PROTECTING EMPLOYEES AND RETIREES IN BUSINESS BANKRUPTCIES ACT OF 2007

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

H.R. 3652

JUNE 5, 2008

Serial No. 110–181

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE
42–723 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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JUNE 5, 2008

PROTECTING EMPLOYEES AND RETIREES IN BUSINESS BANKRUPTCIES ACT OF 2007

THURSDAY, JUNE 5, 2008

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

The Subcommittee met, pursuant to notice, at 9:35 a.m., in Room 2237, Rayburn House Office Building, the Honorable Linda T. Sánchez (Chairwoman of the Subcommittee) presiding.

Present: Representatives Sánchez, Conyers, Lofgren, Watt and Cannon.

Staff Present: Susan Jensen, Majority Counsel; Adam Russell, Majority Professional Staff Member; and Zachary Somers, Minority Counsel.

Ms. SÁNCHEZ. This hearing of the Committee on the Judiciary Subcommittee on Commercial and Administrative Law will now come to order.

Without objection, the Chair will be authorized to declare a recess of the hearing at any time.

I will now recognize myself for a short statement.

The headlines this past week have been particularly disturbing regarding our Nation's auto manufacturing industry. GM announced that it was closing four truck and SUV plants in North America. Chrysler reported a 25 percent drop in sales for last month as compared to May 2007. Likewise, Ford reported a 16 percent drop in sales for last month; and, in May, its F-150 pickup truck lost its status as best-selling vehicle in the United States for the first time since 1991.

The airline industry, with fuel costs almost tripling since 2000, also is cutting costs in trying to raise revenue. In addition to increasing fares, some airlines are now charging for checked baggage and seat selection, and others are eliminating basic amenities.

Yesterday, the Wall Street Journal reported that United Airlines was planning to ground its less fuel-efficient planes and possibly furlough some of its employees. And while many of the principal airlines are well into their bankruptcy reorganization process, there has been another wave of bankruptcy filings by airlines in recent months, including Aloha Airlines, ATA Airlines, Skybus Airlines, Frontier Airlines and Eos Airlines.

As the economic forecast of these companies becomes bleaker and bleaker, we are forced to consider the need to preserve jobs, em-

ployment benefits and protections for retirees against the backdrop of how these issues would be treated under Chapter 11 of the Bankruptcy Code. How do we protect the jobs and livelihood of American workers while preserving the economic viability of U.S. companies?

As many of you know, last year our Subcommittee conducted two oversight hearings on how American workers and retirees are faring in Chapter 11 bankruptcy cases. Our first hearing revealed a series of cases where chief executive officers of businesses in Chapter 11 receive outrageously large salaries and bonuses while they simultaneously slash the wages, benefits and even jobs of workers who are the backbones of these businesses. It is clear that under these practices Chapter 11 is becoming a place where the rich are getting richer while the poor are getting poorer.

Then, in September, we heard how Chapter 11 is being used by some businesses to bust unions and deprive retirees of hard-won wages and benefits, including pension and health insurance that long-time employees had already factored into their retirement plans. Sam Giordano, Executive Director of the nonpartisan American Bankruptcy Institute observed in case after case, bankruptcy courts have applied congressional intent favoring long-term rehabilitation to sweep aside wage and benefit concessions won at the bargaining table.

Chapter 11 of the Bankruptcy Code was originally enacted to give all participants an equal say in how a business, struggling to overcome financial difficulties, should reorganize. Unfortunately, this laudable goal does not reflect reality, especially for American workers.

I commend House Judiciary Committee Chairman John Conyers for his leadership in attempting to address these problems by his introduction of H.R. 3652, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007."

[The text of the bill, H.R. 3652, follows:]

I

110TH CONGRESS
1ST SESSION

H. R. 3652

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

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 25, 2007

Mr. CONYERS (for himself, Ms. LINDA T. SÁNCHEZ of California, Mr. NADLER, Mr. COHEN, Ms. SUTTON, Ms. ZOE LOFGREN of California, and Mr. JOHNSON of Georgia) 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.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007".

SEC. 2. FINDINGS.

The Congress finds the following:

(1) Recent corporate restructurings have exacted a devastating toll on workers through deep cuts in wages and benefits, termination of defined benefit pension plans, and the transfer of productive assets to lower wage economies outside the United States. Retirees have suffered deep cutbacks in benefits when companies in bankruptcy renege on their retiree health obligations and terminate pension plans.

(2) Congress enacted chapter 11 of title 11, United States Code, to protect jobs and enhance enterprise value for all stakeholders and not to be used as a strategic weapon to eliminate good paying jobs, strip employees and their families of a lifetime's worth of earned benefits and hinder their ability to participate in a prosperous and sustainable economy. Specific laws designed to treat workers and retirees fairly and keep companies operating are instead causing the burdens of bankruptcy to fall disproportionately and overwhelmingly on employees and retirees, those least able to absorb the losses.

(3) At the same time that working families and retirees are forced to make substantial economic sacrifices, executive pay enhancements continue to flourish in business bankruptcies, despite recent congressional enactments designed to curb lavish pay packages for those in charge of failing enterprises. Bankruptcy should not be a haven for the excesses of executive pay.

