
- b. Provide an Early Out/Severance Program for a minimum of 1200 Flight Attendants who elect to separate from employment with payouts up to \$27,000.
- c. Allow Flight Attendants wishing to offset wage reductions via increased flying to do so through implementation of a higher monthly maximum (80 – 100 hours per month, with an 87 hour line average), and by increasing Reserve guarantee from 75–80 hours per month. Further information regarding the actual impact on base pay will be posted on ATLAS.

Page 2

- d. Allow more productive flying, due to the elimination of the 8-in-24 domestic duty restriction, and the expansion of 30-in-7 to 35-in-7 domestically. High value turns will be increased, and high density turns will be added, increasing flexibility and allowing Flight Attendants to complete monthly flying requirements in the fewest days possible.
- e. Provide those Flight Attendants who are involuntarily furloughed with a preferential right of hire at Compass Airlines (Northwest's new regional subsidiary) without requiring them to relinquish recall rights to NWA.
- f. Maximize the potential to avoid termination of the Flight Attendant Defined Benefit (DB) Pension Plan. This would be accomplished by freezing the DB Plan and replacing it with a Defined Contribution (DC) Plan that would be amongst the most generous in the airline industry. The DC Plan would also deliver higher (enhanced) benefits to Flight Attendants should DB Plan termination become unavoidable.
- g. Provide Flight Attendants with a comprehensive, company-wide medical plan administered by Blue Cross/Blue Shield.
- h. Maintain significant protections for Flight Attendants in the event of a subsequent merger.

Conversely, if this TA fails to ratify, the Company does not have the luxury of returning to the bargaining table for Round 2. The implementation of labor cost reductions must begin immediately. Northwest will seek to implement terms and conditions that:

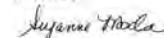
- a. Do not include an Early Out or Severance Program.
- b. Assign 30% of international flying to Foreign National Flight Attendants.
- c. Require additional furloughs of PFAA-represented Flight Attendants beginning in July 2006.
- d. Reduce or eliminate labor protective provisions associated with mergers.
- e. Eliminate the "me too" clauses that provide certain rights to Flight Attendants should other groups receive more favorable treatment in specific areas (i.e., pension, distribution of equity or claims in lieu of equity, etc.).

A perception has been publicly communicated that Flight Attendants are hopeful for a quick return to the bargaining table – potentially with a different bargaining representative – and an improved offer. Those hopes, if they exist, are misplaced. The Company recognizes and respects the right of our Flight Attendants to select their representatives. Representation in no way affects the undeniable fact that the Company requires and must promptly obtain, through a consensual agreement or imposed terms, \$195 million in annual savings from its Flight Attendants.

While these facts may be unwelcome, they are true. The decision facing our Flight Attendants today is the most important decision you have collectively faced. It is important that you have complete and accurate information as you carefully consider the alternatives. Please use the e-mail address above to ensure that all of your individual questions are answered.

In closing, we do recognize and appreciate deeply the economic sacrifices you and your families have already made, and those we are asking of you now. You have done a phenomenal job of continuing to serve our customers with grace and dignity in these very difficult times.

Sincerely,

  
Suzanne Boda



**Congress of the United States**

Washington, DC 20515

November 17, 2005

Mr. Doug Steenland  
President and Chief Executive Officer  
Northwest Airlines  
2700 Lone Oak Parkway  
Department A1030  
Eagan, Minnesota 55121

Dear Mr. Steenland:

We write to express concern regarding recent reports of Northwest Airlines' proposal to outsource the vast majority of flight attendant positions on international flights with foreign nationals. While we understand that Northwest must make hard financial decisions to emerge from bankruptcy, we strongly urge you to reconsider outsourcing these U.S.-based, safety critical flight attendant jobs to non-U.S. citizens.

Implementation of this proposal would mean the loss of approximately 2,600 U.S.-based flight attendant jobs with union-negotiated protections and benefits. In addition to the impact these lay-offs would have on families and communities across the country, we are concerned about the potential impact on the overall safety and security of the U.S. passenger aviation system. In a post-September 11th era, it is of the utmost importance that any foreign nationals hired are properly subjected to meaningful security and background checks, consistent with the background checks of all U.S. flight attendants. We also have concerns that this proposal could hinder effective communication and coordination between the in-flight cabin and cockpit and with passengers in a serious in-flight emergency.

Again, we strongly encourage you to reconsider Northwest's proposal to outsource U.S.-based flight attendant jobs with foreign nationals.

Sincerely,

  
CAROLYN B. MALONEY  
Member of Congress

  
JIM RAMSTAD  
Member of Congress

Carolyn McCauley

Ed Cox

John Smith

Joe Brown

Shelley Berkeley

Joe Arnold

Ken Kline

Melissa L. Bean

Stephen Tucker Jones

Betsy McCallum

Donna

Priz. mail

John F. Tierney

MS Simmons

Joe R. Way

Mike H. Michael

Mit Dyer

Ginny Brown-Waiter

Frank Pullum Jr.

Jim Mayhew

Jim M. Bennett

John A. Baker

Tif Z.

Leann L. Basney

<u>Debbie Wasserman Schultz</u>	<u>Sam Farr</u>
<u>Neil Abernethy</u>	<u>Raul M. Grijalva</u>
<u>Michelle Lujan</u>	<u>Emanuel Leizaola</u>
<u>Dennis J. Kucinich</u>	<u>Linda L. Adles</u>
<u>Barbara Lee</u>	<u>John Lomayago</u>
<u>Jane Harman</u>	<u>Bill Pascrell Jr</u>
<u>Ed Pastor</u>	<u>Marcy Kaptur</u>
<u>Alfred A. Hotijz</u>	<u>Paul Syack</u>
<u>Bart Gordon</u>	<u>John Loe</u>
<u>George Miller</u>	<u>Al Robell</u>
<u>Carl Saul</u>	<u>Robert Drenth</u>
<u>Jim Moran</u>	<u>Rosa L. G. Loe</u>

~~1002. 1002~~

John E. Gildee

~~Howe~~

Tom Allen

Peter Hitzig

Morton D. Shaw

Shirley Brown

Lucille Roper-Allard

Charles B. Rangel

John Barner

Charles H. Johnson

Tim Ryan

Ernie L. Enge

Edward J. Murphy

John Daini

~~Thurston~~

Ray L. Allen

Arnold Nadler

John W. McHugh

~~John A. Glick~~

Vicki Zarnon

Stephen Lynch

Bob A. Brady

John Lewis

<u>Jim Davis</u>	<u>Brian Hester</u>
<u>Julie Carson</u>	<u>Danny K. Davis</u>
<u>Lynn Woolsey</u>	<u>Tim Hobbs</u>
<u>Carine Brown</u>	<u>Steve Israel</u>
<u>Tom Tancredi</u>	<u>Daniel Lipinski</u>
<u>Robert Wyle</u>	<u>RF Rze</u>
<u>Barbara Amato</u>	_____
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Mr. COHEN. Our fifth witness is Mr. Thomas Conway. Mr. Conway was appointed International Vice President of the Steelworkers in 2005 and elected to a full term in office a year later. He became an activist in the Steelworkers soon after he was hired in the Burns Harbor Works at Bethlehem Steel in 1978. While working as a millwright in a coke plant, he served as a grievor for the plant-wide maintenance group and was a member of the Safety and Contracting-Out Committees.

Appointed as a United Steelworkers staff rep in 1987 and assigned to Indiana's former District 31. Appointed secretary of the basic industry conference, Steel Industry Conference in 1995. Was responsible as a court of appeal mobilization of the Steelworkers stand-up for steel campaigns and related trade and legislative efforts at the Federal and State levels.

Mr. Conway, would you proceed with your testimony.

**TESTIMONY OF THOMAS CONWAY,  
UNITED STEEL WORKERS OF AMERICA**

Mr. CONWAY. Thank you Mr. Chairman. I appreciate the opportunity to be here. Our members in the Steelworkers work nearly every segment of manufacturing, not only steel but paper, forestry, rubber, energy, mining, automotive parts and chemicals. And while we think back over the last decade, we think of 40 steel companies who have gone into bankruptcy, many as a result of great over-global capacity in the steel markets, followed by a rash of unfair trade issues. The human dimensions of that were vast. The PBGC terminated some 240,000 steelworker pensions and retirees; 200,000 retirees and surviving spouses lost their health insurance they counted on, while the steel industry recovered substantially due to both tariffs and sacrifices made by our members. This onslaught goes on now, both in our other industries aluminum and steel, glass, iron, paper, every manufacturing sector is facing these issues.

The last major reforms to the Bankruptcy Code that focused on worker interests were in the 1980's and were designed to provide a balance between an employer with a proven distress to obtain necessary leave from their labor agreement; and we believe Congress always intended this imbalance to be in place. But the experience of the last 25 years illustrates the balance has been upset dramatically, and courts regularly grant employer requests for relief under a standard we believe Congress had not intended.

Congress should first now seek to restore that balance, give stronger recognition to the role, the important role of collective bargaining; include demanding that fulsome bargaining occurs before a debtor asks the court to intervene; define more narrowly the meaning of the term "necessary to reorganization," and put meaningful limits on the length of proposed concessions within there.

Secondly, the reform should assign a higher priority to the payment of employee retiree obligations, allowing them to be paid before the claims of other creditors who are typically more able to absorb those losses. Among those other creditors with greater financial reserves are highly compensated executives, lawyers, and investment bankers who gather around these travesties.

Third, the reforms should explicitly inscribe the principles of shared sacrifice, meaning executives should not be allowed to improve their own salaries and benefits while workers and retirees are forced to sacrifice their quality of life. Courts should ask the executives have they first made those sacrifices themselves before exposing workers and retirees.

Linked to this principle is the need to rein in so-called incentive plans which are designed for executives by compensation firms, retained by those same executives, and shower them with new and

oftentimes lavish benefits for results that may have nothing to do with the ultimate success or reorganization.

The unions are not the only ones expressing a concern about this. Recently, in the Southern District of New York, in the Ventura Corporation, the judge recognized that there is this ever-going compensation arms race that is going on. And by acting now, Congress can put an end to this arms race by forcing debtors to justify the fairness of the efforts to increase managing compensation through the guise of all these incentive programs and retention programs.

Fourth, bankruptcy reform must also take into account the impacts of sales and liquidations upon workers and retirees. Congress should clarify that a judge may, in reviewing the sale or auction of a company's assets, favor a purchaser that plans to retain jobs and benefits over a purchaser that would simply liquidate assets.

And as borne out in numerous recent cases, the need for sale-related protections has risen. We have observed with greater frequency, cases in which a company secured lenders which appear to be unwilling in the current climate to extend long-term financing needed for these companies to allow—they pressure the companies to sell the assets quickly. In some instances, the lenders themselves can serve as the buyer. In too many of these cases, the bankruptcy case appears to be run for the exclusive benefit of the lenders and to the detriment of all other credit groups. Congress must act to protect the interests of workers and retirees in those types of transactions.

Long after the banks have been paid, the hedge fund investors have moved on on the next deal. The so-called workout turnaround experts have jetted off to their next assignment, and workers and retirees who depended on this company will remain. This is an opportunity for Congress to put rebalance back into the Bankruptcy Act, to allow workers and retirees a place at the table during these transactions that they deserve.

And I look forward to answering any of your questions. Thank you.

Mr. COHEN. Thank you, sir. I appreciate it, Mr. Conway.  
[The prepared statement of Mr. Conway follows:]

PREPARED STATEMENT OF THOMAS CONWAY



**TESTIMONY OF THOMAS CONWAY  
INTERNATIONAL VICE PRESIDENT (ADMINISTRATION)  
UNITED STEELWORKERS**

**BEFORE THE**

**U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON THE JUDICIARY  
SUBCOMMITTEE ON COMMERCIAL  
AND ADMINISTRATIVE LAW**

**ON**

**H.R. 4677  
PROTECTING EMPLOYEES AND RETIREES  
IN BUSINESS BANKRUPTCIES ACT OF 2010**

**MAY 25, 2010**



I am Thomas Conway, International Vice President (Administration) of the United Steelworkers (USW). Our members are found in nearly every segment of manufacturing, not only steel, but paper, forestry, rubber, energy, mining, automotive parts, and chemicals, as well as health care, service and public employment. On behalf of International President Leo Gerard and our 850,000 members, I appreciate the opportunity to appear before this Subcommittee.

Nearly two and a half years ago, my colleague, International Vice President Fred Redmond appeared before this Subcommittee in connection with bankruptcy reform legislation introduced in the last Congress. Today, as this recession enters its second year, it is all too clear that sensible bankruptcy reform, which elevates the preservation of good paying jobs to a rightful place and treats workers and retirees more fairly, is now more necessary than ever.

Our members in nearly all of our key jurisdictions have suffered through bankruptcy cases. The steel industry, of course, has historically been our major jurisdiction. Last decade, more than 40 steelmakers, including many of our largest steel industry employers, filed bankruptcy cases, mainly as a result of great overcapacity in the world steel industry followed by unfair imports from America's trading partners. The human dimensions were vast. While some companies reorganized or were sold, others simply liquidated. The Pension Benefit Guaranty Corporation terminated pension plans covering nearly 240,000 steelworkers and retirees. And, nearly 200,000 retirees and surviving spouses lost retiree health insurance coverage.

The steel industry recovered substantially, as a result of both the tariffs imposed in March 2002 and the sacrifices made by our members to restructure the industry. However, the consolidation of the steel industry did not come without a price.

Beyond steel, in such industries as aluminum, iron ore, glass, paper and automotive parts, USW members and retirees have also faced devastating corporate bankruptcies. Every day, our bargainers wrestle with enormous challenges and do so within a system that is stacked against the interests of workers and retirees.

The last major reforms to the Bankruptcy Code that focused on worker and retiree interests were enacted in the 1980s, and the United Steelworkers was central in those deliberations. Addressing the right of a reorganizing company to reject a negotiated labor agreement, the legislation passed in the 1980's sought to balance collective bargaining rights against the need of an employer with proven distress to obtain necessary and limited relief. We believe Congress always intended this balance to allow a reorganizing company to reject a labor agreement only after full and earnest bargaining had failed and, even then, only when necessary to avoid liquidation.

But the experience of the last 25 years illustrates that this balance has been upset. The courts regularly grant employer requests for relief under a more lax standard than we believe Congress had intended. Further, employers now push aggressively for changes to labor and pension and retiree insurance agreements,

often as a first shot rather than a last resort. The use of the Bankruptcy Code as a weapon to attack worker and retiree interests calls out for meaningful reform.

First, Congress should seek to restore the balance, giving stronger recognition to the important role of collective bargaining and limiting the right of employers to violate labor agreements, which is after all what rejection really amounts to. This would include demanding that fulsome bargaining occurs before a debtor asks the Court to intervene, defining more narrowly the meaning of the term “necessary to reorganization” so as to force employers to clear a higher bar, and placing meaningful limits on the length of proposed concessions.

Second, reform should assign higher priority to the payment of employee and retiree obligations, allowing them to be paid before the claims of other creditors who are typically more able to absorb losses than is an individual worker and his or her family. Among the other creditors with greater financial reserves are highly-compensated executives, lawyers and investment bankers.

Third, reform should explicitly enshrine the principle of shared sacrifice, meaning that executives should not be allowed to improve their own salaries and benefits while workers and retirees are forced to sacrifice their quality of life. Courts should ask whether executives have first made sacrifices themselves before exposing workers and retirees to losses. Linked to this principle is the need to rein in so-called “incentive plans,” which are designed for executives by compensation firms retained by those same executives, and which shower

executives with new and, oftentimes, lavish benefits for results that may have little to do with the ultimate success of reorganization.

Unions are not the only one to express a concern about the ever-growing problems created by management incentive plans and other compensation schemes. Recently, in considering a management incentive plan proposed by a debtor (and objected to by the United Steelworkers), a bankruptcy judge in the Southern District of New York in the Chemtura Corporation Chapter 11 case observed:

"I'll look to the debtors and debtors' counsel in the future, if any of them read the transcript of this ruling, to present me and other judges with a way to break out of this compensation arms race on motions like this one and in other areas, such as approval of employment contract where we're asked to bless compensation arrangements at ever-increasing levels."

By acting now, Congress can put an end to the "compensation arms race" by forcing debtors to justify the fairness of their efforts to increase management compensation through the guise of "incentive" programs.

Fourth, bankruptcy reform also must take into account the impact of sales and liquidations upon workers and retirees. Congress should clarify that a bankruptcy judge may, in reviewing the sale or auction of a company's assets, favor a purchaser that plans to retain jobs and benefits over a buyer that would simply liquidate assets.

As borne out in numerous recent cases, the need for sale-related protections has risen. We have observed, with greater frequency, cases in which a

company's secured lenders, which appear to be unwilling in the current climate to extend the long-term financing needed to allow a company adequate time to explore reorganization options, pressure companies to sell assets quickly. In some instances, the lenders themselves serve as the buyer. In too many of these cases, the bankruptcy case appears to be run for the exclusive benefit of the lenders and to the detriment of all other creditor groups. Congress can and must act to protect the interests of workers and retirees in these transactions.

The current reform efforts are based upon what most Americans would see as an unimpeachable premise – that in a statutory scheme which exists to allow companies to reorganize, the preservation of jobs and benefits should be a paramount interest. The real long-term stakeholders in a company are its employees and retirees and the communities in which it operates. Long after the banks have been paid, the hedge fund investors have moved on to the next deal, and the so-called turnaround experts have jetted off to their next assignment, the workers and retirees who depend upon the company will remain.

At the Steelworkers, we have long tried to bargain with that basic reality in mind. We know that in some cases, unavoidably, in the interest of securing a long-term future, our members are called upon to modify their labor agreements and forego benefits that, in many instances, they have expected to receive throughout their working life. We also know that a Chapter 11 bankruptcy case is a highly imperfect place to combat the problems caused by areas of economic and social policy, such as three decades of deregulation, trade policies which

disfavor American manufacturing, and a health care system which has long placed American industry at a disadvantage compared to its competitors.

No one is ever objectively happy about confronting these problems, but we also take seriously our responsibility on behalf of our members. Our basic point – and the point which informs the bill pending before Congress – is that the playing field in bargaining should be leveled, that American workers and retirees should not be forced to sacrifice when other stakeholders are spared, and that the U. S. bankruptcy laws should take into account the important social interests of protecting American workers and promoting collective bargaining as a resolution for disputes. Companies still will be able to reorganize, whether on their own or through a sale of the business. The bill before Congress simply would require companies to give greater consideration to the interests of workers and retirees. For all of these reasons, we urge Congress to act quickly on bankruptcy reform.

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Mr. COHEN. The next witness is Mr. Michael Bernstein, a partner at Arnold & Porter, representing secured and unsecured creditors, creditors committees, bondholders, investors, assets pur-

chasers, debtors and other parties in a wide variety of bankruptcy and workout matters and related litigations throughout the U.S.

He has been involved in large bankruptcy cases including US Airways, TWA, Adelphia and Continental Airlines, as well as many other such cases throughout the United States.

He has coauthored two books, published many articles on bankruptcy-related topics and also testified previously before Congress as an independent expert on the status of collective bargaining agreements and retiree pensions and benefits in bankruptcy. Mr. Bernstein, please.

**TESTIMONY OF MICHAEL L. BERNSTEIN,  
ARNOLD & PORTER LLP**

Mr. BERNSTEIN. Thank you, Mr. Franks and Members of the Subcommittee. I appreciate your inviting me to testify at your hearing today. I am a partner in the law firm of Arnold & Porter LLP and chair of the firm's National Bankruptcy and Corporate Restructuring practice; however, I am here testifying today in my individual capacity and not on behalf of my law firm or any of its clients.

Chapter 11 is intended primarily to enable a financially troubled business to restructure its obligations so that it is able to emerge as a viable, going concern. A debtor that achieves this objective benefits its creditors, suppliers, customers, employees, local communities and other constituencies.

H.R. 4677 would modify many provisions of the Bankruptcy Code. Some of these modifications are difficult or impossible to reconcile with the fundamental goals of Chapter 11 and would be likely to impair the ability of debtors to reorganize.

I will make five points in this regard. First, the bill would increase the cost of Chapter 11 reorganizations, including by creating substantial new administrative and priority expenses. Debtors that are unable to pay such expenses would be forced to liquidate.

Second, the legislation would create additional hurdles for a business that needs to modify its labor and retiree cost structure in order to remain viable. It would do so in several ways.

First, it would raise the already very stringent legal standard for obtaining relief.

Second, it would effectively preclude labor cost modifications where a debtor is paying incentive-based compensation to its managerial employees, even if the Bankruptcy Court has found that such compensation is necessary and appropriate.

Third, it would slow down the 1113 process and thereby in most cases slow down the entire reorganization.

Fourth, it would reduce the likelihood of negotiated resolutions, resulting in more litigation, which is contrary to the stated intention of Congress when 1113 was enacted. And even after the labor issues are resolved, whether by settlement or court decision, the bill would permit the union an unlimited opportunity to relitigate the same issues.

Finally, the bill would limit modification proposals to the bare minimum necessary to enable the company to exit bankruptcy and survive for a short time. This would discourage new investment in

reorganizing debtors and make repeat bankruptcy filings more likely.

The bill would also prohibit creditors and other interested parties from even participating in the section 1113 hearing, so the court would be unable to hear their views, even though the outcome of the proceeding may have a profound impact on their recoveries.

Finally, the bill would threaten potential havoc for companies that seek 1113 relief. For example, it would give unions what they sometimes refer to as the “nuclear” option, allowing them to strike in retaliation for a debtor’s implementation of court-approved modifications, even where such a strike would destroy the company. And it would make the mere filing of an 1113 motion grounds for termination of exclusivity.

These provisions are obviously intended to create a disincentive for a company to seek modification of its labor costs. But they create an untenable situation for a company that legitimately needs that relief in order to be able to successfully reorganize. If these provisions are implemented, it is almost certain that some debtors who truly need to modify burdensome and above-market labor costs would be unable to do so.

Such companies are likely to be unable to attract new capital and, instead, would be forced into liquidation. This would be detrimental to all stakeholders, including the employees who lose their jobs in a liquidation.

Third, several of the proposed modifications would make it materially more difficult for Chapter 11 debtors to attract and retain qualified managerial employees. In order to retain and attract management talent, the debtor must be able to pay market-competitive wages and benefits to its management employees, including in many cases incentive-based compensation. This bill would make doing so much more difficult. It would thus make it easier for competitors to cherry-pick a debtor’s best management talent.

Several provisions in the bill would directly link the wages and benefits paid to managerial employees to the wages and benefits of hourly employees. While there may be a superficial appeal to such a linkage, it fails to take into account the economic reality that there are different labor markets for different types of employees.

Fourth, certain of the provisions would substitute inflexible one-size-fits-all rules for the judicial discretion that exists under current law. Because each company, each industry, and each Chapter 11 case is different, the reorganization goal of Chapter 11 is better served by allowing judges to make decisions in each case based on the evidence before them, rather than trying to create identical rules for every case without regard to the facts.

And, finally, by elevating the claims and rights of union employees, the bill would diminish the recoveries and rights of other constituencies. For example, the bill would create substantial new administrative priorities that must be paid in full before any other creditor gets anything at all. It would elevate certain equity interests held by employees to the level of debt. It would create new rejection damage claims that would dilute the recovery of other creditors. It would allow employees to assert pension plan termination claims that are duplicative of the PBGC’s claims. And it would ap-



pear to allow retirees greater rights in bankruptcy than they have outside of bankruptcy.

And where there are competing Chapter 11 plans, it would require the court to confirm the plan labor favors without regard to the interests of creditors or any other constituency.

Viewed in isolation, these new priorities, claims, and rights may not seem particularly problematic. However, in evaluating the extent to which they should be created, it is necessary to consider two points.

One, these administrative and priority claims must be paid in full for a debtor to reorganize; thus, the creation of these claims will make it more difficult for these companies to reorganize and emerge from bankruptcy.

And, finally, the new employee claims will leave less money for the holders of other claims. Thus, while it may be appealing to “say we are giving greater claims to employees,” it is important to keep in mind that by doing so you are diminishing the recovery of other creditors such as, for example, taxing authorities, trade vendors, customers or tort victims who are injured by a debtor’s products.

The rights of employees are important but they need to be balanced against the rights of other constituencies, and the debtor’s need to achieve a sustainable cost structure.

This bill elevates the rights of unions and employees to such a great degree that it would be damaging to the rights of other parties and to reorganization process.

Mr. COHEN. Thank you Mr. Bernstein.

[The prepared statement of Mr. Bernstein follows:]

PREPARED STATEMENT OF MICHAEL L. BERNSTEIN

Hearing on H.R. 4677, the “Protecting Employees and  
Retirees in Business Bankruptcies Act of 2010”

Before the Subcommittee on Commercial and  
Administrative Law

Statement of:

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May 25, 2010

**Prepared Statement of Michael L. Bernstein**

Mr. Chairman, Ranking Member, and members of the Subcommittee, thank you for inviting me to testify at your hearing on H.R. 4677, the “*Protecting Employees and Retirees in Business Bankruptcies Act of 2010*.” I am a partner in the law firm of Arnold & Porter LLP and chair of the firm’s national bankruptcy and corporate restructuring practice.<sup>1</sup> We represent debtors, creditors, committees, investors and other parties in a wide variety of bankruptcy and corporate restructuring matters. I have advised and represented debtors and other parties in connection with matters at the intersection of bankruptcy and labor law, and I have lectured on this subject, as well as on numerous other bankruptcy-related subjects. I am a Fellow of the American College of Bankruptcy and co-chair of the Labor and Employment Committee of the American Bankruptcy Institute. I have also written various books and articles. For example, I am co-author of *Bankruptcy in Practice* (4th ed. 2007), a comprehensive treatise on bankruptcy law and practice.

Chapter 11 of the Bankruptcy Code is intended to enable a financially troubled business to restructure its operations and obligations so that it is able to remain a going concern, and to emerge from bankruptcy as a viable and competitive enterprise.<sup>2</sup> A debtor that achieves this objective benefits its creditors, suppliers, customers, employees, local communities and other constituencies.

A successful reorganization ordinarily requires a debtor to achieve a competitive cost structure. This includes paying market-competitive wages and benefits to all employee groups,

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<sup>1</sup> The views expressed herein are solely those of the author, and do not necessarily represent the views of my firm or any of its clients.

<sup>2</sup> While reorganization is the primary objective of chapter 11, as discussed hereinafter chapter 11 also permits orderly liquidation. There are some cases in which reorganization is not possible, or in which a sale of the debtor’s assets will generate the greatest return to creditors.

from hourly workers to administrative and clerical employees, to mid-level management and senior executives.

Some labor union representatives have argued that current law -- and the way it is being interpreted by the courts -- imposes a disproportionate burden upon a debtor's employees and retirees. They seek legislative reform that would, among other things (1) give unions greater bargaining leverage in negotiations, (2) give union employees more and bigger claims in their employer's bankruptcy, and assign a higher priority to many types of employee claims, (3) make even more stringent the already very high burden on a debtor that seeks to modify its labor or retiree costs, and (4) largely eliminate bonuses, incentive compensation and similar payments to management employees, which they see as unfair in cases where union workers are being forced to make concessions.

While it is perhaps understandable that organized labor would like to see legislative change that increases its own bargaining leverage and gives its constituency a bigger share of the pie, many of the modifications in H.R. 4677 are difficult to reconcile with the fundamental goals of chapter 11, and would likely impair the ability of chapter 11 debtors to reorganize. This would in turn harm all stakeholders in the chapter 11 case, including employees and retirees, whose jobs and benefits depend on a successful reorganization and the emergence of a viable reorganized company.

There are a number of respects in which the bill would make chapter 11 reorganization more difficult to achieve. First, the bill would increase the already substantial cost and burden of chapter 11. It would do this in part by (i) creating new and potentially substantial claims, including priority claims; (ii) slowing down the § 1113 process; (iii) increasing the amount of §§ 1113 and 1114 litigation; (iv) requiring the debtor to pay the unions' professional fees; (v)

discouraging new investment in chapter 11 debtors; and (vi) potentially limiting the availability, and increasing the cost, of secured credit, including prepetition loans, debtor-in-possession financing and exit financing.

Second, the bill would create substantial additional hurdles for a business that needs to modify its labor and retiree cost structure in order to remain viable. If a chapter 11 debtor that needs to reduce above-market or otherwise unsustainable labor costs is precluded from doing so, it will likely be unable to attract new capital and unable to reorganize.

Third, the bill would make it materially more difficult for chapter 11 debtors to attract and retain talented management employees. Because of the substantial risks, burdens and uncertainties that typically come with managing a company in chapter 11, it has historically been a challenge for debtors to retain and attract management talent. Numerous debtors have suffered from management defections, as their competitors cherry-pick the best management employees. The 2005 modifications to the Bankruptcy Code, enacted as part of the *Bankruptcy Abuse and Prevention and Consumer Protection Act of 2005* (BAPCPA), compounded this problem by effectively precluding debtors from paying retention bonuses to management employees. These bonuses had previously been an important means to compensate management employees for the risk and uncertainty of working for a debtor, and incentivizing such employees to remain with the debtor even though they may have more attractive, and more stable, opportunities elsewhere. The additional proposed modifications in H.R. 4677 would make it much more difficult (and perhaps impossible) for debtors to pay other sorts of compensation, including incentive payments, to officers, management employees, and consultants. This would further exacerbate the difficulty debtors face in retaining management talent. Moreover, certain provisions in the bill would link the wages and benefits paid to managerial employees to the wages and benefits of

hourly employees. While there may be a superficial appeal to this linkage, it fails to take into account the different labor markets that exist for different types of employees. Simply put, a debtor must pay its hourly employees the going rate in the community in which it operates for employees with comparable skills and expertise. The same is true for all other employees, up to and including the most senior executives. Thus, while it may sound good to say "if labor suffers a ten percent pay cut, management employees should suffer the same pay cut," a more rational approach would be to say that: (i) each employee should be paid as close as possible to market-competitive wages and benefits, and (ii) the overall labor cost structure should not exceed what the company can afford to pay, in light of its financial circumstances.

Fourth, certain of the proposed provisions would substitute inflexible, one-size-fits-all rules for the judicial discretion that exists under current law. Because each company, each industry and each chapter 11 case is different, the reorganization goal of chapter 11 is better served by allowing judges to make decisions in each case, based on the evidence before them, rather than trying to create identical rules for every case, without regard to the facts.

Finally, as mentioned above, some of the proposed provisions would create potentially substantial new administrative and priority claims. Viewed in isolation, this may not seem particularly problematic. However, in evaluating the extent to which such priorities should be created, it is worthwhile to consider two factors. First, priority claims must be paid in full in order for a debtor to reorganize under a chapter 11 plan. Thus, the creation of new priority claims will make it more difficult -- and in some cases impossible -- for companies to reorganize. Second, priorities create "creditor versus creditor" issues more than "debtor versus creditor" issues. In other words, whenever you give priority to one type of claim, you are leaving less money for the holders of other types of claims. Thus, while it may be appealing to say "we are

giving a greater priority to employee claims," it is important to keep in mind that, by doing so, you are likely to be diminishing or possibly eliminating the recovery of other types of creditors, such as taxing authorities, trade vendors, customers, or tort victims.

I have outlined below certain provisions in the bill that I believe would make reorganization more difficult to achieve, increase the cost of chapter 11 proceedings, and/or otherwise be inconsistent with the objectives of chapter 11. This is not intended as a complete analysis of every provision of the bill, but instead an effort to highlight some of the provisions that I find most problematic.