(4) Employees and retirees, unlike other creditors, have no way to diversify the risk of their employer's bankruptcy.

(5) Comprehensive reform is essential in order to remedy these fundamental inequities in the bankruptcy process and to recognize the unique firm-specific investment by employees and retirees in their employers' business through their labor.

SEC. 3. INCREASED WAGE PRIORITY.

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

(1) in paragraph (4)—

(A) by striking "$10,000" and inserting "$20,000";

(B) by striking "within 180 days"; and

(C) by striking "or the date of the cessation of the debtor's business, whichever occurs first,";

(2) in paragraph (5)(A), by striking—

(A) "within 180 days"; and

(B) "or the date of the cessation of the debtor's business, whichever occurs first"; and

(3) in paragraph (5), by striking subparagraph (B) and inserting the following:

"(B) for each such plan, to the extent of the number of employees covered by each such plan, multiplied by $20,000.".

SEC. 4. PRIORITY FOR STOCK VALUE LOSSES IN DEFINED CONTRIBUTION PLANS.

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

(1) in subparagraph (A), by striking "or" at the end;

(2) in subparagraph (B), by inserting "or" after the semicolon; and

(3) by adding at the end the following:

"(C) right or interest in equity securities of the debtor, or an affiliate of the debtor, held in a defined contribution plan (within the meaning of section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)) for the benefit of an individual who is not an insider or 1 of the 10 most highly compensated employees of the debtor (if 1 or more are not insiders), if such securities were attributable to—

"(i) employer contributions by the debtor or an affiliate of the debtor, other than elective deferrals (within the meaning of section 402(g) of the Internal Revenue Code of 1986), and any earnings thereon; or

"(ii) elective deferrals and any earnings thereon.".

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

(1) by redesignating paragraphs (6) through (10) as paragraphs (7) through (11), respectively;

(2) by inserting after paragraph (5) the following:

"(6) Sixth, loss of the value of equity securities of the debtor or affiliate of the debtor that are held in a defined contribution plan (within the meaning of section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)), without regard to when services resulting in the contribution of stock to the plan were rendered, measured by the market value of the stock at the time of contribution to, or purchase by, the plan and the value as of the commencement of the case where an employer or plan sponsor that has commenced a case under this title has committed fraud with respect to such plan or has otherwise breached a duty to the participant that has proximately caused the loss of value.";

(3) in paragraph (7), as redesignated, by striking "Sixth" and inserting "Seventh";

(4) in paragraph (8), as redesignated, by striking "Seventh" and inserting "Eighth";

(5) in paragraph (9), as redesignated, by striking "Eighth" and inserting "Ninth";

(6) in paragraph (10), as redesignated, by striking "Ninth" and inserting "Tenth"; and

(7) in paragraph (11), as redesignated, by striking "Tenth" and inserting "Eleventh".

SEC. 5. PRIORITY FOR SEVERANCE PAY.

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

(1) in paragraph (8) by striking "and" at the end;

(2) in paragraph (9) by striking the period and inserting "; and"; and

(3) by adding at the end the following:

"(10) severance pay owed to employees of the debtor (other than to an insider, other senior management, or a consultant retained to provide services to the debtor), under a plan, program, or policy generally applicable to employees of the debtor, or owed pursuant to a collective bargaining agreement, but not under an individual contract of employment, for termination or layoff on or after the date of the filing of the petition, which pay shall be deemed earned in full upon such layoff or termination of employment.".

SEC. 6. EXECUTIVE COMPENSATION UPON EXIT FROM BANKRUPTCY.

Section 1129(a)(5) of title 11, United States Code, is amended—

(1) in subparagraph (A)(ii), by striking "and" at the end; and

(2) 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 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.".

SEC. 7. LIMITATIONS ON EXECUTIVE COMPENSATION ENHANCEMENTS.

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

(1) in paragraph (1), 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 prior to the date of the commencement of the case," after "remain with the debtor's business,"; and

(2) by amending paragraph (3) to read as follows:

"(3) other transfers or obligations, to or for the benefit of officers, of managers, or of consultants retained to provide services to the debtor, before or after the date of filing of the petition, in the absence of a finding by the court based upon evidence in the record, and without deference to the debtor's request for such payments, that such transfers or obligations are essential to the survival of the debtor's business or (in the case of a liquidation of some or all of the debtor's assets) essential to the orderly liquidation and maximization of value of the assets of the debtor, in either case, because of the essential nature of the serv-

ices provided, and then only to the extent that the court finds such transfers or obligations are 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.".

SEC. 8. REJECTION OF COLLECTIVE BARGAINING AGREEMENTS.

Section 1113 of title 11, United States Code, is amended—

(1) by striking subsections (a) through (c) and inserting the following:

"(a) The debtor in possession, or the trustee if one has been appointed under this chapter, other than a trustee in a case covered by subchapter IV of this chapter and by title I of the Railway Labor Act, may reject a collective bargaining agreement only in accordance with the provisions of this section.

"(b)(1) Where a debtor in possession or trustee (hereinafter in this section referred to collectively as a 'trustee') seeks rejection of a collective bargaining agreement, a motion seeking rejection shall not be filed unless the trustee has first met with the authorized representative (at reasonable times and for a reasonable period in light of the complexity of the case) to confer in good faith in attempting to reach mutually acceptable modifications of such agreement. Proposals by the trustee to modify the agreement shall be limited to modifications to the agreement that—

"(A) are designed to achieve a total aggregate financial contribution for the affected labor group for a period not to exceed 2 years after the effective date of the plan;

"(B) shall be no more than the minimal savings necessary to permit the debtor to exit bankruptcy, such that confirmation of such plan is not likely to be followed by the liquidation of the debtor or any successor to the debtor; and

"(C) shall not overly burden the affected labor group, either in the amount of the savings sought from such group or the nature of the modifications, when compared to other constituent groups expected to maintain ongoing relationships with the debtor, including management personnel.

"(2) Proposals by the trustee under paragraph (1) shall be based upon the most complete and reliable information available. Information that is relevant for the negotiations shall be provided to the authorized representative.

"(c)(1) If, after a period of negotiations, the debtor and the authorized representative have not reached agreement over mutually satisfactory modifications and the parties are at an impasse, the debtor may file a motion seeking rejection of the collective bargaining agreement after notice and a hearing held pursuant to subsection (d). The court may grant a motion to reject a collective bargaining agreement only if the court finds that—

"(A) the debtor has, prior to such hearing, complied with the requirements of subsection (b) and has conferred in good faith with the authorized representative regarding such proposed modifications, and the parties were at an impasse;

"(B) the court has considered alternative proposals by the authorized representative and has determined that such proposals do not meet the requirements of subparagraphs (A) and (B) of subsection (b)(1);

"(C) further negotiations are not likely to produce a mutually satisfactory agreement; and

"(D) the court has considered—

"(i) the effect of the proposed financial relief on the affected labor group;

"(ii) the ability of the debtor to retain an experienced and qualified workforce; and

"(iii) the effect of a strike in the event of rejection of the collective bargaining agreement.

"(2) In reaching a decision under this subsection regarding whether modifications proposed by the debtor and the total aggregate savings meet the requirements of subsection (b), the court shall take into account—

"(A) the ongoing impact on the debtor of the debtor's relationship with all subsidiaries and affiliates, regardless of whether any such subsidiary or affiliate is domestic or nondomestic, or whether any such subsidiary or affiliate is a debtor entity; and

"(B) whether the authorized representative agreed to provide financial relief to the debtor within the 24-month period prior to the date of the commencement of the case, and if so, shall consider the total value of such relief in evaluating the debtor's proposed modifications.

"(3) In reaching a decision under this subsection, where a debtor has implemented a program of incentive pay, bonuses, or other financial returns for insiders or senior management personnel during the bankruptcy, or has implemented such

a program within 180 days before the date of the commencement of the case, the court shall presume that the debtor has failed to satisfy the requirements of subsection (b)(1)(C).";

(2) in subsection (d)—

(A) by striking "(d)" and all that follows through paragraph (2) and inserting the following:

"(d)(1) Upon the filing of a motion for rejection of a collective bargaining agreement, the court shall schedule a hearing to be held on not less than 21 days notice (unless the debtor and the authorized representative agree to a shorter time). Only the debtor and the authorized representative may appear and be heard at such hearing."; and

(B) by redesignating paragraph (3) as paragraph (2);

(3) in subsection (f), by adding at the end the following: "Any payment required to be made under this section before the date on which a plan confirmed under section 1129 is effective has the status of an allowed administrative expense, as provided in section 503."; and

(4) by adding at the end the following:

"(g) The rejection of a collective bargaining agreement constitutes a breach of such contract with the same effect as rejection of an executory contract pursuant to section 365(g). No claim for rejection damages shall be limited by section 502(b)(7). Economic self-help by an authorized representative shall be permitted upon a court order granting a motion to reject a collective bargaining agreement under subsection (c) or court-authorized interim changes under subsection (e), and no provision of this title or of any other Federal or State law shall be construed to the contrary.

"(h) At any time after the date on which an order is entered authorizing rejection, or where an agreement providing mutually satisfactory modifications has been entered into between the debtor and the authorized representative, at any time after such agreement has been entered into, the authorized representative may apply to the court for an order seeking an increase in the level of wages or benefits, or relief from working conditions, based upon changed circumstances. The court shall grant the request so long as the increase or other relief is consistent with the standard set forth in subsection (b)(1)(B).

"(i) Upon request by the authorized representative, and where the court finds that the prospects for reaching a mutually satisfactory agreement would be aided by granting the request, the court may direct that a dispute under subsection (c) be heard and determined by a neutral panel of experienced labor arbitrators in lieu of a court proceeding under subsection (d). The decision of such panel shall have the same effect as a decision by the court. The court's decision directing the appointment of a neutral panel is not subject to appeal.

"(j) Upon request by the authorized representative, the debtor shall provide for the reasonable fees and costs incurred by the authorized representative under this section, after notice and a hearing.

"(k) If a plan to be confirmed under section 1129 provides for the liquidation of the debtor, whether by sale or cessation of all or part of the business, the trustee and the authorized representative shall confer regarding the effects of such liquidation on the affected labor group, in accordance with applicable nonbankruptcy law, and shall provide for the payment of all accrued obligations not assumed as part of a sale transaction, and for such other terms as may be agreed upon, in order to ensure an orderly transfer of assets or cessation of the business. Any such payments shall have the status of allowed administrative expenses under section 503.