**A. Title I: These Sections of the Bill Would Increase Priority Claims, Reducing the Recovery of Other Creditors and Forcing Some Debtors to Liquidate**

Sections 101-105 of the bill would, among other things, increase the existing wage priority, create a new type of claim (available to some but not all employees) for lost value of stock in a defined contribution plan, and create new types of administrative expense obligations, including for severance pay and for WARN Act damages. Some of these new claims and administrative expenses could be very substantial -- diminishing or eliminating the recoveries of other creditors. And in the case of the administrative expenses, they would have to be paid in full in order for a debtor to confirm a plan of reorganization and emerge from bankruptcy.

Section 101 of the bill would amend § 507 to increase the wage priority.<sup>3</sup> Specifically, it would (i) amend § 507(a)(4) to increase the amount of the wage priority to \$20,000, (ii) amend

<sup>3</sup> Section 507 of the Bankruptcy Code provides for priority payment status of certain types of claims. It currently gives employees a fourth level priority claim up to \$11,725 for wages, salaries or commissions, including vacation, severance and sick leave pay, earned within 180 days of the bankruptcy filing (or the date of the cessation of business, if earlier) and provides a fifth level priority claim for contributions to an employee benefit plan arising from services rendered within 180 days of the bankruptcy filing (or the date of the cessation of business, if earlier) up to \$11,725 (less the aggregate amount paid to the employee pursuant to § 507(a)(4)).

§§ 507(a)(4) and 507(a)(5) to eliminate the requirement that the claim be earned within 180 days of the bankruptcy filing (or the date of the cessation of business), and (iii) amend § 507(a)(5) to increase the amount of the employee benefit plan priority to \$20,000 and to eliminate the provision that requires the claimant to subtract any amounts paid pursuant to § 507(a)(4).

Section 102 of the bill would amend the definition of “claim” set forth in § 101(5) of the Bankruptcy Code to include a right or interest in equity securities of the debtor, or an affiliate of the debtor, held in a defined contribution plan for the benefit of an individual who is neither an insider of the debtor nor one of the twenty most highly compensated employees of the debtor, where the employer or plan sponsor who commenced bankruptcy has committed fraud with respect to the plan or otherwise breached a duty to the participant that proximately caused the loss of value. This section of the bill would elevate employees’ equity interests to the status of debt obligations, or claims. It is not clear how this section of the bill would work in conjunction with § 510(b) of the Bankruptcy Code. Section 510(b) subordinates securities fraud and similar claims. To the extent such claims relate to common stock, they are afforded the priority of common stock, rather than debt. To the extent § 102 is creating a claim, which would then be subordinated to all other claims and treated as an equity interest, the provision would accomplish nothing. On the other hand, if § 102 of the bill is intended to create a claim that is outside of the scope of § 510(b), it could potentially be an enormous claim, diminishing the recoveries of other creditors.<sup>4</sup> The interplay between this section of the bill and § 510(b) would also likely cause significant litigation and create uncertainty.

<sup>4</sup> The new “claim” created by § 102 would not apply to insiders, senior executive officers (a term that is not defined in the bill), or “any of the 20 next most highly compensated employees of the debtor . . . .” The use of “the 20 next most highly compensated employees,” which also appears elsewhere in the bill, is arbitrary. In some cases, it would not capture the entire “top tier” of employees; in other cases it would be over-inclusive, covering employees who have no management role and including union as well as non-

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Section 103 of the bill would add a new administrative expense for severance pay owed to employees of the debtor, under a plan, program or policy generally applicable to employees of the debtor, or pursuant to a collective bargaining agreement, for termination or layoff after the petition date.<sup>5</sup> The Second Circuit has held that severance claims arising from postpetition terminations are entitled to administrative expense priority, and this amendment would be consistent with those decisions.<sup>6</sup> However, most courts have allocated such severance claims between the prepetition and postpetition periods, which typically results in only a small part of the claim being entitled to administrative expense treatment.<sup>7</sup>

The “allocation” approach is more consistent with the fundamental bankruptcy law notion that administrative expense priority is afforded to a claimant only to the extent that the debtor received postpetition value from the claimant. For example, if an employee worked 15 years prior to the bankruptcy filing and three months after the bankruptcy filing, and upon termination is entitled to a severance payment, it is difficult to argue that the consideration received by the debtor for that payment -- the employee’s services -- was received postpetition.

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union employees. See *infra* pg. 17 (discussing § 201 of the bill) and pg. 34-44, n.38 (discussing §§ 301 and 302 of the bill). Such one-size-fits-all rules tend not to work well in bankruptcy.

<sup>5</sup> The administrative expense for severance pay would not apply to insiders, senior management, or consultants retained to provide services to the debtor, or to severance claims under individual employment contracts.

<sup>6</sup> See, e.g., *In re W.T. Grant Co.*, 620 F.2d 319 (2d Cir.1980); *Straus-Duparquet, Inc. v. Local Union No. 3 Int'l. Bhd. of Elec. Workers, A F of L, CIO*, 386 F.2d 649, 651 (2d Cir. 1967) (“After the period of eligibility is served, the full severance pay is due whenever termination of employment occurs.”).

<sup>7</sup> See, e.g., Daniel A. Austin, *Payment of Pre-Petition and Post-Petition Employee Severance Benefits*, 22 AM. BANKR. INST. J. 1, 45 (Mar. 2003) (“The majority rule is that only the portion of the severance pay claim that can be apportioned to post-petition service may be afforded priority treatment as an administrative expense.”); *In re Mammoth Mart*, 536 F.2d 950, 955 (1st Cir. 1976) (“whether a claim for severance pay . . . will be entitled to . . . priority will depend upon the extent to which the consideration supporting the claim was supplied during the reorganization”); *In re Public Ledger*, 161 F.2d 762, 771-73 (3d Cir. 1947).

Instead, a small part of the consideration was received postpetition, but most of the consideration was received prepetition because most of the services were provided prepetition. The "allocation" theory is thus more consistent with the premise of administrative expense priority.

The "allocation" theory also avoids unfair discrimination among employees based upon their date of termination. For example, assume that a debtor has two 20-year employees, each of whom is entitled to a \$50,000 severance payment upon termination. The first employee is terminated a week before the bankruptcy filing and the second employee a week after the bankruptcy filing. Under § 103 of the bill, the two would be treated very differently -- the first might get only cents on the dollar, while the second would be paid in full.

Section 103 of the bill would also encourage debtors to terminate employees who are entitled to severance payments prior to the bankruptcy filing if there is a chance that they might have to terminate these employees, in order to avoid making the entire severance claim an administrative expense. A policy that allows the debtor to keep such employees working, without penalizing the debtor to such a great degree if it eventually has to terminate the employee during the bankruptcy case, would be a more sound policy, both from the debtor's and the employee's perspective.

Finally, as I have discussed elsewhere in my testimony, creating new administrative expenses makes reorganization more difficult -- since all such expenses must be paid in full on the effective date of any plan of reorganization -- and also effectively subordinates other claims, in a situation where there is not sufficient value to pay all creditors in full.

Section 105 of the bill would create a new administrative expense claim for WARN Act damages. In BAPCPA, a new administrative priority was created for:

wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay

attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title

11 U.S.C. § 503(b)(1)(A)(ii).

This bill would broaden the scope of the administrative expense so that it would include WARN Act damages that arise out of a pre-bankruptcy plant closure and termination of employees. It would thus reverse court decisions holding that Bankruptcy Code § 503(b)(1)(A)(ii) does not afford administrative expense priority to WARN Act damages arising from a pre-bankruptcy termination. See *In re Continentalafa Dispensing Co.*, 403 B.R. 653 (Bankr. E.D. Mo. 2009); *In re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008); *In re Powermate Holding Corp.*, 2008 WL 4595199 (Bankr. D. Del. 2008).

Under the WARN Act, certain employees are entitled to at least 60 days' notice of a potential termination. When an employer that falls within the statute fails to give such notice, the affected employees are entitled to back pay and benefits for up to 60 days.<sup>8</sup> Under existing law, WARN Act damages arising from a pre-bankruptcy termination are entitled to the statutory wage priority up to \$11,725 per employee, for wages earned within 180 days prior to the earlier of the bankruptcy filing or cessation of the debtor's business, and are a general unsecured claim to the extent they fall outside the scope of this priority (either because of timing or amount).

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<sup>8</sup> There are various statutory and common law defenses to WARN Act claims.

While the language is less than perfectly clear, it appears that § 105 of the bill would (1) grant administrative priority for WARN Act damages even if the termination occurred prepetition (and therefore no services were rendered during the bankruptcy case), and (2) make the entire 60 days of WARN damages an administrative expense if any of the 60 day period falls postpetition. Thus, for example, if employees were terminated without notice on day 1, and the bankruptcy case was filed on day 58, the entire 60 day WARN Act damages would constitute an administrative expense -- even though no services were rendered postpetition -- because two days of the 60 day period following termination occurred after the bankruptcy filing.

This is potentially problematic for several reasons. First, it is inconsistent with the fundamental bankruptcy law principal, discussed above, that an administrative expense is allowed only to the extent that the bankruptcy estate receives a postpetition benefit. In the prepetition employee termination context, the debtor receives no postpetition benefit for the WARN Act damage claim because no services are rendered to the debtor after the petition date.

Second, as noted above, administrative expense claims must be paid in full in order for a debtor to confirm a chapter 11 plan of reorganization. The creation of material new administrative expenses would make reorganization more difficult. Congress has already added to the administrative expense burden of chapter 11 debtors by enacting § 503(b)(9) of the Bankruptcy Code as part of BAPCPA, which created a new administrative expense for goods sold to a debtor in the ordinary course of business and delivered within 20 days before the petition date<sup>9</sup> (another exception to the principal that administrative expense priority should be

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<sup>9</sup> This created, in some cases, a significant additional administrative expense, thereby increasing the cost of chapter 11 reorganization. See, e.g., Prepared Statement of Richard M. Pulchulski for the *Hearing on Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?* before the House Judiciary Committee's Subcommittee on Commercial and Administrative Law on March 11, 2009 (discussing the

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limited to circumstances in which the debtor receives a postpetition benefit). While there are many types of claims that might be said to be "worthy" of priority treatment, it must be recognized that every time a new priority is created, it will cause some number of debtors to be unable to reorganize and emerge from bankruptcy because of an inability to pay the priority claims in full. That is not in any stakeholder's interest. Certainly, employees do not benefit when a business is forced to liquidate.

Third, as previously noted, the establishment of new administrative expenses, such as the proposed WARN Act administrative expense, creates creditor-versus-creditor issues. Whenever one type of claim is elevated in priority, other claims are effectively subordinated. Except in those relatively rare cases in which there is enough money to pay all claims in full, creating a new WARN Act administrative priority (and the other substantial employee priorities that are contemplated by this bill) will diminish -- and in some cases perhaps eliminate entirely -- the recovery of other creditors. This creates fairness issues -- for example, whether it is fair to increase the recovery of employees at the expense of tort victims injured by a debtor's products, customers who paid the debtor for goods or services but did not receive what they paid for, taxing authorities, or small businesses that sold goods to a debtor.

I believe these factors should be considered, and that they counsel in favor of caution in increasing or creating new administrative expense claims.

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implications of § 503(b)(9) in the Circuit City bankruptcy (and subsequent liquidation) and providing it was the "final death knell" for Circuit City).

**B. Title II: These Sections of the Bill Would Unduly Restrict a Debtor's Ability to Reduce Labor Costs**

*Sections 201 and 202: Rejection of Collective Bargaining Agreements and Payment of Insurance Benefits to Retired Employees*

Section 1113 of the Bankruptcy Code sets forth the requirements for a debtor to reject a collective bargaining agreement. Unlike other contracts, which can be rejected by a debtor if doing so is found to be a reasonable exercise of the debtor's business judgment, rejection of a collective bargaining agreement is evaluated using a considerably more stringent standard.<sup>10</sup> Based on the text of § 1113, courts have established a nine-part test to determine whether a collective bargaining agreement may be rejected:<sup>11</sup>

- (1) the debtor-in-possession must make a proposal to the union to modify the collective bargaining agreement;
- (2) the proposal must be based on the most complete and reliable information available at the time of the proposal;
- (3) the proposed modifications must be necessary to permit the reorganization of the debtor;
- (4) the proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably;
- (5) the debtor must provide to the union such relevant information as is necessary to evaluate the proposal;

<sup>10</sup> See *Comair, Inc. v. Air Line Pilots Ass'n, Int'l* (*In re Delta Air Lines, Inc.*), 359 B.R. 491, 498 (Bankr. S.D.N.Y. 2007) ("Congress enacted Section 1113 not to eliminate but to govern a debtor's power to reject executory collective bargaining agreements, and to substitute the elaborate set of subjective requirements in Section 1113(b) and (c) in place of the business judgment rule as the standard for adjudicating an objection to a debtor's motion to reject a collective bargaining agreement.").

<sup>11</sup> The test was initially articulated by the court in *In re Am. Provision Co.*, 44 B.R. 907, 908 (Bankr. D. Minn. 1984), and has subsequently been adopted by many other courts. See, e.g., *In re Family Snacks, Inc.*, 257 B.R. 384 (B.A.P. 8th Cir. 2001); *In re Nat'l Forge Co.*, 289 B.R. 803 (Bankr. W.D. Pa. 2003); see also *In re Bruno's Supermarkets, LLC*, 2009 WL 1148369, at \*4, n.13 (Bankr. N.D. Ala. Apr. 27, 2009) ("These [nine] elements are almost universally accepted as those that must be satisfied before a CBA may be rejected in a bankruptcy case"). Other courts have combined factors one, two, and five from the *American Provision* analysis, resulting in a seven-part analysis. See, e.g., *In re Carey Transp., Inc.*, 50 B.R. 203, 207 (Bankr. S.D.N.Y. 1985), *aff'd sub nom Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82 (2d Cir. 1987).

- (6) between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union;
- (7) at the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement;
- (8) the union must have refused to accept the proposal without good cause; and
- (9) the balance of the equities must clearly favor rejection of the collective bargaining agreement.

The debtor must satisfy *all nine* of these standards in order to obtain relief. There are many cases in which a debtor's request for relief under § 1113 has been denied.<sup>12</sup>

The additional and modified requirements in § 201 of the bill would make it more difficult for a debtor to modify or reject a collective bargaining agreement. For example, under existing law any proposed modifications to a collective bargaining agreement must be "necessary to permit the reorganization of the debtor." In *Truck Drivers Local 807 v. Carey Transportation Inc.*, 816 F.2d 82, 89–90 (2d Cir. 1987), the court concluded that "'necessary' should not be equated with 'essential' or bare minimum . . . [rather] the necessity requirement places on the

<sup>12</sup> See, e.g., *Teamsters Airline Div. v. Frontier Airlines, Inc.*, 2009 U.S. Dist. LEXIS 61699, at \*3 (S.D.N.Y. July 20, 2009) (District Court vacated and remanded Bankruptcy Court's approval of modification of CBA); *In re Bruno's Supermarkets, LLC*, slip op., 2009 WL 1148369 (Bankr. N.D. Ala. 2009) (union refused proposal "with good cause"); *In re Delta Air Lines (Comair)*, 342 B.R. 685 (Bankr. S.D.N.Y. 2006) (debtor failed to confer in good faith); *In re Nat'l Forge Co.*, 279 B.R. 493 (Bankr. W.D. Pa. 2002) (debtor did not meet its burden of proving that the proposed modifications were fair and equitable); *In re U.S. Truck Co.*, 165 L.R.R.M. (BNA) 2521 (Bankr. E.D. Mich. 2000) (debtor failed to meet its burdens of proving the proposal to be necessary, fair and equitable); *In re Jefley, Inc.*, 219 B.R. 88, 89 (Bankr. E.D. Pa. 1998) (court concluded "that the proposal, as presented, is not 'necessary' to the Debtor's reorganization; [and] does not treat the union workers 'fairly and equitably'"); *In re Liberty Cab & Limousine Co.*, 194 B.R. 770 (Bankr. E.D. Pa. 1996) (debtor's proposal was not fair and equitable); *In re Lady H Coal Co.*, 193 B.R. 233 (Bankr. S.D. W. Va. 1996) (debtor failed to treat all parties fairly and equitably and did not bargain in good faith); *In re Schauer Mfg. Corp.*, 145 B.R. 32, 35 (Bankr. S.D. Ohio 1992) (debtor "has failed to show that the Proposal which it made to the Union makes 'necessary modifications . . . that are necessary to permit the reorganization of the debtor . . .'"); *In re Sun Glo Coal Co.*, 144 B.R. 58, 63 (Bankr. E.D. Ky. 1992) ("the debtors have failed to sufficiently quantify the results of such proposed changes to allow this Court to find that they are 'necessary' to the reorganization of the debtors").

debtor the burden of proving that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully.”<sup>13</sup>

The bill would replace the “necessary to permit the reorganization” standard in § 1113 with “shall be not more than the minimum savings essential to permit the debtor to exit bankruptcy, such that confirmation of a plan of reorganization is not likely to be followed by the liquidation, or need for further financial reorganization of the debtor [] in the short-term.”

This provision would be problematic for several reasons. First, the concept of “short-term” is so vague that it will likely lead to substantial litigation. Second, the goal of chapter 11 is not simply to allow a debtor to emerge from bankruptcy and survive “in the short-term.” Instead, the goal is to enable a debtor to reorganize with a cost structure that will allow it to survive in the long-term as a viable and competitive enterprise. If a debtor is able to make only those modifications to its labor costs that are essential for it to exit bankruptcy and survive in the short-term, we will see more companies having to file second chapter 11 cases, or being forced to liquidate after emerging from chapter 11. Third, typically new investors are necessary in order to facilitate a chapter 11 reorganization. Such investors look for opportunities to invest in companies that have a rational cost structure, such that they are likely to survive and prosper. New investors are not likely to commit capital to a situation in which the debtor is able to

<sup>13</sup> The Third Circuit has interpreted the term “necessary” more strictly. See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., AFL-CIO-CLC*, 791 F.2d 1074, 1088 (3d Cir. 1986) (holding that “[t]he ‘necessary’ standard cannot be satisfied by a mere showing that it would be desirable for the trustee to reject a prevailing labor contract so that the debtor can lower its costs” and suggesting that the use of the word “necessary” equates to “essential” and that rejection under § 1113 should be used only when necessary to prevent liquidation). This interpretation represents a minority view. See, e.g., *In re Mile Hi Metal Sys., Inc.*, 899 F.2d 887, 892 (10th Cir. 1990) (stating that “the majority of cases decided since *Wheeling-Pittsburgh* have declined to interpret section 1113(b)(1)(A) as requiring that a proposal be absolutely necessary”).



rationalize its cost structure only to the extent necessary to “exit bankruptcy” or to avoid liquidation “in the short-term.” If it were available at all, the cost of that new capital would be very high, to take into account the risk. Thus, this provision would make reorganizations materially more difficult to achieve.<sup>14</sup> Finally, it is not practical to require a debtor to emerge with a labor cost structure that reflects the bare minimum necessary for the company to exit bankruptcy. This would require a debtor to leave itself, in creating a post-emergence cost structure, so little leeway that even a minor unforeseen “bump in the road” after emergence could cause another bankruptcy filing. It would be a mistake for Congress to amend § 1113 in a way that would require debtors to emerge from chapter 11 with a cost structure that does not allow some flexibility for the usual ups and downs faced by businesses in the months and years following bankruptcy, as well as for some unforeseen circumstances.

The bill would also require any proposal to be “proposed only as part of a program of workforce and nonworkforce cost savings devised for the reorganization of the debtor, including savings in management personnel costs.” Existing law already requires that a § 1113 proposal assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably. This allows a court to deny § 1113 relief where the debtor seeks to shift too much of the cost-savings burden onto union employees, rather than “spreading the pain.” No legislative change is needed to give a court this power. However, if the bill is instead intended to create a requirement that management costs must be reduced if labor costs are reduced, this provision would be a mistake. There are cases where a debtor is paying market-competitive (or below-market) wages to management employees but is paying above-market or otherwise unsustainable compensation

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<sup>14</sup> Previously proposed legislation would have limited the cost savings that could be achieved through the §1113 process to two years. Investors would be very unlikely to invest in a company that could achieve a rational labor cost structure for only two years. Changing “two years” to “the short-term” does not solve the problem.

and benefits to represented employees. In those situations, the debtor should be able to reduce labor costs to a sustainable, market-competitive level, without necessarily having to make reductions in management employee salaries. There are also situations in which management compensation can and should be reduced without a need to reduce the wages and benefits of represented employees. The point is that a debtor should be able to look at each category of employees to determine whether the wages and benefits afforded to those employees are at a sustainable and market-competitive level -- and to make modifications where necessary to facilitate the debtor's reorganization -- rather than reflexively cutting the wages or benefits of all groups of employees, without regard to the relevant labor market or to the necessity or likely consequences of the reductions.

The bill would create a presumption that a debtor that implemented any incentive compensation or similar plan during the bankruptcy case, or within 180 days before the bankruptcy filing, "for insiders, senior executive officers, or the 20 next most highly compensated employees," fails to satisfy the standard for obtaining §1113 relief.

This provision is also, in my view, a mistake. The guiding principal should not be that every group of employees must take the same pay cut or reduction in benefits, but instead that each employee or group of employees should be paid and receive benefits at, or as close as possible to, a market-competitive level, and that the resulting overall cost structure should be sustainable for the reorganized debtor. For this reason, a provision that would "presume" that a debtor is not treating represented employees fairly if it has implemented any incentive plan for certain management or other highly-compensated employees within 180 days is short-sighted. Surely there are situations in which providing additional compensation to management employees while seeking labor cost reductions from union workers would be unfair -- such as,

for example, where the management employees are already being paid above-market compensation for their services. However, there are other cases in which incentive or similar compensation is necessary to “meet the market” for management employees and/or to provide appropriate incentives, and in those cases paying such compensation should not be presumed to be unfair to labor. A debtor should not be put in the Catch-22 situation of having to choose between seeking labor cost reductions that are necessary for the company to reorganize or paying market-competitive compensation to its salaried and management personnel.<sup>15</sup>

Moreover, focusing on “the 20 next highly compensated employees” is arbitrary. In some cases, the top 20 will all be very senior management people, with substantial influence over the debtor and its decision-making. In other cases -- particularly smaller companies -- the 20 highest compensated employees may include individuals who are not particularly highly compensated, are not officers of the company, and who have no control or influence over the debtors. The top 20 may also include union-represented employees. Thus, tying the ability of a debtor to obtain labor cost reductions under § 1113 to whether incentive compensation has been provided to the 20 highest compensated employees will, in many cases, not achieve the desired result. Such one-size-fits-all rules do not work well in chapter 11. A better approach would be for the courts to be required to take into account whether the “pain” of a debtor’s cost cutting effort is being shared in a fair and rational way, taking into account the realities of the marketplace. The reorganization process works better when judges are able to make these decisions on a case-by-case basis, based on the facts and circumstances and the needs and

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<sup>15</sup> A typical component of management compensation is stock or stock options. In bankruptcy, such stock or stock options are typically worthless. Thus, incentive compensation may be necessary not to enhance compensation, but instead simply to replace a component of compensation that has been rendered worthless.

resources of the particular debtor, rather than being bound by arbitrary cut-offs and one-size-fits-all rules.

The bill would also amend § 1113(d) to slow down the § 1113 process. As amended, § 1113(d)(1) would require a court to schedule a hearing on a motion for rejection of a collective bargaining agreement on not less than 21 days notice (as opposed to current law which provides for a hearing “not later than fourteen days after the date of the filing”), unless the debtor and authorized representative agree to a shorter term. In addition, the bill would delete the current requirement in § 1113(d)(2) that provides that “[t]he court shall rule on such application for rejection within thirty days after the commencement of the hearing . . . .” Most significantly, though, the bill would limit the debtor’s ability to file a rejection application until after “a period of negotiations” and only when the parties “have not reached an agreement over mutually satisfactory modifications, and further negotiations are not likely to produce mutually satisfactory modifications.”

This provision is problematic for a number of reasons. First, it creates ambiguity about when a motion can be filed. What does “a period of negotiations” mean? At what point is it reasonable to conclude that further negotiations would be hopeless? This provision would create a new issue to litigate, concerning when the motion can be filed. One thing debtors and labor unions do not need is another issue to litigate about. Second, while the provision is presumably intended to foster negotiations, it could actually have the opposite effect. It might incentivize a debtor that needs to have relief by a certain date to rush through the negotiation process so that it could get to the point when a motion can be filed. That would not be helpful to the process. In prior cases, very productive negotiations have occurred after an § 1113 application has been filed. Third, addressing labor costs is often a gating item for other issues in the chapter 11

reorganization, such as reaching agreements with major creditor constituencies, and obtaining new investment and exit financing. Requiring a debtor to delay filing a § 1113 application is likely to delay the entire reorganization. Fourth, some debtors need relief promptly because of the burden of excessive labor costs. Debtors may simply be unable to afford the delay that this provision would impose. Finally, such a provision could unfairly tilt the balance of leverage, as the unions could drag out negotiations in order to preclude the debtor from filing a rejection application. If a debtor is prevented from even seeking the relief that it needs, it may be forced to accede to the union's demands simply to avoid the unbearable cost of delay.

Slowing down the process is not in any constituency's legitimate interest. Delay is likely to increase costs and to diminish the prospects for successful reorganization. Slowing down the § 1113 process, and therefore the reorganization process, is also inconsistent with Congress' intent to speed up the bankruptcy reorganization process, which is reflected in the shortening of the exclusivity and solicitation periods included in BAPCPA.<sup>16</sup> If anything, consistent with the shortening of the exclusivity and solicitation periods, and keeping in mind the substantial costs and risks associated with delay, the § 1113 process should be compressed, not drawn out.

The bill would also prohibit creditors and other interested parties from participating in a § 1113 hearing, even though their recoveries could be substantially affected by the outcome.<sup>17</sup> The court already has the authority to streamline hearings, to achieve efficiency and avoid repetition. But there is no valid reason to deny interested parties, such as a creditors committee,

<sup>16</sup> See 11 U.S.C. §§ 1121(d)(2)(A) and 1121(d)(2)(B). As amended, the statute provides that the 120-day period during which the debtor-in-possession has the exclusive right to file a chapter 11 plan "may not be extended beyond a date that is 18 months" after the bankruptcy petition date, and the 180-day period during which only the debtor-in-possession may solicit votes for a plan of reorganization "may not be extended beyond a date that is 20 months" after the bankruptcy petition date.

<sup>17</sup> This would be accomplished by inserting language in § 1113(d) that provides "[o]nly the debtor and the labor organization may appear and be heard at such hearing."

their right to be heard on such important issues in the chapter 11 case, and doing so would be inconsistent with § 1109(b) of the Code, which allows any party in interest to be heard on issues in a chapter 11 case.

The bill would also alter the standard in respect of when a court may grant a motion to reject a collective bargaining agreement. The bill would require "clear and convincing evidence" that the requirements in new § 1113(d)(2) are met before a debtor can reject a collective bargaining agreement. The import of this standard is not clear. As a practical matter, I suspect it would have little impact because I do not think bankruptcy courts grant § 1113 relief unless they find the evidence in support of doing so to be "clear and convincing." However, if this change -- alone or in combination with other changes that are proposed -- materially heightens the standard for obtaining § 1113 relief, the result could be at odds with the intention of Congress in enacting § 1113 and, more generally, with the goals of chapter 11. In enacting § 1113, Congress intended to foster consensual resolutions to the maximum extent possible.<sup>18</sup> This goal has been realized -- the vast majority of situations in which debtors seek labor cost modifications have been resolved consensually. But the balance is a delicate one. Cases are resolved by negotiation in part because each side has risk. If the standard for obtaining relief -- which is already quite high -- is made so high that it is nearly impossible to achieve, a result is likely to be fewer negotiated resolutions, and more litigation. The unions would have great leverage and therefore less incentive to compromise, yet companies would continue to seek the relief because their survival often depends upon it. Unduly raising the standard could also result in some companies that legitimately need labor cost relief in order to reorganize and emerge as viable and competitive

<sup>18</sup> See, e.g., 130 CONG. REC. 20231 (June 29, 1984) (statement of Rep. Morrison) (discussing the proposed enactment of § 1113 and providing that "the overall policy of the provision which is to encourage the parties to reach their own agreement through collective bargaining . . .").

enterprises being denied that relief. This would be counterproductive for all stakeholders, including labor.

Under the bill, granting relief under § 1113 would also require the court to find that implementation of the debtor's proposal to modify wages, benefits and work rules "shall not cause a material diminution in the purchasing power of the employees covered by the agreement." Depending upon how this provision is interpreted, it could make § 1113 relief nearly impossible to obtain. It is almost always the case that § 1113 relief will impact the affected employees' purchasing power. Even where the union employees' wages and benefits are materially above-market, and the debtor seeks relief in order to reduce wages and benefits to a market-competitive level, the result would impact the employees' purchasing power. The test should not be whether a reduction in wages and benefits affects the employees' purchasing power -- it nearly always does -- but instead whether the reductions are necessary to enable the debtor to reorganize, emerge from bankruptcy, and continue as a viable enterprise. In this regard, it is worth keeping in mind that if a debtor that needs labor cost relief does not obtain that relief, and is therefore forced to liquidate and/or to lay off large numbers of employees, the employees' purchasing power will also be diminished, and to a much greater extent than if their wages and benefits are reduced to a sustainable, market-competitive level.

The bill also provides that the court could not permit rejection of a collective bargaining agreement "that would result in modifications to a level lower than the level proposed by the trustee in the proposal found by the court to have complied with the requirements of this section." This appears to mean that the debtor is always bound by the highest and best offer that it makes during modification negotiations. It is not uncommon for a debtor, in § 1113 litigation, to agree that if it is granted relief it will implement the terms proposed in its most recent offer.

However, requiring every debtor to do this in every case is likely to reduce the number of consensual resolutions. If this were the law, the union would feel free to reject every proposal made by a debtor because that proposal would automatically become the union's "worst case scenario." Compromise is more likely if each side has some downside associated with litigating; this proposal would, to a large degree, eliminate that downside for the union. On the other hand, the debtor would be more reluctant to make its best offer during negotiations. In making a settlement offer, it is common for a debtor (or any party) to take into consideration the cost and distraction of litigation, the impact on business relationships, the public relations impact of litigation, the delay associated with litigation, and the like. Forcing a debtor to be bound in litigation to its best settlement offer will make the debtor more cautious in what it offers during negotiations. This can be expected to result in less favorable resolutions for unions and fewer negotiated resolutions.

The bill would also add a new section that would allow the union, at any time, to "apply to the court for an order seeking an increase in the level of wages or benefits, or relief from working conditions, based on changed circumstances," after a deal is reached or a court order is entered allowing rejection. This section of the bill appears to allow the union an unlimited right to relitigate the issues after they have been resolved. This provision is problematic for several reasons. First, it appears to be one-sided; it would permit the union to relitigate based upon changed circumstances, but appears not to allow a company the same right. Second, there does not appear to be any time limit on when such relief can be sought. This would be very problematic. Chapter 11 debtors need finality on the issue of labor costs so that they can do the other things necessary to reorganize and emerge from bankruptcy, such as reach agreements with creditor constituencies, line up new investors and exit financing, formulate a business plan, and



determine the feasibility of their chapter 11 plan. As noted above, in a typical case, a debtor cannot do these things until there is finality with respect to its future cost structure. Having such an open-ended provision with no clear time limitations would make successful reorganizations materially more difficult.

In addition to the foregoing modifications, the bill would add other new provisions to § 1113. For example, proposed § 1113(f) would authorize a claim for “rejection damages” if a collective bargaining agreement were rejected under § 1113.<sup>19</sup> It would also authorize “self help” (presumably a strike or other job action) by labor representatives if the court grants a motion to reject a collective bargaining agreement or a motion for interim modifications to such an agreement.