"(l) A collective bargaining agreement that is assumed shall be assumed in accordance with section 365.".

SEC. 9. PAYMENT OF INSURANCE BENEFITS TO RETIRED EMPLOYEES.

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

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

(2) in subsection (c)(1), by adding at the end the following: "Where a labor organization elects to serve as the authorized representative, the debtor shall provide for the reasonable fees and costs incurred by the authorized representative under this section after notice and a hearing.";

(3) in subsection (f), by striking "(f)" and all that follows through paragraph (2) and inserting the following:

"(f)(1) Where a trustee seeks modification of retiree benefits, a motion seeking modification of such benefits shall not be filed, unless the trustee has first met with the authorized representative (at reasonable times and for a reasonable period in

light of the complexity of the case) to confer in good faith in attempting to reach mutually satisfactory modifications. Proposals by the trustee to modify retiree benefits shall be limited to modifications in retiree benefits that—

"(A) are designed to achieve a total aggregate financial contribution for the affected retiree group for a period not to exceed 2 years after the effective date of the plan;

"(B) shall be no more than the minimal savings necessary to permit the debtor to exit bankruptcy, such that confirmation of such plan is not likely to be followed by the liquidation of the debtor or any successor to the debtor; and

"(C) shall not overly burden the affected retirees, either in the amount of the savings sought or the nature of the modifications, when compared to other constituent groups expected to maintain ongoing relationships with the debtor, including management personnel.

"(2) Proposals by the trustee under paragraph (1) shall be based upon the most complete and reliable information available. Information that is relevant for the negotiations shall be provided to the authorized representative.";

(4) in subsection (g), by striking "(g)" and all that follows through the semicolon at the end of paragraph (3) and inserting the following:

"(g) If, after a period of negotiations, the debtor and the authorized representative have not reached agreement over mutually satisfactory modifications and the parties are at an impasse, the debtor may apply to the court for modifications in the payment of retiree benefits after notice and a hearing held pursuant to subsection (k). The court may grant a motion to modify the payment of retiree benefits only if the court finds that—

"(1) the debtor has, prior to the hearing, complied with the requirements of subsection (f) and has conferred in good faith with the authorized representative regarding such proposed modifications and the parties were at an impasse;

"(2) the court has considered alternative proposals by the authorized representative and has determined that such proposals do not meet the requirements of subparagraphs (A) and (B) of subsection (f)(1);

"(3) further negotiations are not likely to produce a mutually satisfactory agreement; and

"(4) the court has considered—

"(A) the effect of the proposed modifications on the affected retirees; and

"(B) where the authorized representative is a labor organization, the effect of a strike in the event of modification of retiree health benefits;";

(5) in subsection (k)—

(A) in paragraph (1)—

(i) in the first sentence, by striking "fourteen" and inserting "21"; and

(ii) by striking the second and third sentences, and inserting the following: "Only the debtor and the authorized representative may appear and be heard at such hearing.";

(B) by striking paragraph (2); and

(C) by redesignating paragraph (3) as paragraph (2); and

(6) by redesignating subsections (l) and (m) as subsections (n) and (o), respectively, and inserting the following:

"(l) In determining whether the proposed modifications comply with subsection (f)(1)(A), the court shall take into account the ongoing impact on the debtor of the debtor's relationship with all subsidiaries and affiliates, regardless of whether any such subsidiary or affiliate is domestic or nondomestic, or whether any such subsidiary or affiliate is a debtor entity.

"(m) No plan, fund, program, or contract to provide retiree benefits for insiders or senior management shall be assumed by the debtor if the debtor has obtained relief under subsection (g) or (h) for reductions in retiree benefits or under subsection (c) or (e) of section 1113 for reductions in the health benefits of active employees of the debtor on or after the commencement of the case or reduced or eliminated active or retiree benefits within 180 days prior to the date of the commencement of the case.".

SEC. 10. PROTECTION OF EMPLOYEE BENEFITS IN A SALE OF ASSETS.

Section 363 of title 11, United States Code, is amended—

(1) in subsection (b), by adding at the end the following:

"(3) In approving a sale under this subsection, the court shall consider the extent to which a bidder has offered to maintain existing jobs, has preserved retiree health benefits, and has assumed the obligations of any defined benefit plan, in de-

termining whether an offer constitutes the highest or best offer for such property."; and

(2) by adding at the end the following:

"(q) If, as a result of a sale approved under this section, retiree benefits, as defined under section 1114(a), are modified or eliminated pursuant to the provisions of subsection (e)(1) or (h) of section 1114 or otherwise, then, except as otherwise provided in an agreement with the authorized representative of such retirees, a charge of $20,000 per retiree shall be made against the proceeds of such sale (or paid by the buyer as part of the sale) for the purpose of—

"(1) funding 12 months of health coverage following the termination or modification of such coverage through a plan, fund, or program made available by the buyer, by the debtor, or by a third party; or

"(2) providing the means by which affected retirees may obtain replacement coverage on their own,

except that the selection of either paragraph (1) or (2) shall be upon the consent of the authorized representative, within the meaning of section 1114(b), if any. Any claim for modification or elimination of retiree benefits pursuant to section 1114(i) shall be offset by the amounts paid under this subsection.".

SEC. 11. UNION PROOF OF CLAIM.

Section 501(a) of title 11, United States Code, is amended by inserting ", including a labor organization," after "A creditor".

SEC. 12. CLAIM FOR LOSS OF PENSION BENEFITS.

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

"(l) The court shall allow a claim asserted by an active or retired participant in a defined benefit plan terminated under section 4041 or 4042 of the Employee Retirement Income Security Act of 1974, for any shortfall in pension benefits accrued as of the effective date of the termination of such pension plan as a result of the termination of the plan and limitations upon the payment of benefits imposed pursuant to section 4022 of such Act, notwithstanding any claim asserted and collected by the Pension Benefit Guaranty Corporation with respect to such termination.".

SEC. 13. PAYMENTS BY SECURED LENDER.

Section 506(c) of title 11, United States Code, is amended by adding at the end the following: "Where employees have not received wages, accrued vacation, severance, or other benefits owed pursuant to the terms of a collective bargaining agreement for services rendered on and after the date of the commencement of the case, such unpaid obligations shall be deemed necessary costs and expenses of preserving, or disposing of, property securing an allowed secured claim and shall be recovered even if the trustee has otherwise waived the provisions of this subsection under an agreement with the holder of the allowed secured claim or successor or predecessor in interest.".

SEC. 14. PRESERVATION OF JOBS AND BENEFITS.

Title 11, United States Code, is amended—

(1) by inserting before section 1101 the following:

"SEC. 1100. STATEMENT OF PURPOSE.

"A debtor commencing a case under this chapter shall have as its purpose the reorganization of its business and, to the greatest extent possible, maintaining or enhancing the productive use of its assets, so as to preserve jobs.";

(2) in section 1129(a), by adding at the end the following:

"(17) The debtor has demonstrated that every reasonable effort has been made to maintain existing jobs and mitigate losses to employees and retirees.";

(3) in section 1129(c), by striking the last sentence and inserting the following: "If the requirements of subsections (a) and (b) are met with respect to more than 1 plan, the court shall, in determining which plan to confirm, consider—

"(1) the extent to which each plan would maintain existing jobs, has preserved retiree health benefits, and has maintained any existing defined benefit plans; and

"(2) the preferences of creditors and equity security holders, and shall confirm the plan that better serves the interests of employees and retirees."; and

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

"1100. Statement of purpose.".

SEC. 15. ASSUMPTION OF EXECUTIVE RETIREMENT PLANS.

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

(1) in subsection (a), by striking "and (d)" and inserting "(d), and (q)"; and

(2) by adding at the end the following:

"(q) No deferred compensation arrangement for the benefit of insiders or senior management of the debtor shall be assumed if a defined benefit plan for employees of the debtor has been terminated pursuant to section 4041 or 4042 of the Employee Retirement Income Security Act of 1974, on or after the date of the commencement of the case or within 180 days prior to the date of the commencement of the case.".

SEC. 16. RECOVERY OF EXECUTIVE COMPENSATION.

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

"§ 563. Recovery of executive compensation

"(a) If a debtor has obtained relief under subsection (c) or (e) of section 1113, or subsection (g) or (h) of section 1114, by which the debtor reduces its contractual obligations under a collective bargaining agreement or retiree benefits plan, the court, as part of the entry of such order granting relief, shall determine the percentage diminution, as a result of the relief granted under section 1113 or 1114, in the value of the obligations when compared to the debtor's obligations under the collective bargaining agreement or with respect to retiree benefits, as of the date of the commencement of the case under this title. In making its determination, the court shall include reductions in benefits, if any, as a result of the termination pursuant to section 4041 or 4042 of the Employee Retirement Income Security Act of 1974, of a defined benefit plan administered by the debtor, or for which the debtor is a contributing employer, effective at any time on or after 180 days before the date of the commencement of a case under this title. The court shall not take into account pension benefits paid or payable under the provisions of title IV of such Act as a result of any such termination.

"(b) Where a defined benefit plan administered by the debtor, or for which the debtor is a contributing employer, has been terminated pursuant to section 4041 or 4042 of the Employee Retirement Income Security Act of 1974, effective at any time on or after 180 days before the date of the commencement of a case under this title, but a debtor has not obtained relief under subsection (c) or (e) of section 1113, or subsection (g) or (h) of section 1114 of this title, the court, upon motion of a party in interest, shall determine the percentage diminution in the value of benefit obligations when compared to the total benefit liabilities prior to such termination. The court shall not take into account pension benefits paid or payable under the provisions of title IV of the Employee Retirement Income Security Act of 1974 as a result of any such termination.

"(c) Upon the determination of the percentage diminution in value under subsection (a) or (b), the estate shall have a claim for the return of the same percentage of the compensation paid, directly or indirectly (including any transfer to a self-settled trust or similar device, or to a nonqualified deferred compensation plan under section 409A(d)(1) of the Internal Revenue Code of 1986) to any officer of the debtor serving as member of the board of directors of the debtor within the year before the date of the commencement of the case, and any individual serving as chairman and any individual serving as lead director of the board of directors at the time of the granting of relief under section 1113 or 1114 of this title or, if no such relief has been granted, the termination of the defined benefit plan.