Providing unions with the right to seek a claim for “rejection damages” if the collective bargaining agreement is rejected would reverse the decision in the Northwest Airlines bankruptcy case, which held that the union was not entitled to rejection damages under § 1113.<sup>20</sup> Proposed § 1113(f) would also provide that “[n]o claim for rejection damages should be limited by section 502(b)(7).”<sup>21</sup> This proposed amendment to § 1113(g) could substantially increase unsecured claims that a debtor would need to deal with under its plan, and diminish the

<sup>19</sup> This would be accomplished by inserting language in § 1113(f) that provides “rejection [of a collective bargaining agreement] shall be treated as rejection of an executory contract under section § 365(g) . . . .”

<sup>20</sup> See *Northwest Airlines Corp. v. Assn. of Flight Attendants-CWA, AFL-CIO* (*In re Northwest Airlines Corp.*), 483 F.3d 160, 170-75 (2d Cir. 2007) (the rejection “abrogated” the collective bargaining agreement which is distinguishable from a breach entitled to damages under § 365); see also *In re Blue Diamond Coal Co.*, 147 B.R. 720 (Bankr. E.D. Tenn. 1992), *aff’d*, 160 B.R. 574, 576 (E.D. Tenn. 1993) (providing that § 1113 “effectively withdrew the rejected collective bargaining agreement from the rubric of [] § 365 and § 501”). Some other courts have held that collective bargaining agreements are executory contracts and unions are entitled to damage claims related to the rejection of such agreements. See, e.g., *In re Moline Corp.*, 144 B.R. 75, 78-79 (Bankr. N.D. Ill. 1992); *In re Tex. Sheet Metals, Inc.*, 90 B.R. 260, 272-73 (Bankr. S.D. Tex. 1988).

<sup>21</sup> Section 502(b)(7) limits the claim of an employee for damages resulting from the termination of an employment contract to one year’s compensation.

recoveries of other unsecured creditors. In some prior cases, debtors and labor unions have been able to reach modification agreements based on the debtor agreeing to some negotiated claim amount for the union employees in the bankruptcy case. If the union employees have that claim as a matter of right, the opportunity to reach agreement on that basis will be diminished. On the other hand, it is not unreasonable for employees who lose wages or benefits as a result of § 1113 relief to have a claim for the amount of their loss in the chapter 11 case.

The proposed amendment to provide unions with the right to “self-help” is also apparently a reaction to the Northwest Airlines decision which upheld, under the facts of that particular case and based upon certain provisions of the Railway Labor Act, an injunction to prevent a strike following the entry of a § 1113 order.<sup>22</sup> If a labor union, after the court finds that modifications are necessary for the debtor’s reorganization and therefore grants § 1113 relief, is able to torpedo the company’s reorganization by engaging in a retaliatory strike or other job action, the purpose of § 1113 (and of chapter 11 more generally) will be undermined, and the company and its stakeholders will suffer. The union will also have less incentive to negotiate because it can always turn to the “nuclear option” of a strike if the debtor does not accede to its demands, or as retaliation for the debtor’s implementing § 1113 relief. A more balanced provision would be to authorize the bankruptcy court to enjoin a strike or similar job action after

<sup>22</sup> While airlines are governed by the Railway Labor Act (“RLA”), most other debtors are governed by the National Labor Relations Act (“NLRA”). Courts have suggested that in cases governed by the NLRA a union has the right to strike upon entry of a § 1113 order. See *Briggs Transp. Co. v. Int’l Bhd. of Teamsters*, 739 F.2d 341 (8th Cir. 1984) (rejecting request for injunctive relief in an NLRA case based on the Norris-LaGuardia Act’s protection of the right to strike); see also *In re Northwest Airlines Corp.*, 349 B.R. 338 (S.D.N.Y. 2006), *aff’d*, 483 F.3d 160 (2d Cir. 2007). By contrast, under the RLA (which governs, *inter alia*, the airline industry), the Second Circuit has held that the right to strike does not exist. See *In re Northwest Airlines Corp.*, 483 F.3d at 167-68. As noted in the Second Circuit’s decision, the analysis of whether a court can enjoin a strike under the NLRA depends upon the terms of the applicable collective bargaining agreement. See *id.* at 173.

granting § 1113 relief, but only where such an injunction is necessary in order to enable the debtor to reorganize and remain in business as a going concern.

Another newly proposed section, § 1113(g), would require a debtor to pay the union's fees and expenses. Chapter 11 is already very expensive, and this would create an additional administrative burden, to the detriment of creditors and other constituencies. Moreover, the union's obligation to pay its own attorneys' fees creates a disincentive to litigate excessively and an added incentive to reach negotiated resolutions where possible. The same is true for the debtor, which must pay its own attorneys, experts and advisors. If one party can litigate as much as it wants for free -- with the other party paying its legal fees -- that incentive gets skewed.

Finally, this bill would amend § 1114 of the Bankruptcy Code -- the section that sets forth the criteria pursuant to which a debtor may modify retiree benefits -- to provide more stringent requirements for modifying or terminating retiree health and life insurance benefits. Most of the proposed modifications to § 1114 track the modifications to § 1113. As a result, the proposed modifications to this section would create many of the same impediments to reorganization discussed above with regard to § 1113.

The bill would also amend § 1114(a), which defines the term "retiree benefits," to provide that the term applies "whether or not the debtor asserts a right to unilaterally modify such payments under such plan, fund, or program." The apparent purpose of this language is to overrule cases holding that if a trustee has a valid contractual right under non-bankruptcy law to modify or terminate retiree benefits, the provisions of § 1114 do not override that right.<sup>23</sup> To the

<sup>23</sup> See, e.g., *In re N. Am. Royalties, Inc.*, 276 B.R. 860, 866 (Bankr. E.D. Tenn. 2002) ("Section 1114 . . . says nothing about whether the debtor can exercise a power reserved in the contract to terminate it and thereby end any obligation for retiree benefits as defined in § 1114(a). Despite § 1114, the debtor can terminate the contract as allowed by the terms."); *In re Lykes Bros. Steamship Co., Inc.*, 233 B.R. 497, 517 (Bankr. M.D. Fla. 1997) (retiree benefits were terminable at will, and therefore, could be terminated

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extent that the bill would afford retiree benefits under § 1114 beyond the debtor's contractual obligation to provide such benefits, it seems inappropriate. Retirees should not have greater rights against the debtor in bankruptcy than they would have outside of bankruptcy.

Issues involving modification of collective bargaining agreements and retiree benefits are among the most difficult issues faced by the parties, and the courts, in chapter 11 cases. The prospect of reducing employees' wages and benefits, or retirees' benefits, is not something the courts take lightly. A debtor proposing to do this faces a heavy procedural and substantive burden. At the same time, courts recognize that some debtors are so hamstrung by above-market or otherwise unaffordable labor and retiree costs that, without relief from such costs, they will not be able to emerge from bankruptcy as viable and competitive enterprises. If these companies are forced to liquidate because they cannot reduce labor and/or retiree costs, all constituencies will suffer, including workers who will lose their jobs, retirees who will lose their benefits, creditors and shareholders whose recoveries will be diminished or eliminated, suppliers and customers, taxing authorities, and local communities. Sections 1113 and 1114 provide a framework for the parties, and when necessary the courts, to balance these competing concerns and interests.<sup>24</sup> In my experience, in the relatively few cases that are not resolved through

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without the requirement to comply with § 1114); *In re CF & I Fabricators of Utah, Inc.*, 163 B.R. 858, 574 (Bankr. D. Utah 1994) ("The Bankruptcy Code does not create new rights upon filing bankruptcy that were not in existence prior to filing.") (internal citations omitted); compare *In re Farmland Indus., Inc.*, 294 B.R. 903, 917 (Bankr. W.D. Mo. 2003) ("There is nothing in the language of the statute [§ 1114] to suggest that Congress intended to allow the termination of retiree benefits in those instances where the debtor has the right to unilaterally terminate those benefits under the language of the plan or program at issue.").

<sup>24</sup> See 130 CONG. REC. 20094 (June 29, 1984) (statement of Rep. Moynihan). (discussing the proposed enactment of § 1113 and providing that, "Mr. President, I know that few, if any, Members of this body want to see the abrogation of collectively bargained labor contracts, even in the course of bankruptcy proceedings. But in certain circumstances, we must recognize that costs, including labor costs, must be lowered for financially troubled firms to survive").

negotiations, bankruptcy judges do a good job of looking at the total picture and deciding whether relief sought by a debtor is necessary, and whether it is fair. Given the “human dynamic” of these decisions, debtors already face a heavy burden in making their case to the court. Legislation that would further skew the playing field against debtors, or eliminate judicial discretion, is not necessary, and indeed would be counterproductive.

While in any given case, one party or the other may be more or less satisfied with the outcome, as a general matter current law is sufficient to guard against any modifications of collective bargaining agreements and retiree benefits other than those that are necessary for the company to be able to reorganize and successfully emerge from bankruptcy. Sections §§ 1113 and 1114 have worked well in achieving a balance between the objectives of preserving bargained-for wages, benefits and work rules to the maximum extent possible and achieving a cost structure that will enable chapter 11 debtors to reorganize and survive. Congress’ goal of placing a heightened burden on debtors seeking to modify labor agreements, providing all parties with bargaining leverage, and encouraging negotiated resolutions has been largely achieved.

Section 203: Protection of Employee Benefits in a Sale of Assets

Section 203 of the bill would amend § 363 of the Bankruptcy Code<sup>25</sup> to require that, in order to approve an asset sale, the court must consider “the extent to which a bidder has offered to maintain existing jobs, preserve terms and conditions of employment, and assume or match pension and retiree health benefit obligations in determining whether an offer constitutes the highest or best offer for such property.”

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<sup>25</sup> Section 363 permits a debtor to use, sell or lease property in the ordinary course of business without court approval, or outside the ordinary course of business with court approval. 11 U.S.C. § 363(b)(1).

If this section is merely providing that courts should consider all of the possible implications of a sale, including the impact on employees and retirees, then I agree that is appropriate. However, the provision is unnecessary because courts already have the authority to take such factors into account.

If, instead, this provision is suggesting that a court should not be able to approve a sale unless the buyer commits to maintain existing jobs or preserve retiree health benefits, that is, unfortunately, not realistic. The reality is that in many cases there is no buyer who is willing to preserve all of the debtor's employees' jobs and assume all of its retiree liabilities. Passing new legislation will not change that economic reality. Instead, the buyer will simply decline to enter into the transaction. I agree that as between two otherwise equivalent sale offers, the one that preserves jobs and retiree benefits would be preferable to the one that does not. I suspect most bankruptcy judges would share that view. But the law should be clear that asset sales that do not result in job and retiree benefit preservation may still be approved where they are the only alternative, or where, taking all factors into account, they are the best available alternative.<sup>26</sup>

Section 204: Claim for Pension Losses

Upon a debtor's termination of a defined benefit plan, the Pension Benefit Guaranty Corporation (the "PBGC") is entitled to assert a claim in the debtor's bankruptcy case for the amount by which the plan is underfunded. ERISA requires the PBGC to share its recovery on account of such claim with the plan participants, according to a statutory formula. Section 204 of the bill would give an individual plan participant (or a labor union on the participant's behalf)

<sup>26</sup> Noticeably absent from this section of the bill is the requirement that was included in H.R. 3652, a similar bill proposed in 2007, that would have imposed a flat \$20,000 per retiree charge upon all § 363 sales that result in a cessation of retiree benefits. It is encouraging that this provision is not included in the current bill, since it is another one of those one-size-fits-all provisions that be unworkable in many cases and would make it impossible to consummate certain asset sales even if they were in the best interest of the debtor's estate and creditors.

a claim for any shortfall in benefits as of the termination date, as a result of the plan termination and the limitation on benefits that are guaranteed by the PBGC, "notwithstanding any claim asserted and collected by the [PBGC] with respect to such termination."<sup>27</sup> It appears to allow such claim in addition to the sharing that the participant would receive in the PBGC's recovery on account of its claim. This provision would result in duplicative claims -- that is, claims asserted by the PBGC and by the plan participants for the same underfunding amount. Congress should consider the implications of allowing such duplicative claims, which could be expected to diminish the recovery of other creditors. The provision could also result in a plan participant receiving more than payment in full, depending upon the extent to which the participant recovers from the PBGC's sharing of its recovery and the recovery on account of the participant's own claim. It would not make sense for a plan participant to receive a windfall as a result of the bankruptcy and the termination of the debtor's defined benefit plan.

Section 204 of the bill also allows a claim by a participant in a defined contribution plan for the loss in value of stock in the plan from the time that the stock was contributed to (or purchased by) the plan to time of the bankruptcy filing. This section works along with § 102 of the bill (discussed above) to elevate a claim for lost value of stock in a defined contribution claim, arising from fraud or breach of duty, to the priority of unsecured debt. As I discussed above, there is likely to be an issue -- at least in some cases -- of whether this claim is subject to subordination under § 510(b). To the extent the claim is not subordinated, it may be quite large, and could be expected to diminish the recovery of other creditors. This provision may also create a disparity between the beneficiaries of a defined contribution plan and other similarly

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<sup>27</sup> This would also effectively overrule prior case law holding that employees may not assert claims with respect to the unfunded benefit liabilities in a pension plan. See, e.g., *United Steelworkers of Am., AFL-CIO, CLC v. United Eng'g, Inc.*, 52 F.3d 1386 (6th Cir. 1995).

situated shareholders, who also purchased stock that subsequently lost value. It would seem to make sense for all shareholders who lost stock value -- or in the case of this bill, all shareholders who lost stock value as a result of fraud or breach of duty by the company to the shareholder -- to be treated in parity, rather than employee shareholders being treated preferentially to non-employee shareholders.

Section 205: Payments by Secured Lender

Bankruptcy Code § 506(c) currently provides that the trustee may surcharge a secured creditor's collateral to pay the reasonable and necessary costs and expenses of preserving or disposing of the collateral to the extent the secured creditor benefits from the expenditures. This surcharge right is sometimes waived by a debtor in exchange for the prepetition secured lender's consent to the use of cash collateral or providing postpetition financing.

Section 205 of the bill would amend § 506(c) to treat wages, accrued vacation, severance, and other benefits owed pursuant to a collective bargaining agreement for services rendered on or after the commencement of the bankruptcy case as necessary costs and expenses, for surcharge purposes, regardless of any waiver of the surcharge right.<sup>28</sup>

In the overwhelming majority of cases, secured lenders consent to the use of their cash collateral to pay employee wage and benefit obligations and will include such expenses in a postpetition financing budget. However, making this a "mandatory surcharge" would be likely to decrease the availability, and increase the cost, of secured credit. Particularly in a tight credit environment, such as we are currently facing, it would not be prudent to enact legislation that would impede the ability of a debtor to obtain financing.

<sup>28</sup> The provision states that such amounts "shall be deemed necessary costs and expenses of preserving, or disposing of, property securing an allowed secured claim . . . ."



Moreover, it is not true that, in every case, employee wages and benefits are a necessary expense of preserving or disposing of a lender's collateral. Thus, this provision would "deem" something to be true that is, in fact -- at least in some cases -- not true. To illustrate the point, imagine a situation in which a debtor has one plant in Tennessee and another in Arizona. The lender has a lien only on the Tennessee facility. All wages and benefits of the employees at that facility have been paid in full. However, some wages and benefits at the Arizona facility have not been paid. This bill would appear to "deem" the unpaid wages and benefits at the Arizona facility to be "necessary costs and expenses" of preserving the Tennessee collateral. The law should not "deem" something to be true that is demonstrably untrue. Instead, in each case the court should determine whether, in fact, the unpaid employee wages and benefits are a necessary expense of preserving, or disposing of, the secured lender's collateral.

Section 206: Preservation of Jobs and Benefits

Section 206 of the bill would (i) insert a statement of purpose before § 1101 in the Bankruptcy Code and (ii) amend § 1129.

The "statement of purpose" would provide that: "[a] debtor commencing a case under this chapter shall have as its principal purpose the reorganization of its business to preserve going concern value to the maximum extent possible through the productive use of its assets and the preservation of jobs that will sustain productive economic activity."

It is true that the "classic" goal of chapter 11 is to enable a company to reorganize and thereby to preserve going-concern value. However, an alternative purpose of chapter 11 is to enable a company to sell its assets and pursue an orderly liquidation. There are some cases in which a sale/liquidation is the best way to maximize value. It is not clear to me what effect, if any, this "statement of purpose" would have. But if a "statement of purpose" is to be enacted, it

should be modified so that it does not raise questions about whether chapter 11 may properly be used to effectuate an orderly liquidation.

The amendments to § 1129 (which establishes the criteria for confirming a plan) would add additional criteria. The bill would add a new § 1129(a)(18), which would require, as a condition to plan confirmation, that “[t]he debtor has demonstrated that the reorganization preserves going concern value to the maximum extent possible through the productive use of the debtor’s assets and preserves jobs that sustain productive economic activity.” As with the “statement of purpose,” Congress should be careful not to enact legislation that will make it impossible for a debtor to confirm a liquidating chapter 11 plan, where doing so is in the estate’s best interest.

The bill would also amend § 1129(c) to mandate that, in a situation in which competing chapter 11 plans are proposed, the court must confirm the plan that better serves the interests of retirees and employees. It would create a presumption that the plan that incorporates the terms of a settlement with a labor union constitutes the better plan.<sup>29</sup> I agree that, in deciding between competing plans, each of which satisfies the other requirements for plan confirmation, it would be appropriate for a court to take into account the interests of the debtor’s employees. However, this provision appears to require the court to consider those interests *to the exclusion of* other interests, such as those of trade creditors, bondholders, lenders, tort victims, taxing authorities, and customers. Elevating one interest, to the exclusion of others, is inconsistent with the balancing of competing interests that is at the heart of the chapter 11 process.

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<sup>29</sup> The presumption might be difficult to implement, in practice. One can imagine a situation in which each competing plan incorporates a settlement with some, but not all, of the debtor’s unions. Which plan would then receive the benefit of the presumption?

Section 207: Termination of Exclusivity

Section 207 would amend § 1121(d) to allow for termination of the period during which the debtor has the exclusive right to propose and solicit acceptances of a plan in cases in which the debtor seeks § 1113 relief. This provision could put a debtor in the impossible situation of being forced to choose between the need to modify unsustainable labor costs, in order to be able to reorganize, and the need to preserve exclusivity.

Because of the number of diverse interests in the typical chapter 11 case, exclusivity is critical in order for debtors to be able to manage the reorganization process and pursue confirmation of a plan that balances the various competing interests.<sup>30</sup> The alternative of having each stakeholder be able to file a plan that serves its own parochial interest would make the chapter 11 process far more difficult to manage, and far more expensive.

This provision is obviously intended to create a disincentive for debtors to seek § 1113 relief by threatening that, if they do so, they will be forced to deal with the chaos that may result from termination of exclusivity. However, debtors should not be forced to choose between two goals that foster successful reorganization -- modifying labor cost, where necessary in order to facilitate successful emergence, and preservation of exclusivity.

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<sup>30</sup> See, e.g., *In re Texaco, Inc.*, 81 B.R. 806, 809 (Bankr. S.D.N.Y. 1988) ("It [§ 1121] was intended that at the outset of a Chapter 11 case a debtor should be given the unqualified opportunity to negotiate a settlement and propose a plan of reorganization without interference from creditors and other interests.") (citing H.R. Rep. No. 595, 95th Cong., 2d Sess. 221-222 (1978), U.S. CODE CONG. & ADMIN. NEWS 1978, p. 5787); see also *In re Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 Bankr. LEXIS 237 (Bankr. E.D. Pa. Mar. 14, 2000) ("[e]xclusivity is intended to promote an environment in which the debtor's business may be rehabilitated and a consensual plan may be negotiated") (internal citations omitted).

**C. Title III: These Sections of the Bill Would Limit a Debtor's Ability to Retain Management Employees During a Chapter 11 Proceeding and to Determine Appropriate Management Compensation After Bankruptcy**

*Section 301 and 302: Executive Compensation Upon Exit From Bankruptcy and Limitations on Executive Compensation Enhancements*

Sections 301 and 302 of the bill would make it materially more difficult for a debtor to pay bonus or other incentive-based compensation to its officers, directors, management employees and consultants, and would allow the bankruptcy court authority to determine a debtor's management compensation even after the debtor emerges from bankruptcy.

One of the many challenges a chapter 11 debtor faces is how to retain talent, including management talent, through the bankruptcy.<sup>31</sup> Maintaining competent management, without excessive turnover, is important to maximize the debtor's prospects for a successful reorganization. In order to retain management employees, debtors must be able to offer market-competitive compensation and benefits, including, in many cases, incentive or bonus compensation.

By enacting § 503(c)(1), BAPCPA made it nearly impossible for debtors to pay "stay bonuses" to insiders.<sup>32</sup> As a result, debtors have for the most part abandoned the practice of paying such bonuses.

<sup>31</sup> The job of managing a debtor through the chapter 11 process is quite challenging and requires substantial skill and dedication. The hours tend to be long, since many debtors have reduced the size of their management teams, and the remaining managers must both run the business and supervise the bankruptcy process. The job also involves considerable risk and instability. Managers are understandably concerned that their company may end up in liquidation, or may be sold to a buyer who will have its own management team. History has shown that these concerns are legitimate; many managers -- and even entire management teams -- have lost their jobs during or at the conclusion of a bankruptcy case. The people who are willing to do this job and can do it well tend to be in demand, and have many opportunities.

<sup>32</sup> Section 503(c)(1), enacted as part of BAPCPA, requires retention bonus payments to a debtor's insiders (payments intended to induce an insider to remain with the debtor through the chapter 11 process) to meet a set of strict criteria that had never before been imposed. These criteria are typically, as a

Footnote continued on next page

However, recognizing that management defections could severely damage the company and its reorganization prospects, debtors have, since BAPCPA, often sought (and obtained) court permission to pay other types of bonus compensation, such as incentive compensation.<sup>33</sup> Creditors and committees frequently support these payments, recognizing that the amounts at issue are typically inconsequential in the scheme of the overall case, but that the consequences of losing key managers during the reorganization process can be dire.<sup>34</sup>

Footnote continued from previous page

practical matter, impossible to satisfy. They require a finding that (i) the person receiving the payment has a bona fide job offer from another business at the same or greater rate of compensation, (ii) the services provided by the person are essential to the survival of the business, and (iii) the proposed payment is not greater than 10 times the average amount of similar payments made to non-management employees for any purpose during the same calendar year or if no similar payments during such calendar year, the amount of the payment is not greater than an amount equal to 25 percent of the amount of any payment made to the insider during the calendar year before the year in which such payment is made or incurred: 11 U.S.C. §§ 503(c)(1)(A)-(C)(ii). See also *In re Dana Corp.*, 358 B.R. 567, 576 n.11 (Bankr. S.D.N.Y. 2006) (“Under this section [§ 503(c)(1)], a company will now be required to show not only that each key management employee has another offer, but also that they will take the offer absent a KERP. This is nearly an impossible standard to satisfy and would require that each such employee come to court and testify that they have another offer and will leave absent the KERP.”) (internal citations omitted).

<sup>33</sup> The difference between retention bonuses and incentive compensation is that incentive compensation is conditioned upon the achievement of specified objectives. The courts have been vigilant to ensure that the objectives are real and that they confer a material benefit on the estate, rather than simply being an “end-run” around the restrictions on retention bonuses. See, e.g., *In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) (denying a request to authorize compensation where the bonus included “an amount payable to the [executive employees] upon the Debtors’ emergence from chapter 11, regardless of the outcome of [the chapter 11 case]” and finding that “compensation scheme walks, talks and is a retention bonus”); compare with *In re Dana Corp.*, 358 B.R. at 584 (approving a request to authorize compensation where payment of the bonus required the executives to reach certain EBITDAR benchmarks before they would be eligible for any payment and also providing for the imposition of “an appropriate ceiling or cap on the total level of yearly compensation to be earned by the CEO and Senior Executives during the course of the bankruptcy proceedings”); *In re Calpine Corp.*, Case No. 05-60200, Hearing Tr. at 84-85 (Bankr. S.D.N.Y. Apr. 26, 2006) (order approving the incentive plans entered May 15, 2006) (“the record before me validates that the focus of the plans and agreement is to maximize value for all the estates . . . [t]hey are not retention plans, although anyone can always make an argument that if people are made happier than they were before, then they are excited enough to stay with the company, but that’s not the focus of these plans”).

<sup>34</sup> Typically, any proposed management bonus or incentive compensation plan will be discussed with the creditors committee, and in some cases with other major creditor constituencies, before it is proposed to the court for approval. Thus, creditors ordinarily have input into the plan before it is put before the court for approval.

For bonus compensation that is intended to incentivize as opposed simply to retain insiders, and any compensation to non-insider managers, the § 503(c)(1) standard does not apply. Instead, the code requires only that these payments be “justified by the facts and circumstances of the case.”<sup>35</sup> Most courts have held that the § 503(c)(3) standard is the same as the “business judgment test,”<sup>36</sup> although some courts have articulated a higher standard.<sup>37</sup>

Section 302 of the bill would amend § 503 to do four things. First, it would extend the strict requirements imposed on insiders in § 503(c)(1) to “a senior executive officer, or any of the 20 next most highly compensated employees or consultants.” Second, for insiders, senior officers and the “20 next most highly compensated employees,” it would extend the requirements imposed by BAPCPA in § 503(c)(1), which now apply only to “retention bonuses” to insiders, to *all* bonuses, all incentive or performance compensation, and any “financial returns designed to replace or enhance incentive, stock, or other compensation . . .”, essentially making it impossible to make any such payments. Third, for these insiders, executive officers and the “20 next most highly compensated employees,” it would heighten the standard a court would have to apply in awarding compensation from “based on evidence in the record” to “clear and convincing evidence in the record.” Fourth, for compensation to all other managers and

<sup>35</sup> See 11 U.S.C. § 503(c)(3).

<sup>36</sup> The business judgment standard is the same standard that governs other debtor conduct, such as the decision to sell assets under § 363 or to assume or reject executory contracts under § 365. See, e.g., *In re Dana Corp.*, 358 B.R. at 576-77 (acknowledging that courts review key employee incentive programs by considering the standards of the sound business judgment test); *In re Nobex Corp.*, Case No. 05-20050, Hearing Tr. at 86-87 (Bankr. D. Del. Jan. 12, 2006) (order approving the management incentive plan at issue was entered Jan. 20, 2006) (stating that § 503(c)(3) is the “catch-all and the standard . . . for any transfers or obligations made outside the ordinary course of business . . . that are justified by the facts and circumstances of the case . . . I find it quite frankly nothing more than a reiteration of the standard under 363 . . . the business judgment of the debtor . . .”).

<sup>37</sup> See *In re Pilgrim’s Pride Corp.*, 401 B.R. 229 (Bankr. N.D. Tex. 2009) (holding § 503(c)(3) sets a higher bar than the business judgment test).

consultants hired by a debtor, it would replace the current “business judgment” standard in § 503(c)(3) with a considerably more stringent standard, requiring that the court find “based upon clear and convincing evidence” that any payments are “essential to the survival of the debtor’s business,” and “reasonable compared to individuals holding comparable positions at comparable companies in the same industry and not disproportionate in light of economic concessions by the debtor’s nonmanagement workforce during the case.”

Modifying the Bankruptcy Code to implement the proposed amendments in § 302 of the bill would, in my view, be a mistake.

First, the amendment to § 503(c)(1), which would effectively disallow *any* bonus or incentive compensation for senior management or any of the “20 next most highly compensated employees,”<sup>38</sup> would preclude a court from authorizing such compensation even where the evidence shows that paying such compensation is necessary and in the estate’s best interest. I believe that bankruptcy judges are in the best position to determine, under the facts of the particular case and after hearing the evidence and arguments from all interested parties, whether a proposed bonus or incentive compensation plan is in the estate’s best interest. Divesting the court of this authority -- and replacing it with a rule that would effectively preclude such payments regardless of the facts or the merits -- will not further the goals of chapter 11.

As noted above, under current law, payments made to a debtor’s insiders for incentive purposes (*i.e.*, payments that are conditioned upon the accomplishment of specified objectives),

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<sup>38</sup> As I discussed above, inclusion of the “20 next most highly compensated employees” is arbitrary. See *supra* pg. 6, n.4 and pg. 17. The purpose of § 503(c)(1) is to ensure that there is oversight and scrutiny of compensation that is awarded to “insiders” of the debtors -- those individuals who control the debtor and have decision-making authority. However, in some cases, these 20 employees will include employees who have no decision-making control or authority, and no input regarding the company’s compensation decisions. Indeed, in some cases the “top 20” will include union represented employees. Requiring that, in all cases, the twentieth highest paid employee will be treated differently than, say, the twenty-first highest paid employee, is irrational.

as opposed to retention or stay bonuses, are not subject to the § 503(c)(1) restrictions, but are instead evaluated under the “business judgment” standard in § 503(c)(3). However, these incentive payments are not made without significant prior scrutiny. Such payments are not only reviewed by the debtor’s board of directors (typically including outside directors), but also by the creditors committee, bank lenders, the United States Trustee and the bankruptcy judge. Any interested party can object to payments the debtor proposes to make. This scrutiny precludes a debtor from paying excessive or unnecessary compensation to its managers during a chapter 11 bankruptcy, but it permits the court to authorize such compensation where the evidence shows that it is appropriate and in the estate’s best interest.<sup>39</sup> This scrutiny by interested parties, and by the court, is a good thing, and it should continue. But a provision making it effectively impossible to pay senior managers (or the “20 next most highly compensated employees”) any incentive or similar compensation, even where doing so is in the estate’s best interest, would be counterproductive, and is likely to lead to a loss of management talent.

Second, amending § 503(c)(3) to condition any payments to managers (including non-insiders) or consultants on a finding by the court that such proposed compensation is “reasonable compared to individuals holding comparable positions . . .” and “not disproportionate in light of economic concessions . . .” is, at least potentially problematic, depending on how the provision is interpreted.

The first part of the provision -- “reasonable compared to individuals holding comparable positions at comparable companies in the same industry” -- standing alone, would not be

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<sup>39</sup> See *In re Pilgrim’s Pride Corp.*, 401 B.R. at 237 (“section 503(c)(3) is intended to give the judge a greater role: even if a good business reason can be articulated for a transaction, the court must still determine that the proposed transfer or obligation is justified in the case before it. The court reads this requirement as meaning that the court must make its own determination that the transaction will serve the interests of creditors and the debtor’s estate”).



particularly problematic since few debtors seek to pay materially above-market compensation to their managerial employees, and even under current law the court has the authority under § 503(c)(3) to decline to approve above-market or otherwise excessive payments to managers or consultants. So, on the one hand, this part of the amendment would not be troublesome, but on the other hand, it is not necessary because the concern is addressed adequately under existing law.<sup>40</sup>

However, the second part of the provision, which represents an effort to tie management compensation to union workforce compensation, is more troublesome. The requirement that management and consultant compensation be “not disproportionate in light of economic concessions by the debtor’s nonmanagement workforce during the case” language is obviously somewhat vague, but appears to be intended to create a basis for disallowing or reducing management compensation -- even if that compensation is already at or below market-competitive levels -- in cases where the debtor has obtained, through negotiations or court relief, labor cost concessions.<sup>41</sup>

If this provision were construed to prohibit courts from authorizing bonus or other incentive compensation payments to management employees or consultants in cases in which represented employees agree to, or are compelled to, accept concessions, the provision would be problematic. There are some cases in which a debtor must obtain wage, benefit and work rule

<sup>40</sup> One concern, however, is that the “same industry” is not always the best measure of appropriate compensation. In some cases a better measure might be the geographic market in which the debtor operates. Courts should have flexibility to evaluate these issues on a case-by-case basis.