"(d) The trustee or a committee appointed pursuant to section 1102 may commence an action to recover such claims, except that if neither the trustee nor such committee commences an action to recover such claim by the first date set for the hearing on the confirmation of plan under section 1129, any party in interest may apply to the court for authority to recover such claim for the benefit of the estate. The costs of recovery shall be borne by the estate.

"(e) The court shall not award postpetition compensation under section 503(c) or otherwise to any person subject to the provisions of subsection (c) if there is a reasonable likelihood that such compensation is intended to reimburse or replace compensation recovered by the estate under this section.".

SEC. 17. EXCEPTION FROM AUTOMATIC STAY.

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

(1) in paragraph (27), by striking "and" at the end;

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

(3) by adding at the end the following:

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

SEC. 18. PREFERENTIAL COMPENSATION TRANSFER.

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

"(j) The trustee may avoid a transfer to or for the benefit of an insider (including an obligation incurred for the benefit of an insider under an employment contract) made in anticipation of bankruptcy, or a transfer made in anticipation of bankruptcy to a consultant who is formerly an insider and who is retained to provide services to an entity that becomes a debtor (including an obligation under a contract to provide services to such entity or to a debtor) made or incurred on or within 1 year before the filing of the petition. No provision of subsection (c) shall constitute a defense against the recovery of such transfer. The trustee or a committee appointed pursuant to section 1102 may commence an action to recover such transfer, except that, if neither the trustee nor such committee commences an action to recover such transfer by the time of the commencement of a hearing on the confirmation of a plan under section 1129, any party in interest may apply to the court for authority to recover the claims for the benefit of the estate. The costs of recovery shall be borne by the estate.".

SEC. 19. FINANCIAL RETURNS FOR EMPLOYEES AND RETIREES.

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

(1) by adding at the end the following:

"(18) In a case in which the debtor initiated proceedings under section 1113, the plan provides for recovery of rejection damages (where the debtor obtained relief under subsection (c) or (e) of section 1113 prior to confirmation of the plan) 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).''; and

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

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

"(A) provides for the continuation after its effective date of payment of all retiree benefits at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 at any time prior to 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 prior to confirmation of the plan, the continuation of all such retiree benefits maintained or established in whole or in part by the debtor prior to the date of the filing of the petition; and

"(B) provides for allowed claims for 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).".

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Ms. SÁNCHEZ. This important bill will do much to preserve jobs and relevel the playing field for American workers in Chapter 11 business bankruptcy cases.

Accordingly, I very much look forward to the testimony of the witnesses for today's hearing; and at this time I will recognize my colleague, Mr. Cannon, the Ranking Member of the Subcommittee, for his opening remarks.

Mr. CANNON. Thank you, Madam Chair.

I ask unanimous consent to have my written statement included in the record.

Ms. SÁNCHEZ. Without objection, so ordered.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS CANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH, AND RANKING MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Statement of Ranking Member Chris Cannon
Subcommittee on Commercial and Administrative Law
Hearing on H.R. 3652, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007"
June 5, 2008, 9:30 a.m., Room 2237 RHOB

The purported goal of the bill we are considering today, H.R. 3652, is to protect employees and retirees in business bankruptcies. While that is certainly a noble goal, it is my belief that H.R. 3652 will actually have the opposite effect if it is enacted. This bill will make it more difficult for employees and retirees of financially troubled companies to keep their jobs or retirement benefits, because if we enact this bill it will be much more likely that a troubled company will be forced to liquidate.

Liquidation, however, is what Chapter 11 is aimed at preventing. As the House Report that accompanied the enactment of Chapter 11 observed, "it is more economically efficient to reorganize than liquidate, because it preserves jobs and assets."

In the roughly 30 years since Chapter 11 was enacted, it has been beneficial to the U.S. economy and to employees and retirees of companies faced with bankruptcy. Chapter 11 has allowed companies to continue to operate so that they could provide jobs to their employees, pay their creditors, and produce returns for their stockholders.

However, in the name of protecting employees and retirees, H.R. 3652 substantially modifies essential components of Chapter 11. These modifications will make it difficult, if not impossible in many cases, for Chapter 11 to meet its goal of enabling a failing company to rehabilitate and reorganize its business by allowing it to relieve itself of the burden of oppressive debt and begin with a fresh start. As the non-partisan Congressional Research Service has noted, the proposed changes contained in H.R. 3652 "could put burdens on the debtor that would make liquidation more feasible than reorganization."

The problems with H.R. 3652 are too numerous to detail in my opening remarks, but I would like to point to a few of the provisions that could force companies to liquidate rather than to reorganize.

First, H.R. 3652 takes discretion away from bankruptcy judges; discretion that is essential in complex Chapter 11 cases. This discretion is replaced by a one-size fits all approach that ignores the fact that every industry, and therefore every business bankruptcy, is unique.

Second, the bill resets the balance between companies faced with bankruptcy and organized labor — tipping the scales heavily in favor of unions in determining when a collective bargaining agreement or retiree benefits may be rejected. This balance is put so far off kilter that according to the Congressional Research Service, the bill could give organized labor a "definitive role in determining the feasibility of reorganization."

Moreover, the bill limits any modification of a collective bargaining agreement to no more than two years. Such a short time frame will in all likelihood make it nearly impossible for a company with high labor costs to successfully reorganize.

Third, H.R. 3652 will make it exceedingly difficult for companies to attract and retain the key employees and executives needed to successfully reorganize. Turning a company facing bankruptcy around is a difficult task requiring the leadership of talented executives. If companies are hamstrung by the Bankruptcy Code in hiring and retaining key individuals needed for a turnaround, they will not be successful in reorganizing in Chapter 11.

At bottom, the problem with this bill is that it is trying to fix a system that works. Yes, employees and retirees do have benefits that were promised to them reduced in Chapter 11. And yes, that does create hardships. But for many companies that are

struggling to keep their doors open, labor costs are the largest expense in their budgets making modification of those costs essential to a successful reorganization. In other words, in many instances the choice is between reducing salaries and benefits or closing the company thereby completely eliminating salaries and benefits. Where possible, I believe the better course is to keep the company up and running through reorganization.

Chapter 11, like other chapters of the Bankruptcy Code, is about reconciling many interdependent interests. Sometimes this reconciliation of interests leads to perceived inequities, but on balance Chapter 11 has been a success. H.R. 3652, although undoubtedly well intentioned, will obstruct financially troubled companies' ability to reorganize. This obstruction will hurt employees who will lose their jobs, retirees who will lose their retirement benefits, and creditors and shareholders who will have any potential recovery diminished or eliminated. The negative

effects created by H.R. 3652 will also be felt by suppliers, customers, taxing authorities, and local communities.

Simply put, H.R. 3652 is inconsistent with the purpose of Chapter 11 of the Bankruptcy Code and, contrary to its stated intent, will not protect employees and retirees in business bankruptcy.

I look forward to the testimony from today's witnesses and thank them for coming.

Mr. CANNON. Let me just say briefly, the hearing here today is an important hearing. The ideas are important ideas.

Fundamentally, the question is, can Government make the market work or can Government actually protect employees or, in America, where we typically have had a system of a free market and robust market and a market where wages are bid up, is it not the better way—as we go through the process of transition that you laid out, is it not a better way to deal with or to respond to or allow the market to respond to these problems in an unfettered fashion not going to get us better employment, higher wages and greater benefits for all concerned? So I look forward to hearing our witnesses today as they discuss these ideas and yield back the balance of my time.

Ms. SÁNCHEZ. Thank you, Chris.

At this time, I would like to recognize Mr. Conyers, a distinguished Member of our Subcommittee and the Chairman of the full Judiciary Committee, for his opening statement.

Mr. CONYERS. Thank you, Linda Sánchez, our Chair of number five. This is a measure that I brought forward for our examination today, and I thank you for holding the hearing.

Now, Chapter 11, just briefly, is intended to give all participants an opportunity to work out economic differences. But we know what happens in bankruptcy. Namely, as a matter of fact, one of the most common threats that occur when a company is having hard times in their negotiating the collective bargaining terms for a new contract is that somewhere along the way, delicately or not so subtly, they are told this by management: "If we don't work this out, we are going to end up in bankruptcy." He doesn't say, "and then you know what that means," because you don't have to say that. It means that all contracts become undone, everything, including pensions, health care, everything; and the bankruptcy judge is then empowered to rewrite, terminate, diminish in any way he or she sees fit whatever the existing agreements were.

Another thing always happens is that a lot of workers lose their jobs. This is why I wrote the bill. If anybody needs to know why this legislation has been proposed—and I want to thank all of my colleagues. As I recall, I think this is a bipartisan work effort here.

But sometimes these disparities that we talk of don't wait for chapter bankruptcy to kick in. One time we had a hearing, this same Subcommittee. A company used Chapter 11 to extract drastic pay cuts and benefit reductions from workers and retirees or take away their jobs and benefits entirely. And it never fails. In these mergers and bankruptcies, guess what? The people that caused it get multi-million dollar, extravagant bonuses and stock options as if they are being congratulated for driving the company out of business. The automobile industry is replete with examples, if anybody would like to learn more about this.

And so we have tried to stop executive compensation. We had a hearing, and both the Chairman and Ranking Member were at it. We had five heads of oil companies, three of whom told us their compensation, and they—I don't think they blushed or stammered or were embarrassed by it, but two of them made so much money they couldn't remember how much. They didn't know what to tell us.

We are remedying that by referring them to—I presume they filed tax returns on April 15, but we would like to know for the record what this excessive competition that rewards the failures in the American industry are.

And so I thank you, Madam Chair, for allowing me this opportunity.

Ms. SÁNCHEZ. I thank the gentleman for his opening statement.

Without objection, other Members' opening statements will be included in the record.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Workers and retirees have been hit very hard by the growing number of corporate bankruptcies in recent years. Workers and retirees have been asked, and in many cases forced, to make substantial sacrifices in pay and benefits, including wholesale defaults by their bankrupt employers on their pension obligations. 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 pay their CEO's and other senior management executives almost obscene amounts of compensation. That is why I am an original cosponsor of H.R. 3652, 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.

Ms. SÁNCHEZ. I am now pleased to introduce the witnesses on our panel for today's hearing.