<sup>41</sup> One could potentially construe the “not disproportionate” language to mean that management should not be paid above-market compensation while represented workers are paid below-market compensation. However, because the “not disproportionate” language is *in addition to* the provision that limits payments to market-competitive levels in the particular industry, I assume that the “not disproportionate” language is intended to mean more than simply limiting each group of employees to market-competitive compensation for their particular job.

concessions from union employees in order to bring labor costs in line with the market for comparable services -- in other words, to reduce above-market compensation and/or benefits to a market-competitive level. If a debtor that obtains such concessions is thereby precluded from providing market-competitive wages and benefits (including incentive compensation) to management employees, or from paying consultants market-based fees for their services, it would essentially punish the debtor and its management for undertaking difficult but necessary cost-cutting measures, and would interfere with the debtor's ability to retain management employees.<sup>42</sup> I agree that a debtor should not pay its management employees materially above-market compensation (in other words, compensation that goes beyond what is reasonably necessary to retain their services and to incentivize them to accomplish relevant objectives), while paying represented employees below-market wages and benefits. But going beyond that, and creating some artificial linkage between management compensation and the compensation of represented employees, would ignore the economic reality that there are different labor markets for different jobs, and would make retention of management employees even more difficult than it already is.

The provision that would preclude incentive or similar compensation to managers unless it is "essential to the survival of the debtor's business" sets an unreasonably high standard. A more appropriate standard would be whether the payments are in the best interest of the bankruptcy estate.

For many of the same reasons noted above, implementing the amendments proposed in § 301 of the bill would also be imprudent. First, § 301 of the bill would, through an amendment

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<sup>42</sup> This may be a part of the purpose of this provision -- the intent may be to create a disincentive for managers to seek labor cost concessions by threatening the managers' own compensation if they do so. Other provisions of the bill, including § 304, appear to have a similar objective. See *infra* pg. 45.

to § 1129(a)(4),<sup>43</sup> require that payments made to insiders, senior officers, or any of the “20 most highly compensated employees or consultants providing services to the debtors,” could be approved only “as part of a program of payments or distributions generally applicable to employees of the debtor, and only to the extent that the court determines that such payments are not excessive or disproportionate compared to distributions to the debtor’s nonmanagement workforce.” I agree that it is appropriate to ensure that compensation is not excessive. However, the standard should be whether the services rendered were necessary, the extent to which the debtor and its estate received value from such services, and the market rate for such services. A standard that creates artificial linkage between union employees’ wages and benefits, on the one hand, and payments of the type contemplated by § 1129(a)(4) on the other hand, is not useful.

Section 301 of the bill also would, through an amendment to § 1129(a)(5),<sup>44</sup> require the bankruptcy court (i) to approve the compensation to be paid to insiders of the debtor *after* emergence from bankruptcy, and (ii) to find the post-emergence compensation to be “reasonable when compared to persons holding comparable positions at comparable companies in the same industry and not disproportionate in light of economic concessions by the debtor’s non-management workforce during the case.”

Requiring bankruptcy courts to approve post-bankruptcy compensation plans for senior managers is inconsistent with the notion that, once reorganized, a debtor should make its own

<sup>43</sup> Section 1129(a)(4) sets forth the requirements that payment, made or promised by the debtor or person issuing securities or acquiring property under the plan, for services in connection with the bankruptcy case or plan, be disclosed and approved by the court.

<sup>44</sup> Section 1129(a)(5) requires that, in order for a court to confirm a plan of reorganization “the proponent of the plan has disclosed the identity of an insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.” 11 U.S.C. § 1129(a)(5)(B). Under current law, the debtor is required to disclose compensation to insiders, but court approval of such post-bankruptcy compensation is not required.

business decisions and freely compete in the marketplace. Typically the court's supervision of a debtor ends after its plan becomes effective (other than limited post-confirmation proceedings, intended to wrap-up the bankruptcy, such as claim objections). Bankruptcy courts should not be in the business of approving or disapproving a debtor's compensation plans -- or other business decisions made by the company -- after the debtor emerges from bankruptcy.

The provision in § 301 of the bill requiring the court to find the post-emergence compensation to insiders to be "reasonable when compared to persons holding comparable positions at comparable companies in the same industry and not disproportionate in light of economic concessions by the debtor's nonmanagement workforce during the case," is nearly identical to the provision in § 302 of the bill regarding approval of management and consultant compensation during a bankruptcy case under § 503(c)(3) of the Bankruptcy Code, and would suffer from the same failings. A provision that could preclude a company from paying market-competitive wages and benefits to insiders upon emergence from bankruptcy, on the basis that it obtained labor cost concessions during the chapter 11 case, could doom reorganizations to failure, to the detriment of all constituencies, including labor. Debtors emerging from bankruptcy need strong and properly incentivized senior management teams. Moreover, investors who make chapter 11 reorganizations possible are less likely to fund a debtor's emergence from chapter 11 if there are unreasonable restrictions on the reorganized debtor's ability to pay competitive wages and benefits, including appropriate incentives, to the reorganized debtor's management team. In addition to these issues, the proposed amendment to § 1129 could lead to time-consuming and costly litigation at the time of plan confirmation, as plan opponents seek to exert leverage to obtain unrelated plan modifications, and labor unions

seek revenge for §§ 1113/1114 relief. The provision would thereby make plan confirmation more difficult, more time consuming and more expensive.

Simply put, the problem with both §§ 301 and 302 of the bill is that debtors should not be forced to choose between obtaining necessary concessions from labor groups or providing market-competitive wages, benefits, and incentives to management employees. Instead, all employee groups should, to the extent of the debtor's ability to do so, be paid market-competitive wages and benefits, recognizing that there are distinct markets for different types of employees.

Indeed, in order to retain and attract management talent, a debtor *must* be able to pay market-competitive wages and benefits to its management employees. In many cases, this will include bonus or other incentive-based compensation. This is true for at least five reasons. First, bonus and incentive compensation is a typical component of executive pay, which the debtor's competitors are likely to pay -- so the debtor must pay similar bonuses just to remain competitive. Second, because managing a debtor is typically a less attractive job than managing a financially stable competitor -- a harder job with more stress and materially greater risk -- the debtor may need to pay greater bonus amounts than financially stable (non-bankrupt) competitors. Third, and related to the preceding point, competitors of a chapter 11 debtor often see the bankruptcy as an opportunity to "pick off" the competitor's best talent, both at the senior levels and at mid-level management. This can cause tremendous instability for a debtor and diminish the prospects for successful reorganization. Bonus and incentive compensation is often the debtor's only defense to these efforts. Fourth, unlike their competitors, debtors ordinarily cannot offer their management employees compensation in the form of equity (stock or options), because their equity is most often out-of-the-money. In order to remain competitive with other

companies that offer stock compensation, the chapter 11 debtor must pay additional cash compensation. Fifth, chapter 11 debtors find incentive compensation to be a useful tool in motivating their management teams to achieve challenging objectives and to produce results that inure to the benefit of all constituencies.

For all of these reasons, implementing this bill which imposes additional restrictions on the payment of management and consultant compensation would be a mistake. Judges are already, under current law, able to police excessive compensation, and creditors' committees, the United States Trustees, and other constituencies have been active in raising these issues with the courts where they believe the proposed management bonus or other compensation is excessive. However, if this bill is enacted, and it precludes debtors from paying market-competitive compensation, including bonus and incentive compensation, to their managers and consultants during the chapter 11 case and after emergence, their best managers and consultants are likely to find alternative employment, thereby imperiling the debtor's reorganization efforts.

Section 303: Recovery of Executive Compensation

Section 303 of the bill would amend Bankruptcy Code § 365, which deals with the assumption, assignment and rejection of executory contracts, to add two new subsections, (q) and (r). Subsection (q) would preclude a debtor from assuming a deferred compensation plan for the benefit of insiders, senior officers or any of the "20 next most highly compensated employees" of the debtor, if the debtor has terminated its defined benefit plans during or within 180 days prior to the bankruptcy filing. Subsection (r) is almost identical; except it would preclude a debtor from assuming a plan, fund, program or contract to provide retiree benefits to these same senior officers and "20 next most highly compensated employees," if the debtor had obtained

§ 1113/1114 relief in respect of health benefits for active or retired employees during or within 180 days prior to the bankruptcy filing.

There are some cases in which it is necessary to terminate a defined benefit plan (or impose § 1113/1114 relief) in order for a company to be able to remain a viable going concern. Under these circumstances, termination of the plan or benefits is consistent with the fiduciary duty of officers and directors. This provision would punish management for the proper exercise of their fiduciary duty by eliminating what is often an important element of management compensation. It would thereby make the job of attracting and retaining management talent to a company in or on the verge of bankruptcy materially more difficult.

This section also seeks to create an equivalence between unrelated plans -- a management deferred compensation plan and an employee defined benefit plan. Instead of this artificial linkage, a company (and a court) should look at each plan in terms of whether it serves a legitimate business purpose, whether it provides benefits that are competitive in the marketplace, whether the debtor's obligations under the plan are affordable in light of the debtor's financial circumstances, and what would be the likely consequences of a proposed assumption, rejection or termination.

Section 304: Recovery of Executive Compensation

Section 304 of the bill would add a new provision to the Bankruptcy Code, § 563, to create a cause of action against certain officers and directors for the return of their personal compensation in an amount equal to the percentage reduction of collective bargaining obligations (or retiree benefits) implemented by a debtor pursuant to §§ 1113 and 1114, including any reduced benefits as a result of the termination of a defined benefit plan after the date that is 180 days before the petition date. This provision apparently seeks to create a disincentive for a

company to seek to modify collective bargaining agreements or retiree benefits, or to terminate a defined benefit plan, by threatening the personal compensation of individuals involved in making the decision to seek such relief.

As discussed above, §§ 1113 and 1114 relief is available only when a clear case has been made that such relief is necessary for the debtor to reorganize, and where, after the company engaged in good faith bargaining, the union unreasonably refused to make the necessary concessions. Where such circumstances exist, it is appropriate for a debtor to seek relief. Indeed, in such a situation, the debtor's failure to seek relief may well result in liquidation, with a resulting loss of jobs and creditor recoveries. The debtor's officers and directors should not be forced to operate under a threat that, if they do what is in their company's best interest, they will be sued and required to disgorge their own compensation. This would create an inappropriate disincentive for officers and directors. It would put such individuals in a Catch 22 position -- they either decline to implement labor cost reductions that are necessary for their company to reorganize, or they implement such reductions but thereby expose themselves to a lawsuit to disgorge their own compensation. As with several other provisions in the bill, this provision would make it more difficult for a troubled company (particularly one with labor cost issues) to retain and attract officers and directors.

Section 305: Preferential Compensation Transfer

Another provision of the bill that would impose a burden on senior management employees is § 305. This section would amend § 547 of the Code (which establishes the criteria for preference actions) to add a new subsection, § 547(j), providing that transfers made or obligations incurred in anticipation of bankruptcy, to or for the benefit of an insider (or to a consultant who was formerly an insider, and is retained to provide services to the debtor), can be



recovered as a preferential transfers. In addition, new subsection § 547(j) would eliminate the § 547(c) defenses to any such preference action.

By subjecting senior managers and consultants to preference actions, this provision would create an additional disincentive for anyone who had other viable options to contract with or remain employed by a financially troubled company that is considering bankruptcy. Discouraging qualified individuals who are familiar with a debtor and its business from remaining with the company during its chapter 11 case is inconsistent with the reorganization objective of chapter 11. Courts already have sufficient tools to ensure that debtors do not pay excessive compensation to their managers or consultants, whether as a result of obligations incurred in contemplation of bankruptcy or otherwise.

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In enacting chapter 11, Congress observed that, “[i]t is more economically efficient to reorganize than liquidate, because it preserves jobs and assets.” H.R. Rep. 95-595, 95th Cong., 1st Sess. 220 (1977). More than thirty years of chapter 11 history proves that this is true. Where a company is able to reorganize, creditors tend to recover more, customers and suppliers enjoy continued relationships, taxing authorities continue to receive revenues, employees retain their jobs, and local communities benefit. Unfortunately, chapter 11 reorganization is not easy. First, it is expensive. Second, it requires a stable and talented management team to lead the effort. Third, it requires hard decisions, including sometimes painful cost cutting, to bring costs in line with revenues, and with the competitive marketplace. Fourth, it typically requires financing, which is increasingly hard to obtain. Fifth, it requires a balancing among competing interests which are often difficult to reconcile.

In an effort to protect the interests of, and maximize value for union employees, H.R. 4677 is likely to impede chapter 11 reorganizations. It would increase costs. It would make attracting and retaining talented management much more difficult. It would impair a debtor's ability to bring labor costs into line with the competitive marketplace, even when doing so is necessary in order for the company to remain viable. It would make financing less available and, where available, more expensive. And it would, by moving labor to the front of the line, diminish the recoveries of other constituencies, and thereby make the balancing of interests that is at the heart of the chapter 11 process more difficult to achieve.

Therefore, H.R. 4677, may ultimately, if enacted, have the opposite impact of what is intended -- it may make it more difficult for employees to preserve their jobs or retiree benefits because such legislation may cause more companies to liquidate instead of reorganize. In the end, if this bill is enacted, it is likely to be a pyrrhic victory for employees and unions.

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Mr. COHEN. The final witness is Mr. Robert Roach, Junior. Mr. Roach started with the International Association of Machinists as a ramp serviceman for TWA and a member of the local lodge in New York City. He has been a union representative since 1979, holding numerous worker advocate positions. He became a member

of the IAM Executive Council, General Vice President of the Transportation Department in June 1 of 1999, reelected in 2001, 2005 and 2009.

As General Vice President of Transportation, he oversees and coordinates 150 collective bargaining agreements covering U.S. Rail and air carriers, foreign-flag airlines, and airline service companies.

Thank you Mr. Roach. We always like to see people who win elections. Thank you for your testimony.

**TESTIMONY OF ROBERT ROACH, JR., INTERNATIONAL  
ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS**

Mr. ROACH. Thank you, Mr. Chairman and Ranking Member Franks for the opportunity to come and speak before this Committee. My name is Robert Roach, Junior. I am the General Vice President of the Transportation Department for the Machinists Union. I am appearing as the designated representative of International President R. Thomas Buffenbarger. The IAM is among the Nation's largest industrial trade unions, representing nearly 700,000 active and retired members, covering more than 5,000 collective bargaining agreements in transportation, aerospace, ship building and defense-related industries.

I am speaking to you today as a union representative with 25 years experience in bankruptcy and with extensive bankruptcy experience, and as a retired airline employee who has personally felt the effects of airline bankruptcy. I have personally witnessed the destruction of tens of thousands of lives with the Chapter 11 process. The Machinist Union strongly supports the passage of H.R. 4677 to protect employees in corporate bankruptcies.

While Chapter 11 bankruptcy can provide struggling companies an opportunity to regroup and avoid liquidation, it has increasingly been abused as a means to get a leg up on the competition.

In 1984 Congress created section 1113 of the Bankruptcy Code in response to companies using bankruptcy as a weapon to eliminate employee collective bargaining agreements; however, section 1113 of the current law has deteriorated the collective bargaining process and not enhanced it. Recent court decisions actually incentivized employees not to reach an agreement with their unions. Good-faith bargaining can only be achieved when there is a level playing field and both parties have something to gain or lose at the bargaining table.

The employee's right to withdraw services ensures that both the parties understand the consequences of failing to reach a negotiated agreement.

The current inequitable bargaining process has dramatic consequences. United Airlines' IAM members were forced to sacrifice more than \$4.6 billion. Workers lost wages, pensions and jobs.

US Airways. In US Airways' first bankruptcy in 2002, IAM members were forced in two rounds of contract concessions totaling \$276 million per year, \$1.8 billion over 6½ years.

In the second US Airways bankruptcy, pay cuts of up to 15 percent. Northwest bankruptcy, pensions were frozen 11.5 percent, wage cuts, and jobs eliminated.

At the same time, the executives who fail to operate these airlines as an ongoing concern, who put the airlines in bankruptcy in the first place, then reap benefits of high bonuses, stock options, lucrative salaries and perks.

Since these bankruptcy cases focus more on what could be extracted from employees, rather than developing a new business plan, as a result these same carriers seem to be still struggling today. Bankruptcy carriers forced other airlines who were operating as ongoing concerns, like American and Continental, to threaten employees with bankruptcy if they didn't agree to cuts. The current bankruptcy laws were used as a bargaining weapon, not because of the need to restructure, but as an alternative to liquidation.

In the end, somebody must pay. I think the Congress seems to understand that when people lose their jobs, when people lose their health insurance, that somebody pays. And these people either wind up on some social service program, Medicaid, Medicare, or the PBGC assumes these liabilities. And the PBGC today is some \$30 billion underfunded. Auto, steel, banking, newspaper, cable television, and trucking companies are among the more than 100 publicly traded companies that seek Chapter 11 bankruptcy protection each year.

IAM members, at auto parts supplier Dana Corporation, saw their company eliminate retiree medical benefits in bankruptcy. IAM members at Kaiser Looms saw their pensions terminated in bankruptcy, resulting in the loss of some promised.

Bankruptcy laws should be amended to ensure employees engaged in good-faith bargaining bankruptcy laws must strictly limit executive bonuses, stock grants and other executive compensation.

Bonuses paid to executives after emerging from bankruptcy must be reviewed by the court and take into account the amount of pain inflicted upon employees during the filing of bankruptcy. The PBGC, the quasi-governmental agency, should have the financial resources available to guarantee all the vested benefits promised in a pension plan without reduction of maximums.

Congress should make bankruptcy a less attractive mechanism to dump pension obligations onto the Federal Government. The PBGC needs to have the ability to enforce pension funding rules on a level playing field, increase the priority claims limit for wages, provide employees and retirees with the ability to recover pension losses, direct judges to consider how reorganization plans will impact jobs, collective bargaining agreements, pensions, and retiree benefits when approving reorganization plans.

The MachinistS Union strongly supports comprehensive bankruptcy reform contained in H.R. 4677 that will protect our Nation's workers, require shared sacrifice among all stakeholders.

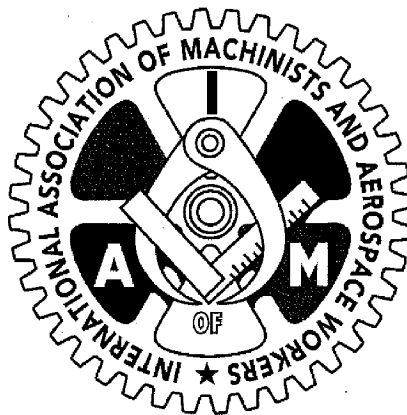
Thank you for the opportunity to speak and for the invitation. I look forward to your questions.

Mr. COHEN. Thank you, Mr. Roach.

[The prepared statement of Mr. Roach follows:]

PREPARED STATEMENT OF ROBERT ROACH, JR.

**Testimony of Robert Roach, Jr.  
General Vice President of Transportation  
International Association of Machinists  
and Aerospace Workers**



**Before The  
House Committee on the Judiciary  
Subcommittee on Commercial and Administrative Law  
“Protecting Employees and Retirees  
in Business Bankruptcies”  
May 25, 2010**

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General Vice President of Transportation  
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"Protecting Employees and Retirees in Business Bankruptcies"  
May 25, 2010**

Thank you, Chairman Conyers, Subcommittee Chairman Cohen, Ranking Member Franks and members of this Committee for the opportunity to speak to you today. My name is Robert Roach, Jr., General Vice President of Transportation for the International Association of Machinists and Aerospace Workers (IAM). I am appearing at the request of International President R. Thomas Buffenbarger. The IAM is among the nation's largest industrial trade unions, representing nearly 700,000 active and retired members under more than 5,000 contracts in transportation, aerospace, shipbuilding, manufacturing and defense-related industries.

I am speaking to you today as both a union representative with extensive bankruptcy experience and a retired airline employee who has personally felt the effects of airline bankruptcies. I have witnessed the destruction of tens of thousands of lives through the Chapter 11 process. The Machinists Union membership strongly supports the passage of H.R. 4677 to protect employees in business bankruptcies.

While Chapter 11 bankruptcy can provide struggling companies an opportunity to regroup and avoid liquidation, it is increasingly abused as a means to get a leg-up on the competition. The Machinists Union has an enormous interest in seeing a floundering company survive because, simply put, if the company doesn't survive neither do our members' jobs. But company's are increasingly using bankruptcy as a means to take what they can from employees outside of the normal collective bargaining process, not just what is needed for a corporation to survive.

In 1984, Congress created Section 1113 of the bankruptcy code in response to companies using bankruptcy as a weapon to eliminate employee collective bargaining agreements. Frank Lorenzo famously manipulated the system in just such a way. In the last decade, that same exploitation of the courts re-appeared, largely in the same industry Lorenzo was expelled from, air transportation.

Under current bankruptcy law, if a company seeks to modify labor agreements and a union does not comply, the company can ask a judge to reject their contracts, and employees have no recourse. Under this unfair corporate advantage, employees have suffered greatly, and changes are needed.

Section 1113 of the current law has deteriorated the collective bargaining process, not enhanced it. It does not offer the employee protections Congress envisioned in 1984. Section 1113 only provides a checklist of perfunctory steps

that must be followed before a judge can reject a labor contract. It does nothing to encourage good-faith bargaining.

In fact, recent court decisions actually incentivize employers not to reach an agreement with their unions. Some courts suggest that workers do not have the right to engage in self-help if the bankruptcy court rejects their collective bargaining agreement. Good-faith bargaining can only be achieved when there is a level playing field and both parties have something to gain – or lose – at the bargain table. Today, there is no downside for employers failing to reach an agreement. They just follow Section 1113 as a roadmap that ends either in contract rejection or employees accepting a disproportionate share of the bankruptcy pain. The right to self-help ensures that both bargaining parties understand the consequences of failing to reach a negotiated agreement, and must be guaranteed.

The current, inequitable bargaining process has dramatic consequences.

Immediately after its Chapter 11 filing, United Airlines asked a bankruptcy judge to impose 14% "emergency" pay cuts on IAM members. The judge complied. More long-term cuts in pay and benefits cost IAM members \$460 million a year (or \$2.644 billion over the life of the agreement). United then took steps to cut health benefits for existing retirees and filed a motion in court to ask a judge to impose cuts if agreements could not be reached with the retirees'



representatives. This merciless move cost fixed-income retirees \$50 million a year.

In the summer of 2004 United ceased funding its pension plans, the first in a series of steps which ultimately led to their termination by the Pension Benefit Guaranty Corporation (PBGC).

In January 2005, United once again sought and received "emergency" pay cuts from the bankruptcy court - this time it was 11%. Six months later IAM members gave up another \$176 million a year to save United. Savings attributable to the termination of IAM member's pensions saved United an additional \$217 million a year.

In total, IAM members were forced to sacrifice more than \$4.6 billion for United Airlines.

In US Airways' first bankruptcy in 2002, IAM members agreed to two rounds of contract concessions totaling \$276 million per year, or \$1.8 billion over 6 1/2 years. Pay was cut by an average of 7.5%. Employees also experienced drastic increases in their contributions for healthcare coverage, which had the effect of reducing take-home pay even further.

Immediately after filing for bankruptcy for the second time in as many years, US Airways management petitioned the court to impose "emergency" pay cuts of

23% for all union-represented employees. The bankruptcy court reduced the amount to a still-staggering 21% cut in pay. Eventually, US Airways' mechanics saw their pay cut by an average of 15%. Management and salaried employees' pay was reduced by only 5% to 10%.

Our Northwest Airlines members saw their pension plans frozen, and took 11.5% pay cuts as a result of management's bankruptcy. This story has been repeated throughout the airline industry.

And how did the executives who steered their airlines into bankruptcy fare in the process? They were rewarded for failure.

US Airways CEO David Siegel was rewarded with \$1.45 million the year his airline exited its first bankruptcy and another \$9 million in 2003, the year in between the airline's two bankruptcies. Siegel's successor, Bruce Lakefield, orchestrated massive pay, benefit and job cuts for front-line employees during the airline's second bankruptcy - but he refused to accept a wage cut for himself.

Northwest CEO Doug Steenland was granted \$26.6 million in stock upon the carrier's 2007 exit from bankruptcy, plus a cash salary that year of over \$500,000.

In 2006, on the day after emerging from the longest bankruptcy in airline history, United Airlines CEO Glenn Tilton was rewarded with \$20 million in stock and

options. During the first month out of bankruptcy he was granted additional stock and options valued at \$18 million. Tilton also had a base salary of \$687,000 and bonuses totaling \$839,000 that year. Finally, he had \$210,000 worth of "other compensation" including a car & driver and reimbursement of taxes. Tilton's total compensation in the first year after United's bankruptcy was \$39.7 million.

In these major airline bankruptcies, much of the financial sacrifices employees made to save their company were diverted into the pockets of the people responsible for the company's failure. It shouldn't be surprising that since these bankruptcy cases focused more on what could be extracted from employees than developing a new business plan, the airlines are still struggling and now looking for mergers to save them.

Because airlines such as Delta, United, Northwest, US Airways and others successfully manipulated the bankruptcy process to extract billions from employees, carriers such as American and Continental threatened employees with bankruptcy if they too did not accept contract concessions. Their threatened bankruptcies were not to avoid liquidation, but those airlines claimed bankruptcy may be necessary to lower labor costs to remain competitive in the industry's race to the bottom. The current bankruptcy laws were used as a bargaining weapon, not because of a legitimate need to restructure or as an alternative to liquidation.

While airline employees have been hard-hit by the impacts of bankruptcy, they are certainly not alone. Auto, steel, banking, newspaper, cable television, and trucking companies are among the more than 100 publicly-traded companies that seek Chapter 11 bankruptcy protection each year.

IAM members at auto parts supplier Dana Corporation saw their company eliminate retiree medical benefits in bankruptcy. Other IAM members at Kaiser Aluminum felt the stinging effects of bankruptcy when the PBGC took over administration of their terminated company-sponsored defined benefit pension plan. Current and future retirees lost value in their promised benefits as well as supplemental disability benefits the PBGC does not guarantee.

Bankruptcy law should be amended to ensure employers engage in good-faith bargaining when seeking contract modifications. Companies should no longer be able to use the bankruptcy code to eliminate decades of collective bargaining gains when there is no justifiable reason - other than corporate greed.

If employees are called upon to sacrifice in order to resurrect their bankrupt employer, bankruptcy law must require that everyone from the break room to the board room shares the pain. Executive bonuses, stock grants, and other compensation enhancements proposed during a bankruptcy must be strictly limited. Bonuses paid to executives after emerging from bankruptcy must be reviewed by the court and take into account the amount of pain inflicted upon employees during and following bankruptcy. Employees cannot be asked to

sacrifice wages, pensions, healthcare and jobs in order to line the pockets of the same people who bankrupted the company in the first place.

The IAM believes companies should be required to pay into pension funds as benefits are earned. An employee accepts lower immediate wages based on an employers' promise of a pension. Employers should not be allowed to abuse bankruptcy laws to break the pension promises workers count on to live in retirement with dignity. Additionally, the PBGC should have the financial resources available to guarantee all of the vested benefits promised in a pension plan without reduction or maximums.

The pension troubles in the airline and steel industries were caused by employers taking advantage of loose pension funding requirements and using equity in pension plans to defer actual cash contribution on behalf of employees. When the stock market tanked, so did the pension plans. Pension defaults in the steel, airline and other industries helped the PBGC move from a surplus of \$7.7 billion at the end of fiscal year 2001 to a deficit of more than \$20 billion today.

Currently, the PBGC has no power in bankruptcy to force companies to make required pension contributions. A company can simply refuse to pay and force the PBGC to initiate a pension termination to prevent a plan from accruing further pension liabilities. Congress must make bankruptcy a less attractive mechanism to dump pension obligations on the PBGC. The PBGC also needs to have the

ability to enforce pension funding rules on a level basis – whether or not a plan sponsor is in bankruptcy.

Comprehensive bankruptcy reform should also increase the priority claim limits for wages, provide employees and retirees with the ability to recover pension losses, and direct judges to consider how reorganization plans will impact jobs, collective bargain agreements, pensions and retiree benefits when approving plans.

The Machinists Union strongly supports the comprehensive bankruptcy reform contained in H.R. 4677 that will protect our nation's workers and require shared sacrifice among all stakeholders.

Thank you again for the invitation. I look forward to your questions.

Mr. COHEN. We have now concluded our testimony and we will go to the questioning period. I will recognize myself first for 5 minutes.

Mr. Sprayregen, I appreciated your testimony and I think you made some really good points. But in your testimony, you said that the debtor's perspective is different than the others testifying today, because the debtor is charged with the responsibility of weighing the interest of creditors, employees, retirees and consumers, among others. "Employees" includes the executives, I guess.

Would you not see a conflict of interest in the executives who bring about, have to bring about, even if they think so, don't want to, to bring their companies into the bankruptcy proceedings, who hire the attorneys who represent the company, having their own compensation and benefits be part of what has to be. The debtor has its duty, being the responsibility of weighing those interests. Can the management really do that? Don't they have a conflict of interest?

Mr. SPRAYREGEN. Sir, yes, they actually do. And that is why in most situations those issues are actually handled at the board of directors' level rather than by management, because of that precise issue.

Mr. COHEN. Let's face it. The board of directors are picked by the president. It is an incestuous situation.

Show me an independent board, and I will show you a dysfunctional company.

Mr. SPRAYREGEN. I would tell you, sir, with all due respect, the boards that I have represented over the years have strived to do a very good job. But more importantly, they have to go before the court with notice and opportunity for all of the various stakeholders to have input on whatever the proposed plan is, and then there have been numerous tweaks to the compensation legislation over the years. And the judge takes into account all of those inputs from various parties.

And my point on that is it is not that that system works perfectly, but more that it needs to be dealt with; with more like a scalpel than a sledge hammer, that I think this bill is.

Mr. COHEN. Well, Mr. Sprayregen, you and Mr. Bernstein both take the position that this bill gives too much to labor. And you don't address too much—and let's say labor should take some hits. But the executives, they are labor too, they may not think it but they are—shouldn't just because they are not organized, because they don't have to be organized because they write the checks—shouldn't there be some changes to what their compensation is?

And to be honest, what was it—in the United Airlines, how much was the package for executives; 40 million or 400 million?

Mr. SPRAYREGEN. Yes, there absolutely should be compensation cuts on the shared sacrifice and shared pain basis. And in fact, United Airlines is a good example. On the first day of the bankruptcy case, the senior management took double-digit pay cuts to lead the way.

Mr. COHEN. Double-digit pay cuts. That was from what to what?

Mr. SPRAYREGEN. I don't have the specific numbers, but they took a percentage of pay reduction. Ultimately, everybody in the

company, both unionized and nonunionized personnel, all took pay cuts. And then as part of the overall exit, there were various compensation packages approved in the plan of reorganization by the court.

Mr. COHEN.. Mr. Bernstein, if it is a pro rata cut, is that what you generally see as pro rata, everybody gets 20 percent or something? Is that what happens?

Mr. BERNSTEIN. Do you mean among management and the labor groups?

Mr. COHEN. Yes, sir.

Mr. BERNSTEIN. Not in all cases. I think the way companies tend to look at these issues is by labor market. In other words, what a company's goal is to do is to pay each group of its employees, from the most senior management to the lower-level management to hourly employees and to the various represented employees, a wage and benefit package that is market-competitive; that is, that is commensurate with the market for those particular services.

Mr. COHEN. So if Masa charges \$300 for sushi, and in Memphis they only charge \$30 for sushi, they should get more money to buy the sushi to benefit the sushi chefs?

Mr. BERNSTEIN. I am not sure, Mr. Cohen, that I understood.

Mr. COHEN. The New York cost of living being outrageously high, and people live there and pay for things that, really, the costs are just insane—that we should pay those people to continue to foster those lifestyles of the rich and famous?

Mr. BERNSTEIN. What happens is if a company has employees in New York playing a certain role, it needs to look at what the going wage is for those services in that particular city for comparable companies.

Now, obviously, the going rate for a CFO is different than the going rate for a mid-level manager, is a different rate than the going rate for a truck driver.

But what a debtor in Chapter 11 can't do is to ignore the economic situation in which it operates, the competitive framework in which it operates. No debtor wants to pay materially more money than it needs to to any group of its employees.

Mr. COHEN. I just have 10 seconds. I have to cut you off and ask Ms. Ceccotti to tell me what you think about their arguments and this idea that management is taking a fair cut.

Ms. CECCOTTI. I think, Mr. Chairman, what that we are seeing here and I think what your questions are alluding to is that the bankruptcy code is now harboring or fostering an indefensible double standard. The notion that executives can use bankruptcy to further various pay schemes, bonuses, retention, and the like is something that is not supported, certainly, by anything in the law.

At the same time, what bankruptcy is supposed to do is it to provide a means for everyone to share the sacrifices. So if we are going to have shared sacrifice, then that means everybody shares. It doesn't mean we have a double standard where some groups are constantly sharing, and sharing to the point of changes to their living standard, while others are simply pocketing money or getting rewards under the guise of incentives or bonuses or however you want to phrase them.



So I think that what we have to do is we have to get back to the notion that the purpose of bankruptcy is to restructure the business through shared sacrifice, and "shared" means everybody.

Mr. COHEN. Thank you, Ms. Ceccotti.

My time has expired, and I recognize the Ranking Member, Mr. Franks, for 5 minutes.

Mr. FRANKS. Well, thank you, Mr. Chairman.

Mr. Sprayregen, I would like to try to just, kind of, get to the bottom line here. The union leaders at the table with you assert that labor unions currently have too little power during the reorganization process. That is essentially, you know, the purpose of the bill here that is being offered.

Tell me, do you agree with this assessment? And, if not, why not? Give us a little perspective on why you think that the unions either have too little or not enough power in the reorganization process.

Mr. SPRAYREGEN. Sir, I disagree with that perspective for numerous reasons. My experience in a number of cases and dealing with many of the witnesses at this table is there is tremendous power and tremendous leverage.

And we have to remember that most of those situations are resolved in the conference room, not in the courtroom. So we hear a lot of citations to things being rejected by judges, but ultimately these statutes are intended to foster bargaining, which is exactly what has happened. And the reason why most of these situations get to agreements is because there is tremendous leverage among the employee bargaining units of the various industries that we are talking about. And management and the boards and the other stakeholders know that and have to deal with that.

And, with all due respect to the folks at this table, the recoveries that are generated by these groups are healthy compared to the recoveries of other stakeholder groups. That is not to say they are good compared to what were the original promises, but the problem is there is not enough money to go around, by definition, in these situations.

Mr. FRANKS. Mr. Bernstein, would you like to take a shot at that same question? Essentially, do unions have too little power in the reorganization process as it stands now?

Mr. BERNSTEIN. No, I think, actually, the balance of leverage is quite good now. And that is consistent with what Congress stated its intention to be when it enacted Section 1113, to have a balance where each of the company and labor had risks, and that encouraged the negotiated resolutions.

And if you look empirically to what is actually happening, the facts on the ground, so to speak, in fact the overwhelming majority of labor management situations in bankruptcy are resolved through consensual negotiation.

We hear a lot about the Northwest Airlines case, and it was talked about today. But even in that case, which is held up as an example of a litigated case, in reality, six out of the seven labor unions reached an agreement with the debtor. It was consensually resolved in six out of seven. And, actually, even the seventh one, the flight attendants, was consensually resolved, except that the membership didn't agree with what its own union had done and vetoed its union's solution.

The reality is that the litigated cases get a lot of attention, but what is actually happening is that the overwhelming majority of the situations are resolved through negotiation, precisely because there is a delicate balance of leverage that Congress achieved in 1113.

What would happen in this bill is that we would upset that balance of leverage in many ways, some of which I alluded to in my written testimony. And, by doing so, it would result in more litigation and fewer negotiated solutions, which is inconsistent with Congress's goal.

Mr. FRANKS. Let me go ahead and ask you another question. We have had several hearings related to labor unions and bankruptcies during which union leaders have asserted that companies file for bankruptcy simply to get out of their union contracts, that that is the main predicate.

In your experience, do companies file for otherwise avoidable bankruptcies in order to force labor concessions?

Mr. BERNSTEIN. Absolutely not, Mr. Franks.

There are some cases in which the labor cost burden is so great that a company must, in connection with its reorganization, restructure its labor costs and rationalize them in order to be able to remain competitive. But no company that can otherwise remain competitive chooses to file Chapter 11 simply because they want to take potshots at labor. This is a very hard thing for a company to do. It is very hard to get approved by the courts. It affects morale, it affects relationships, and no company wants to do this.

But there are companies that have no choice because they are paying above-market wages and above-market benefits, and their very survival as an entity depends on their ability to rationalize their labor costs.

Mr. FRANKS. Mr. Sprayregen, I would like for you to take a shot at that same question. In your experience, do companies file for bankruptcy that, you know, would otherwise be avoidable in order to force labor concessions?

Mr. SPRAYREGEN. Companies file for bankruptcy because they are running out of money. And that is the reason that they file. It is not a decision taken lightly. It is not a fun process, even in the cases where there are no labor issues. It is a difficult process. I would also note that upwards of 65 percent of management, senior management, gets changed out, historically, as bankruptcy cases proceed.

So, no, that is not the purpose or the reason why bankruptcy cases are filed. And, as noted by Mr. Bernstein, if the cost structure of the company is not competitive, that is one of the things that is addressed through the bankruptcies, and that may be one of the reasons why the company is running out of money. But healthy companies very rarely file for bankruptcy.

Mr. FRANKS. Well, thank you, Mr. Chairman.

Thank all of you.

Mr. COHEN. I now recognize the distinguished gentleman from the Bay State, Mr. Delahunt.

Mr. DELAHUNT. Thank you, Mr. Chairman.

You know, I can see this playing out, you know, that there has to be competition with those who are paying—or companies that

find themselves in trouble because they are paying above-market benefits, above-market wages. I can just imagine a continuum of bankruptcies so that the end result will be the lowering of wages and benefits in an entire industry. Not bad. It increases the disparity in income and wealth, and those companies that survive, that management team is going to be doing pretty well. That management team is going to be doing pretty well.

I hear the term "balance," and I think many of the witnesses have used that term.

Mr. Bernstein, am I correct in assuming that you think the balance is right where it ought to be right now?

Mr. BERNSTEIN. Yes, sir, I do believe—

Mr. DELAHUNT. Yes, thank you.

And Mr. Sprayregen?

Mr. SPRAYREGEN. It is not perfect, but it is generally—

Mr. DELAHUNT. Well, how would you improve it?

Mr. SPRAYREGEN. I believe that the amendments contained in this bill largely, as I said, would not improve the—

Mr. DELAHUNT. But how would you improve it?

Mr. SPRAYREGEN. I do think there can be more concentration on the proper compensation structures for both union and non-unionized employees—

Mr. DELAHUNT. I would be very interested if you would, when you leave here today, if you could forward to the Committee just a list of your recommendations.

Mr. SPRAYREGEN. I would be happy to do so.

Mr. DELAHUNT. I think it would be educational.

You know, I think what is particularly sad or disturbing to me is not only the fact that this is really about people at the bottom line—that is my bottom line. And I think there is a particular segment that really have been done a terrible disservice, and those are the retirees, you know, men and women who thought they had a promise and that promise wasn't fulfilled, who thought they were going to get a pension that they didn't end up getting, that they thought that their health care coverage was going to continue and they went to the druggist and were told a day after or a day before the filing of a bankruptcy that they were no longer covered. I am thinking of a case in Massachusetts, the Polaroid company, who really, I thought—it was the ultimate in terms of callousness, et cetera.

Would you all agree that it is Congress that really establishes the priorities, that, you know, maybe—and I would be interested in anybody—Mr. Conway, Mr. Prater—that there ought to be a different treatment to those who have retired that no longer—who oftentimes their skills are outdated, promises have been made to them, and they find themselves so disadvantaged that they are not in a negotiating position.

I have to also allude to this consensual negotiation or resolutions. I mean, the truth is, Mr. Bernstein, you know, when you have a gun to your head, okay, you don't have a consensual relationship there. That is just sheer baloney. You have a choice of either saying, "Pull the trigger and blow my head off" or, "I am going to do what you"—you know, I don't have a choice.

In any event, let me just pose that last question out there. Mr. Prater? Mr. Conway? Anybody?

Mr. CONWAY. I think, as I was listening to both Mr. Sprayregen and Mr. Bernstein describe all the settlements that are reached outside of the court, it is exactly why this law needs to be revised. Because the unions know you can't go in that courtroom because you are not coming out. So you do have that gun to your head, and you have to reach some deal as best you can that impacts all those retirees and all those people.

And that proves the balance that we need restored here. It is so out of balance that to step in front of the judge in the courtroom, surrounded by all the lawyers and the bankers, the union stands little chance, so we cut our deals outside of—

Mr. DELAHUNT. Who are being well-paid, by the way.

Mr. CONWAY [continuing]. As best we can. And it speaks to the need for the change of this law.

Mr. PRATER. Congressman, I would agree with that. The balance has been completely destroyed. In fact, all you have to do is look at companies that have filed bankruptcy while they were profitable just so they could keep up with the Joneses across the street who had filed bankruptcy to destroy their labor contracts.

The impact and effect on our retirees is critical, to watch a 58-, 59-, 60-year-old man or woman be told that they have lost 75 percent of the income they have counted on. What we are missing here is, the CEOs and management teams don't stick around. It is the employees we represent that stick around for 25, 30, 35 years. We are the most vested people wanting to see a company reorganize, but they have thrown it completely out of whack by the imbalance created by the judges.

When 1113 was created, I was one of those employees in bankruptcy on strike to prevent Frank Lorenzo from throwing out our contract at Continental Airlines. 1113 was supposed to introduce fairness to the equation. However, under the recent court decision, it has been thrown out of whack. That is why we are here supporting this legislation.

Mr. ROACH. Yes, certainly, retirees, retirees at U.S. Airways lost their health insurance. At United Airlines, their health insurance costs were dramatically increased. At Northwest Airlines, there had to be a restructuring of health-care benefits.

And I think, again, I would like to say that many of these people wind up on programs funded by the government, and others just drift away. Pensions have been cut, and there is really nobody to speak for them.

And when you say about negotiated agreements, well, the choice is either they give you a number—\$950 million, \$1.2 billion—either you reach that number or they go into court, and the judge's alternative is to keep everything the way it is, which he is not going to do, or terminate that collective bargaining agreement and you start out with zero.

So these things, there is no balance. And you have to argue—I would have to argue that, when somebody goes into bankruptcy and people lose their pensions and health insurance and salaries are cut anywhere from 10 to 25 percent, and the same people who put that company into bankruptcy come out with a \$40 million pay

package, and you say, "Well, we need to keep these people around," those are the people you need to get rid of you. Those are not the put you keep around. They put them in bankruptcy in the first place. And so we pay them additional money to keep them around.

You have every major bankruptcy in the airline industry where people have put airlines into bankruptcy—Dave Siegel from U.S. Airways, he stuck around for about 6 months and got \$5 million. These are the types of things that we are talking about. We are not talking about talented people.

When you talk about a level playing field for companies, you got American Airlines and Continental Airlines paying the same wages as United and U.S. Airways, but they didn't go into Chapter 11. The management ran the business, and so—but they were forced to go to their employees to get cuts because United, U.S. Airways, and Northwest, they go into bankruptcy and cut the wages of the people. Southwest Airlines, 95 percent unionized, pays the highest wages and benefits in this country to their airline employees, and they run a profitable airline.

It has to do with somebody who is running the business has an ongoing concern, or somebody who is looking for the perks and the bonuses and the incentive packages that come along to putting a company into bankruptcy, hiring my good friend, Mr. Sprayregen, who I have spent many nights with, having to deal with the bankruptcy issues, and coming out. My allegiance is to the members, his allegiance to the client. And so, if the client says, "You get me \$40 million, \$50 million," that is what his job is to do. And so my job is to protect the interests of members, and that is what I try to do to the best of my ability with people like my counsel, Sharon Levine from Lowenstein Sandler.

Thank you very much.

Mr. COHEN. Thank you, Mr. Roach. That was an interesting perspective. Sounds like maybe you had some experience in Japan, where the management does take responsibility for catastrophic consequences.

Mr. Watt, you are recognized.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Delahunt asked the primary question I wanted to ask, especially Mr. Sprayregen, about adjustments that need to be made to, particularly, Section 1113. So I would be interested in getting your written comments on that.

Both you and Mr. Bernstein were pretty unhappy about the contents of this bill. Is there anything in it that is worth salvaging, from your perspective?

Mr. SPRAYREGEN. I don't believe this bill comes at it from the perspective of taking into account what happens in real life in these bankruptcy cases—

Mr. WATT. I don't need a speech. I am just asking about, is there anything specific in the bill that you think is worth salvaging, either you or Mr. Bernstein? Any particular provision in the bill that you think is worth salvaging?

Mr. SPRAYREGEN. I have to admit, I don't have off the top of my head a provision I can refer to. But one—

Mr. WATT. Okay. Would you mind addressing that question when you give us the written response?

Mr. SPRAYREGEN. Absolutely.

Mr. WATT. Mr. Bernstein, anything in the bill that you can think of that is worth salvaging? Tell me "yes" or "no," first. And if you have some "yes," then I am happy to have you elaborate.

Mr. BERNSTEIN. I think there is one provision in the bill that, while it could cause problems, also has some merit, from a fairness perspective. And that provision would allow a rejection damage claim when a collective bargaining agreement is modified or rejected through the 1113 process.

Mr. WATT. Okay. That is fine. We will look at that provision.

Now, there is one provision in the bill, in particular, that accords wages up to \$10,000 a higher priority. What was the rationale originally for making wages a lower priority than unsecured claims?

Mr. BERNSTEIN. Mr. Watt, the wages are not a lower priority than unsecured claims under the current code, and, to the best of my recollection, they never were.

The question is, what amount of wages is a higher priority than any other claim? And that number has been going up and up.

In a typical case, this is not a real-world issue, and the reason is because, typically, when companies file bankruptcy, they file—

Mr. WATT. Don't give me a speech, Mr. Bernstein. I have a limited amount of time.

Mr. Sprayregen, what was the rationale for making wages a lower priority than unsecured creditors?

Mr. SPRAYREGEN. Well, ordinarily, the wages are of a like priority, except there is a certain amount of them that actually get a higher priority. And the question there is, what should be the right amount? Should it go from \$10,000 to \$20,000? I think there is a legitimate judgement call as to what the right amount—

Mr. WATT. Do you think that is one of those things that maybe needs to be adjusted?

Mr. SPRAYREGEN. I think that is something that can be looked at, and take into account inflation and the like.

Mr. WATT. What about severance pay? Where should that fit in the order of priorities, from your perspective?

Mr. SPRAYREGEN. Severance pay, unfortunately, is a difficult concept because, as noted, many of these employees have worked 25, 30 years and have tremendous amounts of severance owed to them. Unfortunately, if that is made a high priority, that is the type of thing, while well-intentioned, will put a company in a position of not actually having the money to pay all that.

Mr. WATT. What is the rationale for making that a lower priority than an unsecured creditor? I mean, I am not getting, you know, philosophical about this. I am just trying to figure out, why would anybody think that that would be a lower priority than an unsecured creditor?

Here is somebody that has worked their entire life. They built up an entitlement, one would think, over time to these benefits. And, yet, they get a lower priority than an unsecured creditor. What is the rationale? I don't understand that.

Mr. SPRAYREGEN. They actually get a like priority. The problem is—

Mr. WATT. Or even a same priority. You know, let's not get into the details of it. I don't understand how you can give that person a same priority as an unsecured creditor.

Mr. SPRAYREGEN. Unfortunately, in most of these cases, the unsecured creditors' recovery is very *di minimus*. So unless you give a higher priority to claims like severance or the wages, the recovery is not likely to be that great. And so—

Mr. WATT. So you see agree with me? Is that—are you saying that you agree—

Mr. SPRAYREGEN. Philosophically. The problem is, the Congress has the right to set the priorities. But the capital markets—

Mr. WATT. Well, that is what we are talking about here, whether we should adjust the priorities. I mean, you know, we are not talking about the world as it exists. We are talking about the world as it should exist, which is why I wanted to start with both of you and give you a chance to tell me what part of the bill we ought to be trying to salvage, going forward, rather than worrying about—I mean, nothing we can do about what has already happened back there. But we can adjust the status of these things, going forward.

So my time has expired, Mr. Chairman. I appreciate it.

Mr. COHEN. Thank you, Mr. Watt.

And I now recognize the distinguished Chairman of the criminal law Subcommittee, Mr. Scott of Virginia.

Mr. SCOTT. Thank you. Thank you, Mr. Chairman.

Mr. Sprayregen, let me follow through on that a little bit. Where are wages, traditionally, in bankruptcy, in terms of priority?

Mr. SPRAYREGEN. Wages, traditionally, are even with general unsecured creditors, except there is a certain amount of wages that have a priority above unsecured creditors if they were earned at approximately 6 months prior to the filing.

In most bankruptcy filings, wages are not the biggest problem, because wages are generally current in most of these companies. It is more of the other obligations, like health and severance and the like, that are more problematic.

Mr. SCOTT. In a reorganization, the wages are kind of ongoing. What happens to wages in a reorganization?

Mr. SPRAYREGEN. Post the filing of the bankruptcy case, the wages have a very high priority, only below the secured creditors. And in very few cases are the post-bankruptcy wages impaired. In almost all cases, those are paid 100 percent.

Mr. SCOTT. Somebody asked the question about filing bankruptcy to void collective bargaining agreements. Is that legal? Is it legal to file, use bankruptcy court simply to void a collective bargaining agreement?

Mr. SPRAYREGEN. There is a line of case law that has developed that says bankruptcy cases generally need to be filed in good faith, and if they are filed in bad faith, the court can dismiss the case.

So if someone were to raise—if that were purely the only reason, which I haven't seen in my career as the only reason to file a case, someone could debate whether that is a good-faith reason to do that if the company didn't otherwise need to adjust its costs.

Mr. SCOTT. And what happens to stockholders when there is a reorganization?

Mr. SPRAYREGEN. In most cases and I think in all of the cases we have discussed here, the stockholders have been wiped out.

Mr. SCOTT. On reorganization?

Mr. SPRAYREGEN. In most of the cases. There are some where equity survives. But in most of the types of cases we are talking about here, the recovery to equity is either zero or virtually zero.

Mr. SCOTT. When we talk about wiping out pensions and benefits like that, in a defined contribution plan is the account of the employee beyond the reach of the bankruptcy court? Is that an asset of the employee or an asset of the company? A defined contribution plan.

Mr. SPRAYREGEN. That is an asset of the employee and would not be impacted by the employer's bankruptcy.

Mr. SCOTT. A defined benefit plan, on the other hand, is that subject to loss in bankruptcy?

Mr. SPRAYREGEN. Yes, it is.

Mr. SCOTT. Is there any requirement that a defined benefit plan be guaranteed?

Mr. SPRAYREGEN. Guaranteed by?

Mr. SCOTT. Well, you can fund a defined benefit plan with an annuity, so that the annuity would be the asset of the employee, beyond the reach of bankruptcy court.

Mr. SPRAYREGEN. Yes, there have been resolutions in some cases where annuities have been bought, generally not at 100 percent of what is owed. But that has been a solution in some situations.

Mr. SCOTT. And, about 20 years ago, the accounting rules required companies to put on their books unfunded liability for future benefits. Is that right? It used to be, about 40 or 50 years ago, it wasn't counted as a liability. But wasn't it about 20 years ago, it is required to be placed in your financial statement what your unfunded liabilities are?

Mr. SPRAYREGEN. I am not an accounting expert, but generally I am familiar that that is now the case, yes.

Mr. SCOTT. So that the liability of future benefits that have been promised are on the books but not funded and are subject to evaporation. Is that the present situation if it is a defined benefit, not a defined contribution plan?

Mr. SPRAYREGEN. Generally, yes. And there is no question that the lenders to the companies take into account whether they are on the books or not, what those obligations are, and the cash flow impacts of that.

Mr. SCOTT. Is that something we need to look into on another Committee I sit on, the Education and Labor Committee?

Mr. SPRAYREGEN. I haven't seen that to be a particularly different problem than what we are talking about generally here. I think it is of the same problem. And there is no question that when defined benefit payments are interrupted to employees it causes terrible hardship to employees. And I have tremendous empathy for that. We keep getting back into the situation of, what do we do if there is not enough money to go around? How do we handle that?

Mr. SCOTT. Yeah, but you don't have that problem if it is a defined contribution plan.

Mr. SPRAYREGEN. That is correct, yes. But most of these situations involve defined benefit plans.



Mr. COHEN. Thank you.

Ms. Chu of California, you are recognized.

Ms. CHU. Thank you, Mr. Chair.

Well, over the past decade, I have been becoming far too familiar with stories of companies that are squeezing massive concessions from their employees as a part of the corporate restructuring plans. And, to me, it is even worse that these sacrifices are not equally shared by management. And that is why I have, indeed, joined Chairman Conyers as a cosponsor of the "Protecting Employees and Retirees in Business Bankruptcies Act," so that there is some fairness and equity in this process.

But what I wanted to do was to see what Ms. Ceccotti had in response to some of the allegations by Mr. Bernstein that doing this bill would create new and potentially substantial claims, that it would slow down the 1113 process, that it would increase the amount of litigation, and that it would make it materially more difficult for Chapter 11 debtors to attract and retain talented management employees.

Ms. CECCOTTI. Thank you, Congresswoman. Certainly.

I think what is interesting to remember about Mr. Bernstein's comments is that the various charges or contentions, I guess, that he brought up with respect to the bill really would not be borne out by the changes that are in H.R. 4677 because, by and large, those changes are actually designed to foster better negotiated solutions.

Right now, of course, the bankruptcy code does require negotiations over proposed concessions. I think what the labor groups at today's hearing have said is that the system is now too unbalanced, so you do not get fair negotiated solutions.

I don't think that by better specifying in the bill, as H.R. 4677 does, how the process will work, that the result of that process will be a slower system or a system that debtors, you know, may not want to participate in or that would, in fact, lead to fewer debtors participating in bankruptcy. If anything, with the rules more clearly spelled out, the parties will be better able to focus on exactly what it is that needs to be fixed and how the employees can participate in fixing it.

And I will give you one example from the proposed changes to Section 1113, or a couple of examples, designed to do this.

Right now, the current law does not require a debtor to specify a dollar amount. Very often, debtors do. They go to a labor group and they say, "We need X from your group and Y from your group and Z from another group." However, that is not required. But the bill would require that there be, quote/unquote, a "defined ask," so that the labor groups and the companies could immediately focus on what is the amount; is it the right amount; and if it is the right amount, how it is that the employees will contribute that amount.

What we saw, for example, in the auto sector particularly, you had large auto suppliers filing for bankruptcy with broad goals that were defined as labor transformation goals. And they would file 1113 motions and simply say, "We need to change all this stuff." Therefore, you have a lengthy, protracted, and prolonged discussion over what it is that needs to be changed, and how much, and how much needs to come from the workers.

So I actually think that, by adopting the changes that are in H.R. 4677, the parties would be able to quickly, much more quickly, get to the true issues that are at stake and figure out a way to resolve them. And in order to facilitate that, first, you need more defined rules. And I do think the bill provides that. But, second, you need to give the labor groups a sense that the playing field is balanced, for the reasons that you have heard today: We have had court decisions that say, you don't have a rejection damages claim. Or you have court decisions that say, certain employees can't strike.

All of these court rulings have affected the negotiating process, in that workers do not have a sense that their solutions are being given equal consideration, that their solutions are being given credible consideration, despite the fact that, as one of our witnesses pointed out, it is the workers who are going to be with this company long after the bankruptcy has left the courts.

So that the best way to get a truly negotiated solution that happens the business is, in fact, to make sure that the debtor and the non-debtor stakeholders each have interests that they legitimately—and that the bankruptcy system recognizes are legitimately protected even in bankruptcy, to figure out ways to direct the parties to get to the issues that need to be resolved.

And that will lead the parties to roll up their sleeves and do the work to resolve them without the distraction of litigation, without undue efforts to try to uncover what it is exactly that the company is trying to do, and particularly without the distraction of management programs and bonuses and court time and litigation that is taken up needlessly with inflammatory proceedings that only poison the atmosphere while the workers are being asked to seriously consider measures that are needed to save the company and to allow it to survive.

Ms. CHU. Well, thank you for that thorough answer. I see that my time is up.

Mr. COHEN. Thank you, Ms. Chu.

We have concluded our first round. Mr. Franks, do you—if anybody has any questions, or we will conclude. Or do you want to go to a second round?

Mr. Franks passes.

Mr. Delahunt?

He is a lame duck; he is eager to get in some more questions before he goes into mothballs.

Mr. Delahunt, you are recognized.

Mr. DELAHUNT. Well, thank you.

Mr. Sprayregen, you indicated, in your experience—I think it was Mr. Scott that posed the question about is it legal, and you indicated that, you know, a bankruptcy that is not filed in good faith clearly would violate the statute, and you had never seen it in your own career.

I mean, the reality is, to establish a lack of good faith is extremely difficult to prove. Would you agree with that?

Mr. SPRAYREGEN. Generally, yes, but for good reasons, the reasons basically being that companies don't really want to file for bankruptcy unless they have a reason to do it.

Mr. DELAHUNT. Well, I would suggest that that is still an open question. But the proof of good faith or lack thereof is almost an impossible burden of proof, in the real terms, you know, in a courtroom situation.

I guess I would direct this to you, as well. I think it was earlier referenced. How do you feel about when concessions are made, in terms of workers, as far as pension and health benefits, et cetera, that there be—when the company is restored to vitality and is operating and establishing a process, that the promises that were made to the workers in terms of benefits and health and wages are restored? “Deference,” I think that was the term that was used. Do you have an issue with that?

Mr. SPRAYREGEN. Conceptually, I don’t. But it is another one of those with unintended consequences. Because to get the company to be able to come out of bankruptcy, some investor or lender needs to give it money. And burdened with that type of obligation in the future—it is sort of an unknown obligation, depending on the performance—will make it much more difficult for the company to attract that capital.

Mr. DELAHUNT. But we could direct, you know, benchmarks. I mean, clearly, we want to make sure that, you know, capital is respected and there is a good return on the investment.

But, in terms of a bankruptcy plan, a reorganization plan, I really find it difficult not to understand why that is not more frequently offered, as far as a consensus reorganization plan.

Mr. SPRAYREGEN. Well, I will—oh, I am sorry.

Mr. DELAHUNT. But having said that too, you know, what is missing here in terms of—I would put this out for anyone that wants to respond—it is always the worker, the retiree, that is going to end up costing the taxpayers.

Mr. Roach referenced in his testimony that we are going to have to pick up the Medicaid bill. We are going to have to go to the Pension Benefit Guaranty Trust to take care; it is already \$30 billion in deficit. So, you know, the creditors are clearly in a different financial position. They are investors. They are going to survive. Management is going to survive rather well—a \$40 million bonus. We read about these retention bonuses that absolutely boggle my mind, because I think Mr. Roach is right, you get rewarded for mismanaging the company because somehow it is necessary that you stay on. But, neither here nor there.

When we are reviewing what priorities ought to be established, would you think that we should consider the burden on the taxpayer? Because it is the worker that is costing—to keep the worker and his or her family, you know, from drowning, the taxpayer, the American taxpayer is picking up the bill for the creditor, for the financial markets. It is another form of a bailout, I would suggest.

Anyone? Mr. Conway? Does anyone have—Mr. Roach? Does anyone have—Mr. Sprayregen?

Mr. SPRAYREGEN. I would absolutely say that the burden on the taxpayer should be taken into account. But what I would urge the Committee to consider in that is, I always call it “compared to what?” If these companies had liquidated, the burden on the taxpayer would have been tens of thousands more workers with those issues. These companies did things that people don’t like and were

very painful and very hard, but they did save tens of thousands, if not hundreds of thousands, of jobs.

And it is the "compared to what" that needs to be taken into account, because the alternative is not that they get their old benefits, because, unfortunately, there are just not available.

Mr. ROACH. May I respond to that?

I think part of this law is to make corporations make better decisions. And let me give you an example. United Airlines is a very typical example. United Airlines proposed to the machinists union an increase of 40 percent in pension benefits. And, as we reviewed the books and reviewed their pension plan, we rejected that pension increase. Because we said, "You will never pay it, and people will go out on a promise that you will never pay." And they continued to insist that we take this pension increase, to the point that they testified on the record at the Presidential Emergency Board at United Airlines that they wanted to give this pension increase because, under that current law, they don't have to pay for it, because they have credits in pension.

So people took this—we took the pension increase. How long can you say no? People went out, retired based on what they were promised by United Airlines. And once they got out there, the pension plan was terminated because it had ballooned because of this massive pension increase to a \$6 billion deficit. And now that deficit, part of that deficit, a majority, belongs to the Federal Government, and somebody is going to pay.

But this was a plan—now, had they been thinking or had they realized or recognized that, you know, maybe we shouldn't make this promise in the first place, had we had a law like this in existence then, that we shouldn't make this ludicrous promise, maybe United Airlines would not have went into bankruptcy.

That is the point we are trying to make. We don't want people to go into bankruptcy. We don't want laws that make it difficult or hard to go into bankruptcy. We want people to understand, when you make promises to people and they base life decisions and their family decisions on the promises that you make, then they should be expected to keep those promises.

Mr. PRATER. And one just very quick anecdote. In the Mesaba case, when the judge was informed that, in fact, his decision to cut the wages down below the Federal standards, that, in fact, they would put pilots with a family of three onto the Federal subsidy rolls while working full-time, he said his concern was not with the workers, his concern was only with the debtor.

Mr. COHEN. Thank you, Mr. Delahunt.

Our final questioning will be by Mr. Issa from California.

Mr. ISSA. Thank you, Mr. Chairman. And I apologize for my absence, but I am shuttling between two Committees today.

Mr. Sprayregen?

Mr. COHEN. "Sprayregen."

Mr. SPRAYREGEN. Like "Ronald Reagan."

Mr. ISSA. Oh, okay. I would not spray Reagan.

But anyhow, I heard your testimony, and let me ask you some questions, because I am former businessman—I guess I am still a businessman, but I am recovering by spending other people's

money here, to where my friends in business don't actually want to associate with me anymore.

But over the years, watching bankruptcy, particularly cram-downs and Chapter 11s, it appears to me, as a Member of this Committee and as a businessman, that we have a culture that does need to be dealt with, which is the culture of "I will disburse to my stockholders in the good times, and then I will use Chapter 11 in the bad times."

Certainly, we are seeing it in real estate. We have certainly seen it in the repeat offenders in the aviation business. With the exception of Southwest, basically—and I know there is a lot of aviation-related people here—but, basically, you are in an industry that doesn't plan for profit; they plan for bankruptcy.

Would you like to tell me, in your opinion, what we could do, if not this bill, what we could do to actually break that cycle of Chapter 11s being part of the business plan of the aviation industry?

Mr. SPRAYREGEN. Now, I am not—

Mr. ISSA. Briefly.

Mr. SPRAYREGEN. Yeah. I was going to say, I am not an economist, and I am not sure it is an economic question. But I think—

Mr. ISSA. Well, let me narrow it. And you actually can give me the answer for the record, if you would like, as all of you could.

What could we change in the bankruptcy law that would cause the penalty of haphazardly going into bankruptcy, not just once because of an event but multiple times because it is part of business plan, to stop? What could we do to stop that?

Now, many of you were talking about how we can keep employees from losing pension benefits. From this side of the dais, I want to know what I can do to cause companies, instead of to beat each other into endless losses, to actually run their companies for a profit because Chapter 11 would be more onerous.

So that is what I would like each of you, from both sides of it, all of you, please, to consider answering for this Committee. Because I don't actually like the legislation before us, but I don't like the idea that Chapter 11 is a part of the cycle of the aviation industry.

If you would like to answer, as long as the Chairman gives me plenty of time.

Mr. COHEN. All the time you need.

Mr. ISSA. Thank you, Chairman.

Mr. SPRAYREGEN. I can try. And maybe I will try coming at it the opposite way. Let's assume there was no bankruptcy law whatsoever and it just wasn't an option and it didn't exist—

Mr. ISSA. If we did away with 11 and made it 7 only, and the other airline companies, if they had cash or capital, the capability, came in and bought you out when you failed, would that be better? Maybe that is where I am going.

Mr. SPRAYREGEN. That is what I am approaching it as.

I would submit we would end up with a worse system and more damage and less jobs and less airlines if we didn't have it as an alternative. It is an unfortunate part of the business cycle that this occurs, but, again, I call it "compared to what?" At least a number of these airlines are able to reorganize and go back out and prosper again. I am not sure we can eliminate the cycle.

Mr. ISSA. Well, I am going to take my moment and say, if you call what the airlines are doing today prospering, you are just not reading their balance sheets the way I read them. It is a cyclical investment for every stockholder, there is no question at all. Although they are merging, so we are going to get a lot less. And we will be considering Continental, I guess, shortly.

But let me change a little bit. I was a former member of the International Association of Machinists and Aerospace Workers. Nothing so lofty as aerospace; I was working for General Motors in Cleveland a long time ago. But I was interested in your comments on your union pushing back on an unsustainable pension promise.

Not only do I commend you for doing that, but let me ask you in the form of a question: As Congress looks at future pension reform, should we, in fact, pattern after many of the other unions, such as NECA and so on, where the pension is external, truly external to the employer; the pension, if there is a defined pension, is portable; and its vesting is essentially as we go, meaning if the company goes out of business or stays in business, it doesn't really affect the vested amount?

Is that a reform that you would like to see on behalf of your workers, particularly if your workers may in their career go from American to United to, well, whatever amount of airlines are left?

Mr. ROACH. Yes, we—and the International Association of Machinists is a national pension plan, multi-employer plan which is 100 percent funded. And through the airline bankruptcies, we were able to put all of our airline members—we went through United, U.S. Airways, Northwest—into that multi-employer plan. And that is the plan we were proposing to United Airlines, sort of, pay as you go rather than make promises you can't keep. And if United Airlines were to go out of business or liquidate, whatever the case may be, where people leave, those benefits are there. And if they went to another airline that had that plan, if they went from United to Northwest, they would continue to get benefits.

We think that should be looked at very closely, because the idea of corporations or airlines managing pensions seems to be a useless proposition, with \$30 billion of the PBGC underfunded. So I think that is something that certainly should be looked at. We have worked very closely with the PBGC and have moved numerous airlines into that plan, and we think that that is a better alternative than what has happened in the past.

Mr. ISSA. Okay.

Mrs. Rook, you are in the opposite situation. I fly United almost exclusively. And AFA, of course, represents most of the airlines, but they represent United, and they got screwed. And they got screwed on a contract that you negotiated where they are still working and, retroactively, they lost promises, as they view it. They are completely disgruntled, and they hold the airline responsible. But the truth is, you had the accountants and the lawyers and all the people to know exactly what would happen on a daily basis if they defaulted.

How is it you are changing your union's approach on behalf of the people you represent? Now, you have come to us for a bankruptcy change that changes the residual assets, but there won't always be residual assets. An airline could end up with nothing more

to distribute, without a reorganization or with one, particularly if the debtor in possession of money isn't there because we have changed the rules, which is what the other witnesses talked about.

So assume for a moment that that 11 was a 7. What have you done to change the outcome for United retirees and workers who have 25, 30 years with the airline, who today are getting less money and are looking forward to less retirement than they were promised under a union contract?

Ms. ROOK. I can definitely provide more information about the United bankruptcy. Myself, I am the MEC president for Northwest Airlines. However, I do know that a lot of our newer contracts, we are negotiating contribution plans rather than the typical——

Mr. ISSA. Defined contribution rather than defined benefit.

Ms. ROOK. Correct. Correct.

Mr. ISSA. Which would make this whole bankruptcy argument we are having here today somewhat less significant because you would have every nickel, every payroll, that you are entitled to, at least as to pension, right?

Ms. ROOK. That is right. And, additionally, at least in the Northwest contract and I imagine in the United contract, they have negotiated profit sharing. However, unfortunately, profit sharing has been——

Mr. ISSA. In your industry?

Ms. ROOK [continuing]. A bit of a—it hasn't been much lately.

Mr. ISSA. No CEO of an airline ever negotiated something that was based on profits. They always find a way to do it on stock price or something else that they actually can make happen.

Ms. ROOK. It does seem more and more that the pension programs that were promises made to these employees are little more than a piggybank, and the airlines are just using them when times are hard. And that is why the unions have moved more toward these contribution plans.

Mr. ISSA. Well, I commend you for making that move on behalf of the people that you represent. I think it is long overdue.

I will mention that both the State of California and the Federal Government and our Social Security system continue to be mostly underfunded or unfunded promises that we hope to keep if we don't end up like Greece. So, from this side of dais, let me assure you I don't have high confidence in my pension plan right now either, but, then again, I am in the minority.

Mr. Chairman, thank you for the indulgence. I yield back.

Mr. COHEN. Thank you, sir. Appreciate your joining us.

And now for our final questioner, we recognize once again the esteemed gentlelady from California, Ms. Chu.

Mr. ISSA. Is that the final final?

Mr. COHEN. Yes. It is, once again, the final final. I am a softie.

Ms. CHU. Thank you, Mr. Chair.

Mr. COHEN. You are welcome.

Ms. CHU. Well, this question is for Mr. Sprayregen, and I would actually be interested in what anybody else has to say on this, too.

Mr. Sprayregen, in your testimony, you argue that this bill would actually hurt employees in the long run by making it difficult for companies to emerge from bankruptcy. So let me ask you, how is cutting the wages and benefits of the people that actually produce

this service, while rewarding the very management that was responsible for that bankruptcy through their decision-making, be in the best interest of employee morale and ensuring that the corporation exits bankruptcy?

Does management have any responsibility for the bankruptcy? I mean, the assumption seems to be that these are talented management employees. I know Mr. Bernstein said that this bill would make it difficult to retain talented management employees. But my question is, does the management have responsibility for the bankruptcy?

Mr. SPRAYREGEN. Absolutely. And management, if they have made poor decisions, should be held responsible. And, as I mentioned earlier, often in these bankruptcy cases there is a change in management during the case or shortly after the case exits the bankruptcy.

I would submit to you, though, if we just had a rule that current management is fired on the filing of the bankruptcy, all of these very difficult issues that we are talking about would still exist. So, management can be the problem sometimes, or part of the problem; they can be part of the solution sometimes. But the focus on that doesn't necessarily address the larger issues of, is there enough money to go around to handle the obligations that the company has promised?

Mr. BERNSTEIN. I would only add that no company that files bankruptcy wants to cut wages and benefits of employees. Companies do this as a last resort because they have no choice if they are going to remain viable. So the alternatives are continue to pay above market in unsustainable wages and benefits to employees, not be able to attract new investment capital and end up in liquidation, where the retirees that somebody mentioned earlier and the employees lose their benefits; or do something that is quite difficult, which is modify the labor costs structure but, in the process, save the company so that it can continue to employ people and continue to do business and continue to compete and continue to provide services and pay taxes.

Ms. CHU. Well, I would like to call on Captain Prater. But, Mr. Sprayregen, you said we shouldn't be firing all the management, but this bill doesn't do that. I just want to point that out. The bill is basically saying that the needs of the employees should be balanced against these excessive bonuses that are being paid to the management.

Captain Prater.

Mr. PRATER. I just need to respond to Mr. Bernstein's categorization that managements don't want to file—or they file bankruptcy not with the intention of lowering wages. I am going to say most managements that go into bankruptcy, especially in the airline industry, have used this as a business tool, a business plan, in fact, to get around collective bargaining.

It is to get rid of an employee contract and to use not only the threat of bankruptcy, where we normally negotiate concessions to try to prevent companies from going into bankruptcy, but then filing and getting a second bite at the apple. They have completely used it to destroy collective bargaining, especially under the the Railway Labor Act, that they then seem to trumpet the fact is we



can't seem to recover because we are under bankruptcy rates for maybe 5, 6 years and then another 3 years under the Railway Labor Act to amend those contracts. So we live with the era of bankruptcy over us for 8 years, up to a decade.

Ms. CHU. Thank you.

Mr. COHEN. Thank you, Mr. Chairman.

Mr. Delahunt, I appreciate all the Members who attended today. It was obviously a hearing that had a great deal of interest, and I thank the witnesses for their testimony. It was very enlightening.

Without objection, Members have 5 legislative days to produce other questions that they will submit to you and we ask that you respond to them as quickly as possible. They will be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other material.

I thank everybody for their time and patience, particularly Mr. Delahunt for asking more questions, so I can continue to learn from him and improve my own legislative style and career once he moves on.

This hearing of the Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 12:57 p.m., the Subcommittee was adjourned.]



## A P P E N D I X

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MATERIAL SUBMITTED FOR THE HEARING RECORD

RESPONSE TO POST-HEARING QUESTIONS FROM BABETTE CECCOTTI,  
COHEN, WEISS AND SIMON LLP

Questions for the Record  
Subcommittee on Commercial and Administrative Law  
Hearing on H.R. 4677, the “Protecting Employees and Retirees in Business  
Bankruptcies Act of 2010”  
May 25, 2010

Babette Ceccotti, Cohen, Weiss and Simon LLP

Questions from the Honorable Steve Cohen, Chairman

1. **Please respond to the assertion that H.R. 4677 would impose such inflexible requirements on Chapter 11 debtors that successful reorganization would be more difficult to achieve and that more debtors would be forced into liquidation.**

Response: Charges that proposed changes to the Bankruptcy Code are inflexible, would make reorganization more difficult, or would force companies to liquidate are often voiced by opponents of *any* change to the Bankruptcy Code that is perceived to impose *any* limitation on a debtor’s discretion in a reorganization case. What the objectors fail to acknowledge is that bankruptcy law has never granted a debtor complete, unfettered discretion in a reorganization case nor guaranteed total flexibility. While bankruptcy law affords a debtor considerable advantages, the Bankruptcy Code was crafted to afford non-debtor stakeholders important rights as well. By balancing those rights, the law is designed to promote negotiated resolutions. Over the years, as the process has become too skewed in favor of the debtor, rules have changed periodically to balance other stakeholders’ interests. Despite protests that reorganizations will be doomed by these changes, they have not led to liquidations or avoidance of the bankruptcy system. An employer’s bankruptcy can lead to dramatic losses by employees and retirees, losses that can often mean severe, life-changing reductions in jobs, pay and benefits, and retirement security. In recent years, protections for employees and retirees have eroded substantially. Businesses and reorganization professionals have come to rely upon the ability to use bankruptcy to bring about major workforce changes and drastic labor and benefit cost reductions. Current law inadequately accounts for the consequences of an employer’s bankruptcy for employees and retirees. The changes proposed in H.R. 4677 are intended to create more balance between a debtor’s bankruptcy remedies and employees’ and retirees’ interests. Building in more balanced rules improves the prospects for consensual resolutions on matters affecting employees and retirees. The business bankruptcy system continues to grow and remains a formidable process for achieving business change that is not likely to be forsaken merely because amendments to the Code provide greater protections to employees and retirees.

2. **H.R. 4677 would amend Section 1113 of the Bankruptcy Code to specify that a debtor’s proposal to reject or modify the terms of a collective bargaining agreement must be “no more than the minimal savings necessary to permit the debtor to exit bankruptcy . . . .” Why is the current language, which states that proposed modifications must be “necessary to permit the reorganization of the debtor,” not adequate?**

Response: The current rules under Section 1113, including the statutory requirement that proposals for modifications to a labor agreement must be limited to those “necessary” proposals that are “necessary” to permit the reorganization, were originally intended to limit the circumstances under which a business could use bankruptcy to reject a labor agreement. Congress sought to achieve this goal by incorporating both bankruptcy policy and federal labor policy favoring collective bargaining into the rules that would apply where a company sought to reject a labor agreement in bankruptcy.<sup>1</sup> Despite this goal, however, bankruptcy policy has come to dominate the interpretation of Section 1113 while labor policies have been ignored. The “necessary” requirement is one casualty of this development as courts have approached Section 1113 primarily with reference to the debtor’s goals and aspirations for the bankruptcy, with little regard for labor policy or the effects of a debtor’s proposed contract modifications on the workforce.<sup>2</sup>

Absent a balance between the debtor’s bankruptcy goals and federal labor policies, the “necessary” requirement has offered employees little protection against overreaching by companies seeking to get as much as they can out of the bankruptcy process. The result has been a process dominated by the threat of a court-ordered result, largely dictated by the debtor, that has left workers overburdened with grossly disproportionate losses. In order to reset the rules to work as Congress initially intended, the statutory standard needs to be rewritten to better convey the dual-policy goals that were supposed to be reflected in the statute. Towards that end, H.R. 4677 would replace the current standard and provide that, in consideration of federal labor policy, proposed changes to a labor agreement must be the minimum savings essential to permit the debtor to exit bankruptcy through a feasible restructuring plan. This new standard would require the debtor and court to approach proposed changes to a labor agreement in terms of *both* the debtor’s bankruptcy goals *and* the promotion of policies favoring the peaceful resolution of disputes through collective bargaining, strengthens the prospects for reaching a mutually acceptable solution that reflects a more balanced give and take between the parties.

**3. Please respond to the assertion that requiring a court to determine whether proposed modifications to a collective bargaining agreement would cause “a**

<sup>1</sup> See *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074, 1089 (3d Cir. 1984) (rejecting construction of Section 1113 that would “nullify the insistent congressional effort to replace the *Bildisco* standard with one that was more sensitive to the national policy favoring collective bargaining agreements, which was accomplished by inserting the ‘necessary’ clause as one of the two prongs of the standard that the trustee’s proposal must meet.”).

<sup>2</sup> See for example, *In re Mesaba Aviation, Inc.*, 341 B.R. 693, 740, 759 n. 100 (Bankr. D. Minn. 2006), *aff’d in part, rev’d in part*, *Ass’n of Flight Attendants-CWA v. Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006), in which the court acknowledged that while effect of the proposed cuts on the employees was “an utter horror,” the court nonetheless ruled in favor of the debtor based upon the court’s view that the central inquiry was “what, in the complex and dynamic world of the current market, will best promote the longer-term viability of the Debtor.” See also *In re Delta Air Lines, Inc.*, 359 B.R. 468, 475 (Bankr. S.D.N.Y. 2006). Using a frame of reference limited to the debtor’s bankruptcy goals, the court noted that “[i]t is important to bear in mind the context in which this statute operates. Section 1113 is not a labor law, it is a bankruptcy law.” Overruling the union’s objection to the rejection motion, the court ruled that the airline could not be expected to make commitments to job security that could “further erode the airline’s ability to compete.” *Id.* at 488.

**material diminution in the purchasing power of” covered employees would make Section 1113 relief almost impossible to obtain.**

Response: Like other proposed changes to Section 1113, this proposed new standard is meant to prevent a debtor’s employees from losing so much in pay and benefits that their financial security is jeopardized. The change is important because, unfortunately, in rendering decisions under Section 1113, courts have deemed the impact of the proposed cuts on employees’ financial circumstances to be legally insignificant, and have instead defined the paramount issue solely in terms of whether the proposed changes enhance the company’s long-term business prospects, a standard that, as discussed in response to questions 2 and 7, is unworkable given the interests that are at stake.<sup>3</sup> A legal standard that does not take into account the effects of proposed changes on employees leaves employees at risk of sacrifices so burdensome that they face disruptive changes in their living standards and threats to their retirement security. Business bankruptcy should not have to lead to consumer bankruptcy for a company’s workers. The extent to which debtors have been able to overreach in using bankruptcy, and Section 1113 in particular, to obtain dramatic workforce reductions and cuts in labor and benefit costs has fueled expectations by companies and their restructuring professionals that there are few, if any, limits on cutting labor or benefit costs.<sup>4</sup> The proposed change would set a limit on the degree to which workers’ financial security can be adversely affected by cost cutting. The charge that this proposed change would render section 1113 relief “almost impossible to obtain” is merely another objection to *any* change in the current operation of a statute which has worked very favorably for companies and restructuring professionals but has been disastrous for workers.

**4. Please respond to the assertion that placing additional limitations on compensation for management and other highly compensated employees would make it too difficult to retain the best at-will employees.**

Response: Although a frequently cited concern, there is no evidence that placing limits on executive compensation schemes has led to disruptive losses in key talent. Excessive and poorly incentivized executive pay are widely known and recognized problems, both for companies inside of bankruptcy and outside of bankruptcy. The strong protests over executive compensation practices that led to the issuance of compensation reform rules for firms that received TARP assistance and the appointment of the Special Master for TARP Executive Compensation demonstrate that companies are tenacious in protecting their executive pay practices and that these schemes will persist and proliferate—even in financially distressed companies— unless restrictions are imposed. Earlier this year, the TARP Special Master found that 84% of executives covered by the Special Master’s 2009 compensation rulings remained with their companies despite cuts in pay.<sup>5</sup> This

<sup>3</sup> See note 2 above.

<sup>4</sup> I have written about so-called “labor transformation” bankruptcy cases in “Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code,” 15 ABI Law Rev. 415 (Winter 2007). A copy was submitted with my hearing statement.

<sup>5</sup> “Special Master Issues 2010 Rulings for ‘Top 25’ Executives at Firms Receiving Exceptional Taxpayer Assistance and ‘Look Back’ Letter on Review of Pre-Recovery Act Compensation,” U.S. Treasury Department,

finding strongly suggests that fears of a disruptive exodus of key employees fleeing executive pay reforms are largely unfounded and should not thwart proposed amendments intended to rein in the executive compensation “arms race.”<sup>6</sup>

**5. Please respond to the assertion that increased priority claims for wages and benefits and new administrative expense priorities for severance pay and WARN Act damages would undermine the debtor’s ability to successfully reorganize.**

Response: Most debtors now voluntarily continue their payroll practices and benefit programs in bankruptcy, uninterrupted by the bankruptcy filing, in order to maintain employee morale during the case. Debtors routinely seek authority to maintain their pay practices at the very outset of the bankruptcy case. They include their regular payroll programs as well as a broad array of “ordinary course” benefit programs. By and large, the changes proposed in H.R. 4677 are intended to bring the Bankruptcy Code in line with these well established and accepted practices. Accordingly, the charge that increases in the wage priority would undermine a successful reorganization is difficult to credit. In fact, debtors typically say that they want to keep up their compensation practices and programs precisely because, by maintaining employee morale, they *contribute* to a successful reorganization. Regarding the WARN Act clarification in the bill, Congress provided for enhanced treatment for WARN Act damages in the 2005 amendments through an amendment to Section 503(b).<sup>7</sup> As noted in my hearing statement, some courts have refused to read this provision to include WARN Act damages, even though WARN Act damages would be considered back pay awards for breach of a federal law. H.R. 4677 merely adds a specific citation to the WARN Act to eliminate any further claim that the provision is ambiguous in this regard. Of course, a company can avoid paying WARN Act damages altogether by complying with the notice provisions of the WARN Act.

**6. Please respond to the assertion that increasing existing priorities and creating new ones will unfairly reduce the potential recovery for other creditors.**

Response: As noted above in response to question 5, the proposed amendments to the priority scheme do not represent a significant departure from current practices. Where a debtor seeks to continue its payroll practices and benefit programs while in bankruptcy, such requests are usually unopposed by other creditors, because the parties recognize that a debtor operating in bankruptcy must be able to maintain employee morale. Disputes that do arise tend to occur in circumstances where a company is liquidating, or operations

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March 23, 2010, available at [http://www.financialstability.gov/docs/20100323%20Exec%20Comp%20Fact%20Sheet%20\(Final%20Revised\)Furher%20Revised.pdf](http://www.financialstability.gov/docs/20100323%20Exec%20Comp%20Fact%20Sheet%20(Final%20Revised)Furher%20Revised.pdf) (last visited August 5, 2010).

<sup>6</sup> See Hearing Testimony of Thomas M. Conway, International Vice President, United Steelworkers, citing *In re Chemtura Corporation*, Case No. 09-11233 (April 19, 2010) (decision on debtors’ motion to implement key employee incentive program)(expressing concern about compensation consultants recommending and approving compensation at higher and higher and looking for a solution to the “compensation arms race”).

<sup>7</sup> 11 U.S.C. § 503(b)(1)(A)(ii).

are winding down, in anticipation of a liquidation. In these cases, some general creditors may object to employees' obtaining all of their earned payments. However, in determining payment priorities, Congress can--and should--take into consideration the relative harm to employees who do not receive money they have earned compared to other creditors who are less likely to be dependent on their bankruptcy recoveries to pay their living expenses.

7. **Please respond to the assertion that considering only the debtor's "short term" viability when determining whether a collective bargaining agreement can be rejected under the proposed new Section 1113 outlined in H.R. 4677 undermines bankruptcy policy's goal of ensuring that the debtor maximizes its chances of remaining a viable business in the long run.**

Response: For a reorganization plan to be approved ("confirmed") by the court, the debtor must demonstrate that the plan is "feasible," which means that "confirmation is not likely to be followed by the liquidation, or the need for further reorganization of the debtor. . . ."<sup>8</sup> This standard is well-established in the law and requires a debtor to show that a reorganization plan offers "a reasonable prospect of success and is workable."<sup>9</sup> The debtor is not required to prove that the business has "maximize[d] its chances of remaining a viable business in the long run."<sup>10</sup> The Code's "feasibility" standard recognizes that bankruptcy is not a "silver bullet" that can fix a business forever, and sets the more realistic goal that a reorganization plan is not likely to be followed by a liquidation or a further financial reorganization. Nonetheless, as debtors increasingly use bankruptcy to target labor and benefit costs, the "necessary to the reorganization" standard under Section 1113 has come to be viewed as something well beyond plan feasibility. Companies look to bankruptcy as a way to ensure their viability long into the future-- something the law has never purported to offer. Moreover, defending against proposed cuts where the time horizon is expressed in long-range, "silver bullet" terms is virtually impossible: whether a company can remain a viable business in the long run would require speculation about future business conditions, industry conditions, economic conditions and other unknowns. In addition, cuts of *any* kind could be said to make the prospects for future success more likely.<sup>11</sup> Employees and retirees will always be on the losing end under a standard that goes beyond what is required to confirm a reorganization plan. It also means that *only* employee and retiree interests will be subject to a greater-than-feasibility standard in chapter 11. As a result, employees and retirees

<sup>8</sup> 11 U.S.C. § 1129 (a)(11).

<sup>9</sup> 7 Collier on Bankruptcy ¶ 1129.02 [11] (Alan N. Resnick and Henry J. Sommer eds. 16<sup>th</sup> ed.)

<sup>10</sup> See e.g., *In re Briscoe Enterprises*, 994 F.2d 1160, 1165-66 (5th Cir. 1993) ("the court need not require a guarantee of success," which of course would be difficult to predict for any venture, much less one emerging from Chapter 11. "Only a reasonable assurance of commercial viability is required.") (citations omitted).

<sup>11</sup> See *New York Typographical Union No. 6 v. Royal Composing Room, Inc.*, 848 F.2d 345, 353 (Feinberg, J., dissenting) (noting criticism of rejection standard that was "so undemanding that it would 'almost always leads to approval of' a contract rejection because 'it is a rare case in which . . . relieving the employer of [the] burden [of the contract] will not . . . aid the 'success of the reorganization.'" (quoting 130 Cong. Rec. S6184 (daily ed. May 22, 1984) (statement of Sen. Packwood).



would be expected to pay a much higher price for the company's bankruptcy than other stakeholders. Congress's intent in enacting Sections 1113 and 1114 was to prevent disproportionate sacrifices by workers and retirees. A revised standard that provides a more realistic time frame, consistent with the standard for confirming a reorganization plan, is one means of ensuring that their sacrifices are not disproportionate and that they alone are not subject to a greater burden than all other stakeholders.

**8. Please respond to the assertion that including "the 20 next highly compensated employees" in H.R. 4677's executive compensation provisions is arbitrary.**

Response: Under the Bankruptcy Code, "insiders" (defined as "officers, directors and persons in control of the debtor")<sup>12</sup> are currently subject to the Code's restrictions on retention and severance payments under Section 503(c)(1) and (2). Obligations to officers, managers, consultants and others are subject to restrictions under Section 503(c)(3).<sup>13</sup> The executive compensation changes proposed in H.R. 4677 would apply to insiders and the 20 next most highly compensated employees. Applying the proposed amendments to insiders and the 20 next most highly compensated employees is consistent with the executive compensation principles that were issued by the Treasury Department in the June, 2009 interim final regulations on TARP standards for executive compensation and corporate governance. Under these rules, for example, bonus payments for named executive officers and the next 20 most highly compensated employees are limited where a TARP recipient received more than \$500 million in aid. Bonuses received by the senior officers and the next 20 most highly compensated employees are subject to a claw back if the payment was based on materially inaccurate performance criteria. Similarly, the Special Master was empowered to review the compensation for the senior officers and highly compensated employees in firms that received special assistance.<sup>14</sup> By drawing on the TARP rules, the amendments under H.R. 4677 would apply to a key employee group already identified by the federal government for compensation reform principles.

**9. H.R. 4677 would require that a court consider an alternative proposal set forth by a labor organization for modification of a collective bargaining agreement before granting a debtor's motion for Section 1113 relief. Does this mean that a court must accept the alternative proposal or deny the debtor's motion for Section 1113 relief if the alternative proposal meets the requirements of the new Section 1113? What happens if both the debtor's proposal and labor's alternative both meet those requirements?**

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<sup>12</sup> 11 U.S.C. § 101(31).

<sup>13</sup> Obligations "outside the ordinary course of business" and "not justified by the facts and circumstances," including obligations and transfers to officers, managers and consultants, are not allowable administrative expenses of the estate. 11 U.S.C. § 503(c).

<sup>14</sup> See TARP Standards for Compensation and Corporate Governance; Interim Final Rule, 74 Fed Reg. 28394 (June 15, 2009) (codified at 31 C.F.R. Part 30, §§ 30.8, 30.10, 30.16).

Response: If during pre-hearing bargaining, the debtor rejects an alternative proposal by the union in favor of going to court to seek rejection of its labor agreement, the debtor runs the risk that the court will find that the union's alternative proposal was sufficient. If the court finds that the union's alternative proposal was sufficient, then the debtor's motion for rejection would be denied and the parties would continue to bargain. Under the proposed amendments, the court must find that an alternative proposal by the union does not meet the statutory requirement in order to rule in favor of the debtor.

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**Babette Ceccotti, Cohen, Weiss and Simon LLP**

**Questions from the Honorable Bill Delahunt**

**1. During the hearing, I asked you whether you believe the “balance” in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.**

**Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.**

**Response**

My response will focus on recommendations to improve the balance of power and equities between the debtor, on the one hand, and labor groups and retirees on the other hand, in a Chapter 11 proceeding. H.R. 4677 contains many provisions intended to re-balance bankruptcy law on matters directly affecting employees and retirees.

As enacted in 1978, the Bankruptcy Code (and Chapter 11 in particular) incorporated a balance between the debtor’s ability to use bankruptcy remedies and the rights of creditors. Bankruptcy law provides creditors with certain rights to counter-balance those afforded a debtor, including recognizing important non-bankruptcy rights that creditors retain in a bankruptcy case (for example, a claim by a secured creditor retains the attributes of a secured claim that put the secured creditor at the “front of the line” in terms of payment priority).

Over time, businesses have used the Bankruptcy Code as a means of addressing obligations that go well beyond traditional financial and commercial obligations. In the 1980’s, the Bankruptcy Code became a strategic tool used by companies to obtain cuts in labor and benefit costs. Congress reacted twice during that time to create rules for, and establish the balance between, debtors and labor and retiree constituencies where a company seeks to use bankruptcy to change its labor cost or benefit cost obligations. In recognition of important non-bankruptcy policies, Congress enacted Sections 1113 and 1114 of the Bankruptcy Code, to provide labor groups and retirees with protection against an imbalanced process that was weighted heavily in favor of the debtor. Congress intended that the important policies reflected in these two provisions (collective bargaining and the protection of retiree health benefits) should be balanced with bankruptcy policy--debtors should not have free rein to break labor contracts and eliminate retiree health benefits obligations. What has happened since the time these provisions were enacted is that the protections intended for labor agreements and retiree benefits have been eroded by the courts to

the point where they work decidedly in favor of the debtor, as if these provisions had not been incorporated into the Bankruptcy Code. This means that bankruptcy policies which are interpreted to permit broad cuts in labor and benefit costs take precedence over policies that work to protect retirees and the process of collective bargaining.

H.R. 4677 proposes changes that would restore the balance between the debtor and labor/retiree groups. H.R. 4677 would:

- Tighten the rules by which a debtor can propose modifications in retiree benefits or other labor costs to prevent employees and retirees from bearing a disproportionate burden of a company's bankruptcy
- Require good faith negotiations over proposed modifications until it becomes clear that no agreement can be reached, and only then permit the debtor to use the bankruptcy court to impose changes
- Strengthen the bankruptcy court's review of a debtor's request to reject a labor agreement or modify retiree health benefits by
  - requiring a denial of the debtor's request where the debtor has not exhausted its bargaining efforts
  - permitting only the minimum changes necessary for the debtor to exit bankruptcy under Chapter 11's test for confirming a feasible reorganization plan
  - requiring that the proposed changes be examined from the standpoint of the affected labor or retiree groups, as well as the effect on the business and its ability to retain a qualified workforce, and not solely on the basis that the proposed modifications save the company money
- Clarify the law to provide for a damages claim where a labor agreement is rejected (as the law currently provides in the event of a termination or reduction in retiree health benefits), and a claim for lost pension benefits, if a defined benefit pension plan is terminated
- Clarify the law to confirm that labor groups can exercise their right to engage in self-help in the event of a court-ordered rejection of a labor agreement
- Prohibit companies from relying on "fine print" "reservation of rights" clauses to avoid the retiree protections of Section 1114
- Tighten the rules for approval of executive compensation schemes and prohibit executive pension and health benefit plans from riding through bankruptcy where workers' and retirees' benefits are cut.

**2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be**

**outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?**

As Congress saw in 1986, when LTV Steel filed a chapter 11 case and abruptly stopped paying retiree health benefits on the grounds that they were “general unsecured claims” --and again when Polaroid cut its retiree benefits off before filing its Delaware bankruptcy case -- retirees do need special protection in business bankruptcy cases. Congress took swift action in 1986, and again in 2005, to thwart the ability of companies to use bankruptcy as a means of eliminating their retiree health benefits obligations. As set forth in the response to question 1 above, these protections need to be strengthened.

Under current law the courts construes priority payments of any kind on a strict basis. Therefore, if Congress seeks to protect particular payments, or payments to particular groups, it must do so expressly in the Bankruptcy Code as it has done in Section 1114. Given the growth in the uses of bankruptcy, and the apparent ease with which debtors have been permitted to reduce or eliminate obligations for retiree health benefits, pensions and other vital benefits, it is entirely appropriate for Congress to take action to limit retirees’ losses, whether through a damages claim, priority payments, or both. Left without specific statutory protection, payments to former employees can face a legal objection that they are not “actual, necessary costs and expenses of preserving the estate” under the rules for allowance of expenses of administration of the debtor’s estate,<sup>1</sup> because the payments are intended for former employees, rather than employees who are currently providing services to the company in bankruptcy. Moreover, particularly where companies face industry-wide restructurings that reduce jobs, and in light of the increasing use of bankruptcy to bring about changes that will reduce a company’s operations, programs such as severance plans for rank and file workers, early retirement incentives, or similar special programs for workers whose jobs will disappear provide a necessary “soft landing” for a restructured industry. Payments of this type should be protected payments in bankruptcy.

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<sup>1</sup> See 11 U.S.C. § 503(b).

RESPONSE TO POST-HEARING QUESTIONS FROM JOHN PRATER, CAPTAIN,  
AIR LINE PILOTS ASSOCIATION, INTL.

Questions for the Record  
Subcommittee on Commercial and Administrative Law  
Hearing on H.R. 4677, the "Protecting Employees and Retirees in Business  
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Captain John Prater, President, Air Line Pilots Association, Intl.

Questions from the Honorable Bill Delahunt

1. During the hearing, I asked you whether you believe the "balance" in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.

Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.

Thank you for your question Congressman. Currently, there is no balance. H.R. 4677 seeks to correct today's severe imbalance that greatly disadvantages workers in the following ways:

Reestablish the necessity standard as a true test for "needed" changes for a successful reorganization. Today, bankruptcy judges lend an incredible amount of deference to what a company "wants" rather than what they truly need. Too many corporations use our broken bankruptcy laws as a business strategy to unfairly extract deep and lasting compensatory and work rule concessions from workers and retirees while paying themselves and bankruptcy attorneys huge sums of money in the form of retention bonuses and fees.

Today, the pain of bankruptcy is felt almost exclusively by the workers, who have the greatest stake in ensuring the survival of their employers and jobs. H.R. 4677 seeks to ensure that the financial hardship and pain of a Chapter 11 reorganization is shared more equally by workers, management, vendors and other stakeholders.

As I stated in my testimony, today, a profitable company can file for bankruptcy and hold workers hostage. The company very rarely loses in Chapter 11 and they know this all too well. They use this near certainty to essentially extort huge givebacks from employees. I held out the bankruptcy at Hawaiian Airlines as an example of how truly broken our bankruptcy laws are today. A profitable company was able to extract concessions from workers through the 1113 process.

H.R. 4677 make a variety of technical changes to the bankruptcy code in Titles I and II to close various loopholes that exist today to the detriment of workers and to restore the original intent of 1113 to its purpose of promoting superior collective bargaining solutions. The legislation seeks to provide bankruptcy court judges with the tools they currently lack and a wider degree of

latitude to consider issues beyond the present narrow focus on the wishes of the debtor. The most common complaints we hear from bankruptcy court judges today is that they currently lack the authority in section 1113 to consider the wider context of the proposed exit strategy on employees and their economic security. To them, it doesn't matter how the dollar amount is arrived at or whom the burden primarily falls upon. As long as the amount of concessions are consistent with the amount the debtor has requested via section 1113 and section 1114, the bankruptcy court judge is highly likely to approve the plan. Our reforms give the bankruptcy judges the ability to consider whether sacrifices are being fairly shared and whether the concessions demanded are truly necessary and proportionate to the need for successful reorganization.

2. **In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?**

I believe other workgroups may be able to speak to this better than the pilots I represent. Pilots are very well-trained and governed by the Federal Aviation Administration (FAA). Ours is a highly specialized profession and our skill sets don't transfer to other sectors of the economy.

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RESPONSE TO POST-HEARING QUESTIONS FROM JAMES H.M. SPRAYREGEN,  
KIRKLAND AND ELLIS LLP

**Questions for the Record**  
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James H.M. Sprayregen, Kirkland & Ellis LLP

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**Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.**

In my opinion, the most appropriate way to improve the Chapter 11 process and the Bankruptcy Code generally is to remove the special interest-motivated amendments that prefer one type of creditor over another in favor of the 1978 version of the Bankruptcy Code. Though the many amendments may have been well-intended, most have missed the mark.

As I explained in my written testimony, when Congress considered the passage of the Bankruptcy Reform Act of 1978, its principal goal was to create a mechanism through which a company could restructure its debt in a way that maximizes value for all parties with an interest in the company and ensures equal treatment of similarly-situated creditors. The essence of a Chapter 11 situation is that there simply are insufficient assets to satisfy all stakeholder claims. To that end, Congress created an elegant set of checks and balances to ensure that no single party accumulates too much leverage or power in the reorganization process. Since that time, however, this system of checks and balances has been significantly eroded through numerous amendments, most recently the amendments in 2005.

For example, two such amendments relevant in the current economic downturn are: (1) the safe harbor exemption from the automatic stay for certain derivatives contracts, including securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements; and (2) the 210-day cap on the time period for debtors to decide whether to assume or reject unexpired leases of non-residential real property.

Congress’ stated reason for exempting the termination of derivatives contracts from the automatic stay was “to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.” H.R. Rep. No. 97-420, at 1 (1982). The idea was to ensure sufficient liquidity in the capital markets by permitting the counterparty to a derivatives contract to terminate the contract and seize its collateral notwithstanding the automatic stay. As the recent credit crisis unfolded, however, it



became apparent that the intended effect of the safe harbor modifications—to ensure adequate liquidity in the market and avoid systemic risk—had the exact opposite effect. Indeed, in the case of American General Insurance (“AIG”), the safe harbor provision in section 560 of the Bankruptcy Code largely rendered a potential Chapter 11 filing a nullity. If AIG had filed Chapter 11, counterparties to AIG credit default swaps, unimpeded by the automatic stay, would have been able to terminate the contracts and seize the collateral that secures AIG’s obligations under those contracts. This potentially catastrophic result for AIG would have had far-reaching negative consequences for AIG’s trading partners, many of whom were large financial institutions.

Likewise, Congress’ desire to protect real property lessors in bankruptcy proceedings drove its decision to impose a 210-day deadline for a chapter 11 debtor to decide whether to assume or reject an unexpired lease of non-residential real property. This modification, however, has led to the liquidation of many retailers to the detriment of all stakeholders, including lessors. The 210-day limit affords a debtor little time to formulate a viable business plan, implement operational restructuring initiatives, and negotiate a plan of reorganization. Moreover, lenders are even more reluctant to finance a debtor’s reorganization absent an indefinite period of time to monetize leases in the event the restructuring fails. Finally, not only does the time limit severely restrict a debtor’s ability to restructure, it also inhibits a debtor’s ability to find buyers willing to pay fair market value through a comprehensive sale process.

In light of these and other examples of situations where well-intended amendments have had unintended collateral effects, I believe that it would be appropriate to remove many of the amendments that have been passed since the 1978 Bankruptcy Code was enacted. This re-rationalization of the leverage points among debtors and parties in interest will serve the interests of the greater good by bringing back in line the balance of power and equities among affected parties in a Chapter 11 reorganization, thus permitting a debtor to maximize value for all stakeholders.

**2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?**

As mentioned in my answer to question 1, the principal goal of the Bankruptcy Code has always been to create a mechanism through which a company could restructure its debt in a way that maximizes value for all parties with an interest in the company and ensures equal treatment of similarly-situated creditors. Thus, as a general rule, all unsecured claims (those claims that are not backed by a form of collateral) that arise before the filing of a bankruptcy should be treated with like priority. Moreover, I believe that Congress should limit the circumstances in which it elevates the priority of unsecured claims that arise before a bankruptcy filing relative to other unsecured claims.

There should be (and are) exceptions to that general rule where establishing a higher priority for a category of claims can be justified as furthering the principal goal of maximizing the company’s value for the benefit of all stakeholders. For example, providing priority status to

claims of employees for wages earned in the days leading up to a chapter 11 filing ensures that such employees will continue to provide necessary services to the company during a time when an interruption of the business could seriously jeopardize the company's reorganization.

Unfortunately, the payment of many other prepetition unsecured claims, including claims of retirees, generally does not maximize value. The payment on account of retiree claims merely represents a distribution cost to the debtor's estate with no concomitant benefit, unlike the payment to current employees whose continued service to the company provides value to the operating enterprise. Notwithstanding the legitimate moral justification for the payment of retiree claims given the disparate balance of power and leverage, as I discussed in my written testimony, the capital markets are sensitive to cost requirements. Given the necessity of capital to a debtor's successful reorganization, the elevation of priority of prepetition unsecured claims should be limited to those prepetition claims where the payment of such claims can be linked to some benefit to a debtor's overall restructuring. Otherwise, we risk burdening a debtor with so many priority claims that reorganization becomes impossible.

That being said, the Bankruptcy Code currently provides protection to certain retiree claims on an elevated priority basis. First, section 1114 of the Bankruptcy Code limits the ability of a debtor in possession or trustee to "modify" "retiree benefits" following the filing of a chapter 11 case. In particular, the Bankruptcy Code requires a debtor to follow the same framework established by section 1113 of the Bankruptcy Code before it can terminate or modify certain retiree benefits (i.e., "vested" retiree benefits). Second, section 1129(a)(13) of the Bankruptcy Code requires, as a condition to confirmation of a plan of reorganization, that the plan of reorganization provide for the continuance of all vested retiree benefits (as defined in the Bankruptcy Code) at existing levels (as modified during the bankruptcy under section 1114 of the Bankruptcy Code) when the debtor exits from bankruptcy.<sup>1</sup> Thus, as drafted, the Bankruptcy Code attempts to keep in place, subject to a company's compliance with the 1114 process, whatever vested retiree benefits existed as of the time the company filed for bankruptcy and ensures that before a debtor is allowed to exit bankruptcy the payment of such retiree benefits are provided for in the plan of reorganization.

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<sup>1</sup> "Retiree benefits" are defined as payments "for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death, under any plan, fund, or program ..." that was maintained or established prior to the filing of the chapter 11 case. 11 U.S.C. § 1114(a).

RESPONSE TO POST-HEARING QUESTIONS FROM JANETTE ROOK,  
ASSOCIATION OF FLIGHT ATTENDANTS-CWA

**Questions for the Record**  
**Subcommittee on Commercial and Administrative Law**  
**Hearing on H.R. 4677, the “Protecting Employees and Retirees in Business**  
**Bankruptcies Act of 2010”**  
**May 25, 2010**

**Janette Rook, Association of Flight Attendants-CWA**

**Questions from the Honorable Bill Delahunt**

**1. During the hearing, I asked you whether you believe the “balance” in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.**

**Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in Chapter 11 reorganization.**

As I testified, my experience in bankruptcy comes from that of an employee who witnessed corporate executives manipulate the bankruptcy laws in order to plunder the assets of my company and to enrich themselves at the expense of thousands of workers. It appears to me that the bankruptcy law, which was designed to protect workers, is not balanced at all. It is my opinion that bankruptcy laws, as interpreted by the courts, seem to favor corporations.

Improvements, such as those proposed in HR 4677, will create a framework requiring corporations to negotiate openly and in good faith and provide collective bargaining groups with advance notice about the types of modifications (including the financial liability) that will be needed during and following restructuring.

A balance could be returned to the process by:

- 1) Respecting the collective bargaining process – including the right to self help if the courts grant a motion to reject a collective bargaining agreement.
- 2) Allowing courts to look back in the 12 months prior to a bankruptcy filing and consider concessions already granted by a labor organization.
- 3) Ensuring that no work group is unfairly burdened by the concessions required to emerge from bankruptcy.
- 4) Allowing the courts to take into consideration the amount of executive compensation packages.
- 5) Limiting the duration of concessionary agreements.

**2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?**

From my perspective section 1113 of the bankruptcy code doesn't ensure equal treatment of all parties during bankruptcy. The laws, as interpreted, have created a process which treats all groups differently.

Legislation, like HR 4677, could restore conditions that have been eroded over the years for retirees and provide several protections lacking today. This would even the impact for all groups, by allowing the courts to consider the minimum savings needed for a company to exit bankruptcy. The courts could ensure the sacrifices made by effective parties, including retirees, aren't disproportionate.

By restoring the congressional intent and protecting collective bargaining rights in bankruptcy, Congress can ensure retirees and workers concessions are minimized thereby protecting them from corporate greed.



RESPONSE TO POST-HEARING QUESTIONS FROM THOMAS CONWAY,  
UNITED STEEL WORKERS OF AMERICA

Questions for the Record  
Subcommittee on Commercial and Administrative Law  
Hearing on H.R. 4677, the "Protecting Employees and Retirees in Business  
Bankruptcies Act of 2010"  
May 25, 2010

Thomas M. Conway, International Vice President (Administration), United Steelworkers

Questions from the Honorable Bill Delahunt

1. During the hearing, I asked you whether you believe the "balance" in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.

Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.

2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?

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Thomas M. Conway  
Vice President (Administration)

June 25, 2010

VIA FAX: (202) 225-5658

The Honorable William D. Delahunt  
2454 Rayburn House Office Building  
Washington, D.C. 20515

Re: **Protecting Employees and Retirees in Business Bankruptcies  
Act of 2010**

Dear Representative Delahunt:

It was an honor to appear before the Subcommittee on Commercial and Administrative Law on May 25, 2010, and it is my pleasure to reply to the additional questions that you have posed concerning my testimony.

With respect to your question about recommendations to address the balance of power and equities among affected parties in a Chapter 11 reorganization, the United Steelworkers believes that the Protecting Employees and Retirees in Business Bankruptcies Act of 2010 ("Act"), when taken as a whole, would place back in balance the need of debtors to achieve labor cost savings in appropriate cases and the right of workers and retirees to preserve hard-earned wages and benefits.

The Act will cause debtors seeking modifications to their labor and retiree benefit agreements to take seriously the obligation to bargain. The Act requires companies to more clearly define the bargaining demands and limits the concessions to those needed to exit bankruptcy. These requirements will assure that employees and retirees are not required to bear a disproportionate burden of targeted cuts. The Act also would change judicial procedures so that courts are

United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union

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The Honorable William D. Delahunt  
June 25, 2010  
Page 2 of 3

required to give due consideration to proposals offered by unions which meet the company's legitimate needs but which achieves those savings in a manner which imposes less harm upon workers and retirees. Further, the Act limits the ability of a debtor to seek concessions from its workers and retirees when the debtor seeks to implement new bonus programs for its executives. Shared sacrifice is (or, at least, should be) an underlying principle in bankruptcy reorganization, and the Act restores that principle to its rightful place.

The Act also re-balances the equities in the Chapter 11 process by increasing the payment priority for lost wages and benefit plan contributions to \$20,000 per employee, clarifying certain technical points about the treatment of WARN Act damages and severance pay, and creates a new claim for 401(k) plan losses in company stock because of company fraud. The creation of new and enhanced claims will never replace a lost job or lost pension or retiree insurance benefits. However, the fundamental notion of equity demands that workers and retirees receive fair consideration for their losses.

In addition, as a further way of improving equity among affected parties, the Act places limits on the ability of a debtor to implement new bonus and other compensation programs for executives and managers. I testified about a recent case where a bankruptcy judge in New York remarked upon the "compensation arms race" in current cases. The Act is a way of ending this arms race. Companies would now be required to meet more exacting standards before obtaining court approval of lavish programs for its top executives and others. The Act would increase the ability of a court to review these programs and would require the company to support its request through realistic comparisons with the pay practices of comparable companies. Furthermore, as addressed above, companies would be required to consider whether implementing new executive compensation programs would limit its ability to modify labor and retiree benefit agreements. Once again, the Act restores the notion of shared sacrifice.

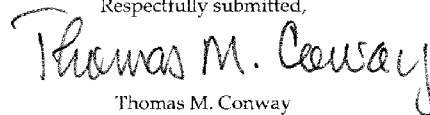
Regarding your question about whether different treatment or priority should be given to retirees, for the various reasons described above, the Act would elevate the protections given to retirees by requiring earnest bargaining in advance of modifying benefit programs and creating increased claims for lost benefits. Oftentimes, companies, banks and investors find that retirees are the

The Honorable William D. Delahunt  
June 25, 2010  
Page 3 of 3

easiest group to target in a bankruptcy case. The Act would go a long way towards erasing that point of view.

Thank you again for the opportunity to address your questions. On behalf of myself and the 850,000 members of the United Steelworkers, I urge Congress to act promptly on this important piece of legislation.

Respectfully submitted,

A handwritten signature in black ink that reads "Thomas M. Conway". The signature is written in a cursive, flowing style.

Thomas M. Conway  
Vice President (Administration)

TC/ss

A solid black horizontal line.



RESPONSE TO POST-HEARING QUESTIONS FROM MICHAEL L. BERNSTEIN,  
ARNOLD & PORTER LLP

**Questions for the Record**  
**Subcommittee on Commercial and Administrative Law**  
**Hearing on H.R. 4677, the “Protecting Employees and Retirees in Business**  
**Bankruptcies Act of 2010”**  
**May 25, 2010**

Michael L. Bernstein, Arnold & Porter LLP

**Questions from the Honorable Bill Delahunt**

**1. During the hearing, I asked you whether you believe the “balance” in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.**

**Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.**

As a general matter, I believe that the existing balance of leverage between debtors and labor unions in Chapter 11 proceedings is appropriate. Debtors, in negotiations with their labor unions, have a strong incentive to make the compromises necessary to achieve a consensual resolution for several reasons. First, the standard for obtaining relief under sections 1113 and 1114 is stringent and difficult to satisfy. Thus, a company faces a serious risk that, if it does not reach an agreement with its unions, it will not obtain any relief from its labor costs. Numerous debtors have gone to contested section 1113 hearings and had their motions denied. Second, if a company does not act reasonably in its negotiations with its unions -- including bargaining in good faith, providing all necessary information, and not asking for more relief than is necessary for the debtor to be able to reorganize -- then the court will deny section 1113 relief. Thus, a company has a strong incentive to negotiate in good faith. Third, labor peace is important for a company's stability, and employees' goodwill is an important asset. Thus, any company would much prefer to resolve labor issues consensually, rather than through litigation. Unions likewise have an incentive, under current law, to try to reach agreements. Doing so avoids the risk that their contract will ultimately be rejected. It also allows them to structure any necessary concessions in a way that is sensitive to their membership's priorities, rather than having a judge make an “up or down” decision. Finally, most unions do not want to win section 1113 litigation, only to see the company liquidated because it is crushed by the burden of unsustainable labor costs. This would be a pyrrhic victory for the union.

This “balance” that exists under current law encourages negotiated resolutions. Each side faces risk associated with litigation, and each side benefits from a negotiated settlement. One indication of this balance is the fact that the overwhelming majority of situations involving a need for labor cost modifications have been resolved through negotiations in which each side makes concessions. Only a small minority of cases are litigated.

Congress should not enact amendments that would alter the “balance” that exists under current law. Of course, unions and companies will each say that they need more leverage. Every constituency wants to improve its own position. But the current system is working well -- enabling companies to reorganize while protecting employees’ bargained-for wages and benefits to the maximum extent possible. Modifications that would materially alter the balance-of-power, such as those set forth in H.R. 4677, would result in fewer negotiated resolutions, more litigation, increased costs, and ultimately more companies being liquidated rather than reorganized. This would be inconsistent with the purpose of Chapter 11 and with the best interests of all stakeholders, including employees.

If Congress wants to amend the Bankruptcy Code in a way that will benefit nearly all stakeholders -- including companies and their employees -- it should consider:

- (1) repealing section 503(b)(9), which unfairly discriminates among prepetition unsecured creditors and increases the costs of Chapter 11 reorganizations -- by increasing the administrative expense burden -- to the detriment of companies and their employees;
- (2) modifying section 365(d)(4)(B) -- which forces some debtors to make premature decisions concerning the assumption and rejection of real estate leases, making reorganizations more difficult to achieve and in some cases depleting significant value that could be used to pay creditors, employees and other constituencies -- to permit the court to extend the time for a debtor to assume or reject a lease of nonresidential real property for an appropriate period of time, up to the date of plan confirmation, upon a showing of cause (rather than the current provision, enacted in 2005, which limits this period to a maximum of 210 days absent the landlord’s consent); and
- (3) extending the maximum exclusivity period under section 1121(d) of the Bankruptcy Code, since some debtors will need more than 18 months to reorganize in bankruptcy, and in those cases artificially limiting the process to 18 months is inconsistent with the reorganization objectives of Chapter 11, and contrary to the interests of both companies and their employees.

**2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?**

Retirees are already given different treatment than general unsecured creditors of a debtor. For example, section 1114 of the Bankruptcy Code assures that the retiree’s interests are represented in the bankruptcy case and creates a very high legal standard for modification of retiree benefits, and section 1129(a)(13) requires that a Chapter 11 plan provide for continuation of retiree benefits at the level established pursuant to section 1114 for the full period during which the debtor is obligated to provide such benefits.

The question of whether retirees should be given even greater protections in Chapter 11 is a difficult one. On the one hand, as the question points out retirees are often in a very difficult position when their benefits are reduced in Chapter 11 because they may be unable to replace the lost income. On the other hand, if a company that is reducing other expenses also needs to reduce retiree expenses in order to remain viable and be able to emerge from bankruptcy, then it may be better to permit such reductions, rather than have the company liquidate, and as a result be unable to pay any retiree benefits at all. The unfortunate reality is that, for some companies, maintaining retiree benefits at the current level is simply not an option. In those cases, reducing the retiree payments, and thereby enabling the company to survive, may be the lesser of two evils.

Finally, there is a “creditor versus creditor” issue. As Justice Black wrote in *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945), “historically one of the prime purposes of the bankruptcy law has been to . . . protect the creditors from one another.” If Congress were to make it more difficult, or impossible, to modify retiree benefits in bankruptcy, it would (in addition to making reorganization more difficult to achieve) reduce the amounts available for other creditors, including current employees. Assume, for example, that a company needs to save \$20 million a year in order to obtain the necessary exit financing and emerge from bankruptcy as a viable and competitive entity, and that its business plan calls for \$2 million of that savings to come from a reduction in retiree benefits. If the law were amended to preclude that \$2 million modification, the savings will have to come from some other place. This may mean, for example, that current employees are required to take deeper wage and benefit cuts than would otherwise be necessary.<sup>1</sup>

In some cases, labor unions represent both current employees and retirees. This enables the union to negotiate with the debtor regarding the necessary cost savings, and to allocate those savings between current employees and retirees as the union deems appropriate. Of course, it also creates a potential conflict of interest, and for that reason some unions decline to represent their retirees in bankruptcy.

While a focus on the interests of retirees is entirely appropriate, given the pain that they can suffer as a result of a reduction in their benefits, Congress should be cautious in enacting amendments to the Bankruptcy Code that would make it legally or practically impossible for a company to modify retiree benefits. Such an amendment would, at least in some cases, force the company to liquidate, which would harm retirees, current employees, creditors, and other constituencies. And even in those cases where a company could still reorganize, doing so would typically require greater sacrifice from current employees and other stakeholders.

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<sup>1</sup> Another alternative would be to achieve cost savings through reducing the recovery of other creditors, such as trade vendors, taxing authorities, customers, lenders, or tort victims. However, these reductions would be “one-time savings” and are therefore often insufficient without also reducing recurring expenses.

POST-HEARING QUESTIONS POSED TO ROBERT ROACH, JR.,  
INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS\*

Questions for the Record  
Subcommittee on Commercial and Administrative Law  
Hearing on H.R. 4677, the "Protecting Employees and Retirees in Business  
Bankruptcies Act of 2010"  
May 25, 2010

**Robert Roach, Jr., General Vice President for Transportation, International Association of  
Machinists and Aerospace Workers**

Questions from the Honorable Bill Delahunt


1. During the hearing, I asked you whether you believe the "balance" in Chapter 11 is where it should be, in terms of the bargaining power and treatment accorded to retirees and other affected parties.

Please provide to the Committee a list of recommendations of ways to improve Chapter 11, specifically regarding the balance of power and equities among affected parties in a Chapter 11 reorganization.

2. In Chapter 11 bankruptcy, do you believe there ought to be different treatment or priority given to retirees of the company, given that their work skills are likely to be outdated or they are otherwise likely to be disadvantaged from seeking additional income through the workforce?

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\*The Subcommittee did not receive a response to these questions.



PREPARED STATEMENT OF THE INTERNATIONAL UNION, UNITED AUTOMOBILE  
AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

**STATEMENT OF THE  
INTERNATIONAL UNION, UNITED AUTOMOBILE  
AEROSPACE & AGRICULTURAL IMPLEMENT  
WORKERS OF AMERICA (UAW)**

**on the subject of**

**PROTECTING EMPLOYEES AND RETIREES IN BUSINESS BANKRUPTCIES  
ACT OF 2010 (H.R. 4677)**

**Submitted to the**

**SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW**

**COMMITTEE ON THE JUDICIARY**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**MAY 25, 2010**

The International Union, United Automobile Aerospace & Agricultural Implement Workers of America (UAW), represents more than one million active and retired workers. We appreciate the opportunity to submit this testimony to the Commercial and Administrative Law Subcommittee of the House Committee on the Judiciary on the subject of the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010" (H.R. 4677).

The UAW and its members have been in the headlines recently for two very large bankruptcies at GM and Chrysler that were handled outside the parts of the bankruptcy code that the legislation before us is intended to correct. In this testimony, we do not address those bankruptcies because they are not relevant to this legislation. Instead, this testimony will speak to our experience with bankruptcy in the auto parts sector and how this bill can improve the outcome of future bankruptcies or prevent them.

As evidenced by passage of labor legislation beginning with the Norris-Laguardia Act, Congress has long sought to restrict federal judicial intervention in labor disputes and instead foster the practice of collective bargaining in conducting labor relations. Section 1113 of the Bankruptcy Code - enacted by Congress in response to the Supreme Court's ruling in *NLRB v. Bildisco & Bildisco*<sup>1</sup> that a collective bargaining agreement could be rejected by a debtor just like any other executory contract – sought to carry this long standing and well recognized practice into the bankruptcy process.

Unfortunately, a long line of court rulings interpreting the substantive and procedural requirements for rejection of a collective bargaining agreement under Section 1113 have eroded its fundamental aspects encouraging collective bargaining. It has become all too frequent for companies to file chapter 11 and approach organized labor with all sorts of overreaching demands, oftentimes presenting proposals for contract modifications that more closely reflect a labor relations manager's Christmas wish list than the minimum modifications necessary to permit the company to emerge from bankruptcy as the statute requires. Debtors file Section 1113 motions to reject collective bargaining agreements and Section 1114 motions to modify retiree health insurance benefits as a tool for leverage in negotiations, rather than as a last resort once negotiations have proven unsuccessful as the statute provides.

The litigate now, bargain later approach can pollute the bargaining environment with the threat that if the union does not agree to deep concessions, the court will impose even deeper ones. As a result, companies using the bankruptcy process are provided with tools to shift a disproportionate share of the restructuring burden on to workers and retirees. Corporations are able to use bankruptcy to undermine collective bargaining agreements and slash retiree benefits while simultaneously granting lucrative compensation packages for top executives.

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<sup>1</sup> 465 U.S. 513 (1984).

This has had a disastrous effect on individuals and communities throughout the United States – resulting in lower wages, lost health care benefits for retirees, lower pension checks for early retirees and the loss of employment opportunities through plant closings.

One example is Delphi Corporation, which filed for Chapter 11 bankruptcy on October 8, 2005. The company was able to use the bankruptcy process to eliminate its U.S workforce and shift its jobs abroad. Four of the Delphi's UAW-represented plants remain in operation as General Motors plants. At those locations our members had to accept wage cuts up to 50%. In addition, they had to pay an increased share of their health care costs out of their reduced wages. For new hires, defined-benefit pensions and health insurance were eliminated entirely.

Meanwhile, in 2006, the bankruptcy court approved an incentive plan that awarded \$38 million to the company's top executives, some of whom had presided over the losses that led to the bankruptcy. Some were even under investigation for false financial reporting at the time the bonuses were approved. In 2008, the court approved an additional package of equity stakes in the reorganized company valued at more than \$400 million and cash bonuses worth over \$16.5 million. CEO Steve Miller, who took Delphi into bankruptcy after previously doing the same at Bethlehem Steel has said that bankruptcy is a growth industry. For him, it certainly is!

Variations on the Delphi theme have occurred over and over again in the auto parts industry at such companies as Dana Corporation, Tower Automotive, Collins & Aikman, Metaldyne, Meridian Automotive, Dura, Visteon and many others.

The proposed bankruptcy reform legislation would put a stop to the abuses that the UAW has witnessed in the auto parts sector and other unions have witnessed in the coal, steel and airline sectors. Title I increases protection for the claims of individual employees whether or not they are covered by a collective bargaining agreement. Title II requires the parties to negotiate in good faith before a motion for rejection or modification of an agreement can be filed. This protects the employees from having to negotiate while the weapon of contract rejection is pointed straight at them. It restores to the bankruptcy code the federal labor policy favoring negotiated resolution of disputes between unions and employers. In addition, Title II reaffirms the idea that corporate bankruptcies should aim to rehabilitate productive enterprises, preserving jobs and thereby strengthening communities. Title III responds to abuses in executive compensation programs still prevalent under the current law by, among other things, limiting executive compensation enhancements and tightening standards for assumption of compensation plans. Title IV allows for unions to file proofs of claim on behalf of their members and exempts labor dispute resolution proceedings, such as grievances and arbitration, from automatic stays.

### Improving Recoveries for Employees and Retirees

Many traditional unsecured creditors in a business bankruptcy case have “limited” exposure. For suppliers or vendors, an account with a debtor commonly represents one of its many business relationships. Holders of unsecured corporate debt tend to be investment houses and financial institutions whose investments in a particular firm are limited relative to their total investments and whose total holdings are spread throughout the entire spectrum of Wall Street offerings. Workers, on the other hand, devote substantial resources to a particular firm. Through their contribution of labor, skill and knowledge, workers provide a valuable service to their employers and are compensated in numerous ways. In addition to a salary, workers typically earn vacation and paid personal time off, sick pay, severance benefits, contributions to 401(k) plans and other retirement vehicles and various medical savings accounts.

The commencement of a bankruptcy case by an employer can often result in the loss or significant reduction in medical insurance and pension benefits to retirees who spent decades working for the employer and building up their retirement benefits. When an employer enters bankruptcy, many wage, compensation and benefit obligations can end up as general unsecured claims, the lowest category of claim in a bankruptcy proceeding. Holding a general unsecured claim can often entail a lengthy wait for that creditor and a distribution of “pennies on the dollar” on the underlying obligation. The enhanced protection for the claims of individual employees, contained in Title I of the bill and described here, apply to all employees regardless of whether they are covered by collective bargaining agreements or belong to unions. Thus, the bill benefits both represented and non-represented employees.

In enacting the Bankruptcy Code, Congress initially provided for a “heightened” recognition of wage and benefit obligations earned within 180 days before a bankruptcy filing by categorizing such claims as priority claims.<sup>2</sup> Unfortunately, for purposes of priority claims recognition, all wage and benefit obligations owing to an employee are capped at \$10,000.00 and must have been earned within the six month period preceding the bankruptcy filing.<sup>3</sup> Benefits such as vacation pay are often intended as deferred compensation in payment for services already performed<sup>4</sup>, and firms vary widely with respect to employees’ accrual of benefits (e.g., earned in one year and used in the following year). As a result of the 180 day limitation and varying vacation accrual policies, workers commonly see only a portion of their vacation pay recognized as a priority claim. And due to the priority claim limit in Section 507(a)(4) and offset requirement in Section

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<sup>2</sup> See 11 U.S.C. §507(a)(4), (5).

<sup>3</sup> *Id.*

<sup>4</sup> From the Supreme Court on down, vacation pay is recognized as deferred compensation. See, e.g., *Foster v. Dravco Corp.*, 420 U.S. 92, 95 (1975); *Smith v. Kingsport Press, Inc.*, 366 F.2d 416 (6<sup>th</sup> Cir. 1966).



507(a)(4)(B), workers with benefit plan claims such as unpaid 401(k) plan contributions or unpaid medical plan benefits see their wage claims encroaching on the ability to have benefit claims reach priority status.

Section 101 of the proposed legislation addresses these shortcomings by amending the Bankruptcy Code to increase the amount of the priority wage claim in Section 507(a)(4) to \$20,000 and eliminate the 180 day reachback limitation. Section 101 also amends Section 507(a)(5) to increase the priority wage claim amount to \$20,000, eliminate the offset requirement and eliminate the 180 day limitation. These changes to the Bankruptcy Code will go a long way to protecting workers' hard earned contributions to their employer and ensuring that workers are not completely vulnerable in a bankruptcy proceeding.

Existing legal precedent prohibits pension plan participants from filing claims against a debtor for any shortfall in their pension benefits as a result of a pension plan termination under the Employee Retirement Income Security Act of 1974 ("ERISA"), recognizing the Pension Benefit Guaranty Corporation ("PBGC") as the only party able to file such claims, even when the PBGC does not subsequently make up any of the individuals' pension shortfall. Section 204 of the proposed legislation remedies the unfair treatment accorded to pensioners and retirees. It adds a new subsection to Section 502 of the Bankruptcy Code, requiring the court to allow a claim by an active or retired participant (or by a labor organization representing such participants) in a defined benefit pension plan terminated under Title IV of ERISA for any shortfall in pension benefits accrued as of the date of plan termination as a result of such termination and limitations upon the payment of pension benefits imposed pursuant to ERISA, notwithstanding any claim asserted and collected by the PBGC with respect to such pension plan termination.

Under 401(k) defined contribution plans, which have become the primary retirement income vehicle for many Americans, workers bear the sole risk for market downturns. Since employers frequently make their discretionary contributions to such plans in the form of employer equity, workers' retirement security can become captive to an employer's transgressions. Cases like Enron and Worldcom demonstrate the dangers this arrangement presents to workers' retirement savings. When an employer enters bankruptcy, a worker's holdings in securities of their employer will stand at the bottom of the recovery waterfall. Section 102 of the proposed legislation remedies this shortcoming by elevating, to general unsecured status, a worker's claim for losses in company stock held in a retirement savings plan when employer fraud is involved. This goes a long way towards alleviating the harsh economic pain innocent workers can experience in business bankruptcies. This protection is directed to the "rank and file" employees of a business – the ones who frequently bear the greatest burden in a business bankruptcy. It can not be made by a senior executive officer of the employer or one of the 20 next most highly compensated employees.

With increasing frequency, companies are entering bankruptcy with limited cash availability and secured lenders' low level of tolerance for reorganization. In many instances, lenders deliver a mandate that the debtor sell its assets under chapter 11. All too often, workers are left unpaid for the valuable services they contribute to the debtor. To secure continued cash availability during the bankruptcy proceeding, debtors often enter into financing agreements with their secured lenders that grant waivers of any claims under Section 506(c) of the Bankruptcy Code. Section 506(c) was enacted by Congress to assure that when a claimant expends money or resources to provide for the reasonable and necessary costs and expenses of preserving a secured lenders' collateral the debtor should be entitled to recover such expenses from the secured lender. The rationale behind this is simple. People who undertake efforts to allow a business to continue operating or preserve its value during a bankruptcy proceeding should not be penalized. Such provisions waiving Section 506(c) claims raise concerns because a debtor can fail to, or be unable to, honor its contractual wage and benefit obligations to its employees for services rendered post-petition. Oftentimes medical claims and premiums, or even wages, will go unpaid while a debtor sells its assets or winds down its business. At the same time they may have not received their earned wages, workers can then be stuck paying medical claims a debtor's insurance carrier should have covered. It is wrong for workers' services and contributions to an employer to go unpaid, especially when such services contribute to preserving an operating business during a sale process for the direct benefit of secured lenders. That is why Section 205 of H.R. 4677 is so important. Section 205 amends Section 506(c) to deem unpaid wages and benefits owed pursuant to a collective bargaining agreement to be necessary costs and expenses of preserving property, and would allow for the recovery of such obligations even if a debtor has waived the provisions of Section 506(c) pursuant to a financing agreement.

Given the uncertainty surrounding a debtor operating in bankruptcy and the increased risk of restructuring-related plant closings and consolidations, severance pay is an important part of a safety net built to deal with loss of employment. By operation of the Bankruptcy Code, severance arrangements that exist prior to a debtor's chapter 11 filing – either under a collective bargaining agreement or pursuant to an employer's programs or past practice – and the benefits they confer on employees who lose their jobs are generally only recognized as unsecured, non-priority claims. As general unsecured claims, severance obligations can be paid months or years after a job loss, and frequently at a fraction of what the employee was entitled to. This is unfair and unjust to workers who have already provided valuable service to the employer. Section 103 of the proposed legislation would protect severance pay owed to workers by allowing it as an administrative expense, while excluding "golden parachutes" and similar severance provisions that benefit only upper-level management and executives.

Bankruptcy should not shield employers from their responsibilities under federal or state laws aimed at protecting workers' rights and interests. With increasing frequency, employers are able to disregard liability for violations of federal labor law by entering Chapter 11, even if the National Labor Relations Board ("NLRB") or a court has ruled in favor of employees. One example of this kind of abuse is the use of bankruptcy to avoid the obligation under the Worker Adjustment and Retraining Notification Act ("WARN" Act) to notify employees 60 days before a plant closing or mass layoff. The law provides a penalty of up to 60 days pay for failure to provide 60 days notice, but bankruptcy courts have often failed to recognize court awards pursuant to the WARN Act. Section 105 responds to these employer abuses by recognizing an administrative expense claim for wages and benefits awarded pursuant to a judicial or NLRB proceeding. This administrative claim would be recognized for awards issued after a debtor has commenced a bankruptcy proceeding irrespective of when the unlawful conduct occurred. The claim could include any award issued by a court for a layoff that occurred after a chapter 11 petition was filed, if the debtors' payment of that award would not increase the likelihood of layoff of current employees or nonpayment of domestic support obligations.

### **Reinforcing the Foundation of Collective Bargaining**

As indicated above, Congress moved promptly in response to the *Bildisco* decision by enacting Section 1113 to provide "enhanced" standards for rejection of a collective bargaining agreement. Section 1114 was enacted by Congress responding to LTV Steel's unilateral termination of health insurance benefits for over 68,000 retirees. This section of the Bankruptcy Code allows a debtor to modify its non-pension retiree benefits only by agreement with the authorized representative of retirees<sup>5</sup> or, failing agreement with the union, after meeting procedural and substantive requirements demonstrating the financial necessity for modifying such benefits. Hence, absent agreement with the retirees' authorized representative or by order of the Court, a debtor is required to maintain its retiree benefits. Unfortunately, court rulings have eroded Section 1113 and Section 1114's fundamental purpose: encouraging collective bargaining. It has become all too frequent for companies to file Section 1113 motions to reject collective bargaining agreements and Section 1114 motions to modify retiree health insurance benefits as a tool for leverage in negotiations, rather than as a last resort once negotiations have proven unsuccessful as the statute provides.

Sections 1113 and 1114 are broken.<sup>6</sup> That is a simple fact, evidenced not only by the testimony of the UAW and other unions, but equally shown in empirical studies and academic literature. A 2007 General Accounting Office study on

<sup>5</sup> A labor organization is presumed, for purposes of Section 1114, to act as the authorized representative of retirees receiving benefits covered by any collective bargaining agreement. 11 U.S.C. §1114(c)(1).

<sup>6</sup> While Section 1113 governs rejection of collective bargaining agreements and Section 1114 concerns modification of retiree benefits, the standards for obtaining court-ordered relief are virtually the same.

Chapter 11 bankruptcies found that of the thirty-two contested Section 1113 motions filed between 2004 and 2006, the court granted the debtor's motion and rejected the collective bargaining agreements in all cases.<sup>7</sup> Another study analyzing Section 1113 motions filed in large corporate bankruptcies in the Second and Third Circuits shows that every debtor was able to reject its labor agreements.<sup>8</sup> Unions, their members and retirees experience these cold facts personally. From debtor efforts to eliminate virtually all worker protections in a collective bargaining agreement to attempts to terminate all retiree benefits while simultaneously seeking tens of millions of dollars in enhanced executive compensation, the UAW is all too familiar with the horrors that the Bankruptcy Code has to offer. Reform is needed to restore Congress' intent to facilitate negotiated resolution of labor disputes.

The Bankruptcy Code is silent as to a union's right to receive contract rejection damages if a debtor's Section 1113 Motion is granted. There is no logic to the Code's incongruous treatment vis-à-vis rejection damages for executory contracts and collective bargaining agreements. Union members sustain an economic loss from the rejection of a collective bargaining agreement, just as counterparties to rejected executory contracts with a debtor. Section 104 of the proposed legislation addresses the collective bargaining agreement rejection damage issue. Economic losses resulting from rejection of a collective bargaining agreement would be recognized by amending Section 1129(a) - the section of the Bankruptcy Code dealing with the specific criteria that must be satisfied in order for a chapter 11 plan of reorganization to be confirmed - to add an additional requirement to confirmation: a plan of reorganization must provide for the recovery of damages for the rejection of a collective bargaining agreement or for other financial returns as negotiated by the debtor and labor union under Section 1113. Adding this requirement to Section 1129(a) ensures that workers receive similar treatment as parties to executory contracts rejected under Section 365 of the Code. And section 201 of the proposed legislation makes conforming changes to Bankruptcy Code Section 1113 in order to provide that rejection of a collective bargaining agreement gives rise rejection damages.

Upon commencement of a case under chapter 11, a debtor is required to timely pay health and life insurance benefits to its retired employees.<sup>9</sup> Section 1129(a)(13) of the Bankruptcy Code requires that, to be confirmed, a plan of reorganization must provide for the continuation of retiree benefits either as agreed to by the debtors and authorized representative or as ordered by a Court in granting a debtor's Section 1114 motion. Section 104 of the proposed legislation amends Section 1129(a)(13) by adding an additional requirement, namely, that the plan must provide for the continuation of retiree benefits maintained or established in whole or in part by the debtor before the bankruptcy

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<sup>7</sup> See Andrew B. Dawson, *Collective Bargaining Agreements in Corporate Reorganizations*, 84 Am. Bankr. L. J. 103, 116 (2010).

<sup>8</sup> *Id.* at 119.

<sup>9</sup> See 11 U.S.C. §1114(e)(1).

case was filed. This amendment merely clarifies that unless retiree benefits are modified during a chapter 11 proceeding in accordance with Section 1114, the benefits will continue. In addition, Section 104 amends Section 1129(a) by adding a requirement that a plan provide for the recovery of claims resulting from the modification of retiree benefits. This amendment is akin to the contract “rejection damage” claim and has, as its basis, existing language in Section 1114 recognizing the possibility of a claim based on reduction of retiree benefits.<sup>10</sup> Both of the changes contained in Section 104 address Section 1114’s existing purpose to maintain retiree benefits at their pre-bankruptcy levels absent a debtor’s demonstrated financial need for modifications and, if modified, to provide retirees with a claim or other financial return to address the financial impact of a reduction in benefits.

In Title II, Sections 1113 and 1114 would be amended in several important respects. In order to ensure that any negotiations are meaningful, a debtor would be required to confer in good faith with the union, base each proposal for modification on a business plan for reorganization reflecting the most complete and reliable information available. A debtor could file a motion to reject a collective bargaining agreement or modify retiree benefits only *after* a period of negotiations and a demonstration that further negotiations are not likely to provide a mutual agreement between the parties. In order to prevent overreaching by debtors, these sections would be amended to provide that an application to reject or modify could be approved only if the modifications sought are the minimum savings essential to permit reorganization and the burden of cost savings does not disproportionately burden the employees and/or retirees. If a debtor has implemented a program of executive pay, bonuses or other financial returns to executives and highly compensated employees, the court would presume that the debtor has failed to satisfy reasonable proposal requirements of Sections 1113(c)(3) and 1114(f)(4). And section 201 would clarify the right of a labor organization to engage in economic self-help upon a court order granting rejection of a collective bargaining agreement under either Section 1113(d) or (e).

### **Controlling Executive Compensation**

Enhancement of executive compensation during chapter 11 cases has become widespread and common. Standards for approval of executive compensation have not been raised, notwithstanding the noble goals of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCA”). A specialized niche industry of compensation consultants has emerged to service corporate executives’ needs, uniformly telling executives and corporate boards alike that management is underpaid compared to its peers. Many of these same consultants also advise these very same debtors on general corporate compensation and benefits matters and are paid handsomely for it. It is no

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<sup>10</sup> See 11 U.S.C. §1114(i).

wonder then that consultants are loath to find executives "overpaid" and "paid just right".

The problem with enhanced executive compensation in business bankruptcies is multifaceted. In cases where consolidation or sale of a company's operations is contemplated or where labor contracts or retiree benefits might be subject to modification, proposing and enacting executive compensation can severely taint the negotiation process. Not only does it destroy the notion that all employees and stakeholders should share in the sacrifices of turning a business around, it can also erode employee moral and good will that is often crucial to the successful emergence of a debtor. The primary goal of a business bankruptcy should be preserving the going concern value of the debtor through the productive use of assets and preservation of jobs. As such, reforms are necessary in order to curb executive compensation abuses.

Section 301 of the proposed legislation adds much needed transparency and judicial oversight to the process of granting executive compensation. First, it amends Section 1129(a)(4) of the Bankruptcy Code, making a condition to confirmation of a chapter 11 plan the requirement that any payment to insiders, senior executive officers or the next 20 most highly compensated employees be approved as reasonable, not excessive or disproportionate as compared to distributions to a debtor's non-management workforce. In addition, Section 1129(a)(5) is amended to further provide that any such above-mentioned payments be provided only if there is a showing that the compensation is reasonable when compared to that paid to individuals holding comparable positions at comparable companies and, more importantly, that the compensation is not disproportionate in light of the economic concessions made by the debtor's non-management workforce.

While BAPCA intended to limit executive compensation by adding prerequisites, debtors and bankruptcy courts have found numerous ways around the Section 503(c) requirements. Section 503(c)(1) was intended to prohibit retention based compensation absent a showing that the payments are essential to retention of the individual because he has another bona fide job offer and the same or greater rate of compensation, his services are essential to the business and there is some type of similar transfer available to non-management employees or within a certain threshold of payments previously made to that individual. Section 302 amends Section 503(c)(1) by providing that the provision also applies to the debtor's senior executive officers or the next 20 most highly compensated employees, clarifies that the prohibition on payments includes performance or incentive compensation, bonuses or other financial returns designed to replace or enhance compensation in effect prior to the case. It also amends Section 503(c)(1) to require that the Court's findings be based on clear and convincing evidence in the record. Section 302 also replaces the existing Bankruptcy Code Section 503(c)(3) with more stringent requirements for granting payments to executives. Due to abuses under the current law, the new Section

503(c)(3) is intended to require a clear and convincing showing by a debtor that the payments for the benefit of insiders, senior executive officers or the next 20 most highly compensated employees are essential to the survival of the business, the services to be performed are essential in nature and the proposed payments are reasonable compared to individuals at comparable companies and the payments are not disproportionate in light of the economic concessions made by the non-management workforce. The changes proposed in Section 302 advance the cause of fairness, demonstrated need and reasonableness in granting executive compensation.

Equality of sacrifice among all constituents is an important part of any concessionary agreement labor agrees upon. All too often, this requirement is sidestepped by executives. Section 303 remedies this by providing that no deferred compensation arrangement for a debtor's insiders, senior executive officers or the next 20 most highly compensated employees may be assumed if a defined benefit pension plan for the debtor's employees has been terminated under Title IV of ERISA during a chapter 11 case or 180 days prior to commencement of the case. Further, Section 303 amends Bankruptcy Code Section 365 by adding a new provision prohibiting a debtor from assuming a plan or program to provide retiree benefits for insiders, senior executive officers or the next 20 most highly compensated employees of a debtor if it has obtained Section 1113 or Section 1114 relief to impose reductions in health benefits for active employees or retirees. Sections 304 and 305 of the proposed legislation further the goals of equality of sacrifice by allowing for the recovery by the estate of the debtor of certain compensation paid to any officer serving on the debtor's board of directors or an individual serving as chairman of the debtor's board of directors if relief is sought and obtained by the debtors under Sections 1113 or 1114 or Title IV of ERISA concerning its pension plans.

#### **Preservation of Jobs, Union Proof of Claim and Protecting the Grievance Procedure**

The UAW and its members have experienced a tremendous amount of uncertainty as a result of instability in the auto parts sector. Virtually every major auto supplier to file for chapter 11 in the last seven years has sold part of its business operations through an auction process governed by Bankruptcy Code Section 363(b). It is common for several bidders to emerge during the sale process. Unfortunately, bidders are not uniform in their intentions for a particular business. Some prospective purchasers are only looking to buy a bundle of customer orders or transfer a book of business away from the debtor's facilities to their own, having no interest in the underlying productive assets. A sale in such instances, while sometimes providing consideration to the debtor, leaves the debtors' employees without jobs, devastating workers, their families and communities. Section 203 amends the provision of the Bankruptcy Code governing the sale of a debtor's assets. A new Section 363(b)(3) would require a court, in determining whether a bidder's offer constitutes the highest or best offer

in the sale of a debtor's assets, to consider the extent to which a bidder's offer would maintain existing jobs, preserve existing terms and conditions of employment and assumes or matches pension and retiree benefit obligations of the debtor. Maintaining the productive use of assets in the American economy and preserving jobs should be a priority, and Section 203 moves us a step closer in that direction.

Section 206 proceeds in a similar vein by adding a statement of purpose to chapter 11 of the Bankruptcy Code, specifying that in a chapter 11 case a debtor must have as its principal purpose the reorganization of its business to preserve going concern value to the maximum extent possible through the productive use of its assets and the preservation of jobs that will sustain productive economic activity. Section 206 also amends Bankruptcy Code Section 1129(a) – the section setting forth the criteria for confirming a plan of reorganization – adding a requirement that the debtor demonstrate that reorganization preserves going concern value again through productive use of the debtor's assets and preservation of jobs. Rehabilitation of a business was a principal goal in creation of the Bankruptcy Code. Adding the statement of purpose and plan confirmation requirement is a logical extension of the original goal and a sound policy move aimed at strengthening the American economy and use of one of its most important assets - its productive workforce.

The Bankruptcy Code presently allows a creditor to file a proof of claim in a bankruptcy case.<sup>11</sup> An indentured trustee is afforded the right to file a claim on behalf of the individual bond holders.<sup>12</sup> While prevailing bankruptcy and federal court decisions have held that a labor union, as party to a collective bargaining agreement, may file a proof of claim on behalf of its members<sup>13</sup>, the Bankruptcy Code is silent. Since Congress and federal courts have recognized a union's right to assert claims, and enforce rights, on behalf of its members, there is no reason for the Bankruptcy Code to remain silent. Numerous factors, including reducing administrative burdens on the debtors and courts by allowing an omnibus or collective union claim filed on behalf of its members and retirees, weigh in favor of amending Section 501(a) of the Bankruptcy Code to permit a labor organization to file a proof of claim. Section 401 of the proposed legislation accomplishes just that.

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<sup>11</sup> See 11 U.S.C. §501(a).

<sup>12</sup> *Id.*

<sup>13</sup> Courts have uniformly recognized that the union, as an authorized representative and bargaining agent, has the right to assert, on behalf of bargaining unit employees, claims for unpaid obligations arising under labor contracts. See, *In re Altair Airlines, Inc.*, 727 F.2d 88, 91 (3rd Cir. 1984); *UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696, 699-700 (1966) (union may sue to recover wages and benefits claimed by its members pursuant to the terms of a collective bargaining agreement); *Smith v. Evening News Co.*, 371 U.S. 195, 198, 199-201 (1962) (recognizing that both unions and individual employees have standing to sue to collect wage and benefits under labor agreements, even where the contractual obligations are "uniquely personal").



Section 402 amends the automatic stay provision of the Bankruptcy Code. The filing of a chapter 11 petition creates a stay of judicial, administrative and other proceedings against the debtor. However, since Section 1113(f) provides that no other provision of the Bankruptcy Code may be construed to allow a debtor to unilaterally modify or alter any provision of a collective bargaining agreement, many courts have held that the automatic stay does not apply to arbitrations arising under a labor agreement.<sup>14</sup> Section 402 makes clear that an exception to the automatic stay is granted with respect to the commencement or continuation of a grievance, arbitration or dispute resolution proceeding established by a collective bargaining agreement that was or could have been commenced against the debtor before the filing of the bankruptcy case. The amendment to Section 363(b) also makes clear that the exception to the automatic stay also applies to payment or enforcement of awards or settlements of such proceedings.

### Conclusion

In sum, the Protecting Employees and Retirees in Business Bankruptcies Act of 2010 (H.R. 4677) supports and protects public policy goals that have always been the intent of bankruptcy and labor law. These include:

- preserving the going-concern value of businesses reorganizing under Chapter 11,
- promoting fair and good faith negotiation over litigation as the primary means of modifying collective bargaining agreements during bankruptcy, and
- equitable sharing of sacrifice among the stakeholders of a business during difficult times.

As a result of recent rulings by the courts, bankruptcy law no longer effectively promotes these goals. The UAW believes this legislation is needed to restore the balance and to ensure that bankruptcy law promotes these important public policy goals.

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<sup>14</sup> See *In re Ionosphere Clubs*, 922 F.2d 984 (2<sup>nd</sup> Cir. 1990), *cert denied sub nom. Air Line Pilots Ass'n v. Shugrue*, 112 S. Ct. 50 (1991); *In re Bob's Supermarkets*, 118 B.R. 783 (Bankr. D. Mont. 1990).

LETTER FROM BRIAN COVE, CHIEF OPERATING OFFICER,  
COMMERCIAL FINANCE ASSOCIATION

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March 22, 2010

Honorable Steve Cohen, Chairman  
Honorable Trent Franks, Ranking Member  
Subcommittee on Commercial and Administrative Law  
Committee on the Judiciary  
2138 Rayburn House Office Building  
Washington, DC 20515

Dear Chairman Cohen and Representative Franks:

The Commercial Finance Association ("CFA") is pleased to submit this letter with regard to the Subcommittee's March 23<sup>rd</sup> hearing on H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010." CFA respectfully asks that this letter be included in the hearing record. For reference, annexed to this letter is a brief history of the CFA and a description of the leading services provided by CFA members.

As more fully discussed in the annexed attachment, CFA is the principal trade association for asset-based lenders in the United States. CFA member institutions extended more than \$700 billion in asset-based loans and factored financing in 2008, and more than half of our members increased their credit commitments in 2009 during a time of severe economic distress, thereby enabling many U.S. businesses to survive. These loans are overwhelmingly targeted to small and medium-sized businesses. Many customers of CFA members, particularly manufacturers, have entered into collective bargaining agreements with their employees. Our members work closely with their customers and understand every aspect of each customer's business in the course of a cooperative relationship.

In consideration for extensions of credit from CFA members, a borrower usually grants to CFA members a security interest in all of its assets. As a result, when a borrower of a CFA member files for reorganization, its assets are often subject to a security interest in favor of CFA members. Any change in the Bankruptcy Code that limits the extent of that security interest will result in higher interest charges or lessened credit availability (or both) and, in those situations where a prospective borrower's risk is perceived to be too high, may cause CFA members to decline extending credit at all.

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Chief Executive Officer  
Andrei L. Suskavovv

CFA understands the concerns of Chairman Conyers, Chairman Cohen, and other members who have cosponsored H.R. 4677. Workers often accept various benefits designated in a collective bargaining agreement in exchange for foregoing increased wages, and are of course dismayed when these benefits are forfeited in whole or part in a Chapter 11 case. On the other hand, companies only enter Chapter 11 when their business model is no longer sustainable, and cutting costs – including wages and benefits – is often an essential means by which a viable reorganization plan can be developed.

In recognition of the need for providing fair treatment to workers in the Chapter 11 context, Congress enacted Section 1113 of the Bankruptcy Code, which provides a protective procedure for the rejection of collective bargaining agreements. Section 1113 requires good faith negotiations between labor and management as well as a judicial finding that the authorized employee representative has refused a proposed modification of the agreement without good cause and that the balance of equities favors rejection of the agreement. Substantial case law now exists regarding the meaning and mechanics of this process, and any significant alteration of relevant Code provisions introduces risks attendant to new judicial interpretations in addition to the substantive provisions of the legislated change.

In the current economic climate, U.S. businesses have faced significant challenges in obtaining financing to support their operations. This, in turn, has limited businesses' ability to support existing jobs and create new ones. At a time when policy makers are looking for ways to encourage financing of businesses and job creation, CFA fears that certain provisions of H.R. 4677 will do just the opposite. Specifically, CFA believes that the proposed bill creates substantial new risks for secured lenders, both directly and by diminishing the prospects for successful reorganization by companies subject to its terms.

The result of enacting H.R. 4677 would be to increase the odds that unionized firms will need to seek bankruptcy protection because they will have diminished and less favorable access to secured lending, which often provides the bulk of working capital to small and medium-sized enterprises. Enactment of H.R. 4677 would also have the ironic, and doubtless unintended, consequence of placing unionized enterprises at a market disadvantage to non-union companies in the credit markets.

**The most serious threat contained in H.R. 4677 to facilitating the flow of capital to U.S. businesses and encouraging job creation is Section 205 of H.R. 4677, "Payments By Secured Lenders." Section 205 declares that unpaid post-petition wages, accrued vacation, severance, or other benefits owed under the debtor's policies and practices or under a collective bargaining agreement shall be deemed necessary costs and expenses of preserving or disposing of property securing an allowed secured claim. In other words, Section 205 essentially exposes the value of a lender's collateral securing pre-petition credit extensions to liability to pay the aggregate value of unpaid post-petition benefits, without limitation.**

**In some situations, Section 205 could well result in the entirety of a creditor's collateral being disposed of to provide for these unpaid benefits. The result would be to completely undermine and extinguish a lender's secured claim in order to pay for workers' unsecured claims. This could occur for both unionized and non-union borrowers under the express terms of the proposed amendment.**

We do not agree that the payment of such post-petition unsecured claims fits within any reasonable definition of costs of preservation or disposition of collateral securing a claim.

Adoption of this proposal would also be at complete odds with the intent of the “absolute priority rule,” -- one of the cornerstones of the Bankruptcy Code -- which mandates that secured claims must be paid in full before unsecured claims receive payment.

As H.R. 4677 threatens the entirety of a secured lender’s security interest, adoption of H.R. 4677 would create a very substantial new risk for secured lenders. This risk would inevitably result in a significant pullback of secured credit to companies that could be subject to the provisions of H.R. 4677 because lenders will create “reserves” against otherwise available credit to provide for the future payment of these claims, thereby extending less credit to such companies than their assets might otherwise justify.

Other provisions of H.R. 4677 that would increase credit risk by reducing the probability of successful reorganization include:

- Section 101, which doubles the amount of employee unsecured claims for wages, salaries, and commissions (including vacation, severance, and sick leave pay) that qualifies as a priority unsecured claim, while eliminating the requirement that such claims be limited to those that arise within 180 days prior to the bankruptcy filing.
- Section 102, which creates a new priority claim of unlimited potential for the value of losses on employer (debtor) stock purchased by a defined contribution plan.
- Section 103, which creates a new administrative expense for severance pay that must be paid in order to confirm a plan of reorganization.
- Section 104, which would require that a reorganization plan provide for the continuation of retiree benefits at pre-petition levels, as well as recovery of claims arising from the modification of a plan.
- Section 201, which amends Section 1113 of the Code to establish a much stricter test for court approval of the rejection of a collective bargaining agreement -- a test that will likely be impossible to meet due to the requirement that the court find that such rejection will not cause a material diminution of employees’ purchasing power.
- Section 202, which amends Section 1114 of the Code to establish a much stricter standard for court approval of modification of retiree benefits.
- Section 203, which creates a new claim for pension losses measured by the market value of stock at the time it was contributed to or purchased by the plan and its value as of the commencement of the bankruptcy case.
- Section 207, which reduces the length of the initial 120 day post-petition period in which the debtor has the exclusive right to propose a reorganization plan if a motion is made to reject a collective bargaining agreement pursuant to Section 1113 of the Code.
- The provisions of Title III, which collectively may make debtor’s retention of skilled and experienced management personnel more difficult.

Again, CFA understands the concerns that motivate these proposals. But the reality is that business organizations file Chapter 11 cases when their business model is no longer sustainable, including instances when the promises they have made to their employees can no longer be sustained if the business is to survive in any form. Changes to the Bankruptcy Code that make it more difficult for a company to modify costs (including labor costs), or that create higher barriers that must be surmounted to confirm a plan of reorganization, are not in the long-term interests of

its survival or in the preservation of the jobs it provides. At a time when Congress is seeking to ensure that the job-creating small business sector has adequate access to reasonably priced credit, and is also exploring means of increasing the feasibility of small business reorganizations under the Bankruptcy Code, enactment of H.R. 4677 as introduced would run directly counter to those laudable policy goals.

**We urge the Subcommittee to keep our views in mind as it considers further action on H.R. 4677. In particular, we would urge that Section 205 be removed from the bill because its adoption would cause a quantum leap increase in secured lender risk that would be highly detrimental for the credit prospects of small and medium-sized businesses that rely on secured lending for their bedrock working capital.**

CFA will be happy to provide additional information and to work cooperatively with Subcommittee members and staff as may be helpful. We appreciate your attention to our comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Brian P. Cove". The signature is fluid and cursive, with the first name "Brian" and last name "Cove" clearly distinguishable.

Brian Cove  
Chief Operating Officer

Attachment I**The Commercial Finance Association: Background Information**

Founded in 1944, the Commercial Finance Association (CFA) is the primary trade association for asset-based lending and factoring organizations, the main source of capital for small and medium-sized businesses in the United States. CFA's 260 members include the asset-based lending divisions or subsidiaries of major U.S. money center banks, regional banks, community banks, and independent finance companies, as well as bank-affiliated and independent factoring organizations. Approximately two-thirds of CFA's membership consists of non-bank commercial finance companies.

Asset-based lending is a type of commercial financing that generally consists of a secured loan that is backed by the borrower's assets such as accounts receivable, inventory, machinery or real estate, and is typically structured as a revolving line of credit.

In factoring, the client makes a sale, delivers the product or service and generates an invoice. The factor buys the right to collect on that invoice by agreeing to pay the client the invoice's face value less a discount. Because factors extend credit to their clients' customers, they are more concerned about the customers' ability to pay than the client's financial status and credit rating. That means a company with creditworthy customers may be able to factor even if it can't qualify for a loan.

CFA members provide working capital for American businesses of all sizes and are the major source of funding for thousands of small and medium-sized American businesses. In 2008, (the last year for which data is available), collateralized and monitored asset-based lending in the U.S. totaled approximately \$590 billion, according to the CFA's Annual Asset-Based Lending & Factoring Survey. In addition, factoring volume in the same period amounted to \$136 billion.

Asset-based lending has remained a reliable source of small business credit despite current economic difficulties. The CFA's recently released Quarterly Asset-Based Lending Index for the 4<sup>th</sup> Quarter of 2009 shows that 50 percent of asset-based lenders surveyed reported an increase in new credit commitments. The discipline exercised by asset-based lenders and factors, and their ability to evaluate collateral and monitor their borrowers, have enabled them to keep capital flowing to American businesses at a time when most other lenders have pulled back.