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 benefits plans, and individual employees. Ms. Ceccotti divides her time between the firm's bankruptcy practice and employee benefits practice. She has represented labor organizations in numerous bankruptcy cases in a wide range of industries and has served as an outside counsel to the AFL-CIO on bankruptcy matters since 1998.

Ms. Ceccotti is a frequent speaker and contributor to programs on labor and employee benefit interests in bankruptcy cases, including programs sponsored by the American Bar Association, the AFL-CIO Lawyers Coordinating Committee, the American Bankruptcy Institute and the National Conference of Bankruptcy Judges. She has written numerous articles and has been a contributing editor of the Employee and Union Member Guide to Labor Law and a contributing author of the Employee Benefits law treatise Supplement.

I want to welcome you to today's hearing.

Our second witness is Marcus Migliore. Mr. Migliore is a managing attorney for the Air Line Pilots Association, International and joined the union in 1993. He started his legal career as a law clerk to Chief Judge William C. Pryor of the District of Columbia Court of Appeals. After his appellate clerkship, Mr. Migliore joined the law firm of Dickson, Shapiro and Warren, where he represented labor unions. Mr. Migliore has spent most of his career as a labor litigator representing ALPA and other unions in Federal court, handling cases in most of the United States Court of Appeals. He also represented ALPA and other unions in arbitration

proceedings before the National Mediation Board and in collective bargaining associations.

Welcome to our panel.

Our third witness is Michael Bernstein. Mr. Bernstein is a partner at Arnold & Porter LLP and represents secured and unsecured creditors, creditors' committees, bondholders, investors, asset purchasers, debtors and other parties in a wide variety of bankruptcy and workout matters and in related litigations throughout the United States. He has been involved in large bankruptcy cases, including US Airways, TWA, Adelphia, Asarco, Mirant, Fannie Mae, FoxMeyer Drug, Alterra Healthcare Corporation, Fruit of the Loom and Continental Airlines, as well as many other cases throughout the United States.

Mr. Bernstein's bankruptcy experience spans many industries, including telecommunications, energy, real estate, finance, mining, manufacturing, technology, retail, airline, health care and pharmaceuticals. He has co-authored two books and has published many articles on bankruptcy related topics. He is a frequent lecturer and has also testified previously before Congress as an independent expert on the status of collective bargaining agreements and retiree and pension benefits in bankruptcy.

Welcome to our panel.

Our final witness is Karen Friedman. Ms. Friedman is a policy director at the Pension Rights Center, the Nation's only consumer rights organization dedicated solely to protecting and promoting the pension rights of American workers, retirees and their families. She has more than 20 years of experience in retirement policy and communications and regularly represents the perspective of consumers in congressional hearings, speeches and interviews with the media.

Ms. Friedman has written articles for *The Washington Post, The New York Times, the Los Angeles Times* and the *San Francisco Chronicle* and is featured regularly in print and electronic media, including appearances on different news programs. She also is the director of the Conversation on Coverage, a Pension Rights Center initiative that has brought together 45 experts of varying viewpoints to develop common recommendations to increase pension coverage, particularly for low and moderate wage earners.

I want to thank all of you for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record; and we will ask that you limit your testimony today to 5 minutes.

You will note that we have a lighting system which we sometimes remember to turn on and sometimes don't. You will get a green light when your time begins. After 4 minutes, you will see a yellow light, which will warn you you have 1 minute remaining in your testimony; and when your time has expired you will see the red light. If you are caught mid-thought or mid-sentence when your time expires, we will of course allow you to finish your thought before we move on to our next witness.

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

So, with that, I am going to invite Ms. Ceccotti to please proceed with her testimony.

TESTIMONY OF BABETTE CECCOTTI, ESQUIRE, COHEN, WEISS AND SIMON LLP, NEW YORK, NY, ON BEHALF OF THE AFL-CIO

Ms. CECCOTTI. Thank you and good morning. Again, Madam Chairwoman, Chairman Conyers, Representative Cannon, on behalf of the AFL I would like to thank you for this opportunity to appear today in support of H.R. 3652.

Congress designed the business bankruptcy system to prevent the liquidation of viable businesses. At the heart of the concerns of the system is the preservation of jobs, specifically jobs worth having. But workers' experience with the bankruptcy system is the opposite of what Congress intended.

Business bankruptcy works very well for powerful, moneyed constituencies, but workers who cannot diversify risk or absorb losses the way other constituents can end up losing jobs, decent wages, pensions, health care and other valuable benefits. Business bankruptcy has become a process in which management lowers the living standards of its employees and enriches itself in the process.

H.R. 3652 would remedy many defects in the current system and provide important protections for workers and retirees. I will briefly touch on some of these changes and refer you to my written statement for a more extensive description of the benefits of this bill.

First, the bill would rectify serious deficiencies in the section 1113 process when debtors seek to modify labor agreements. Section 1113 was supposed to protect workers from paying too high a price for their employer's bankruptcy by requiring a debtor to use the collective bargaining process to negotiate modifications by placing limits on how much of a burden workers would bear. But debtors have been grossly overreaching in their concessionary demands and running roughshod over the collective bargaining process with heavy handed, expensive litigation which they used for litigation to try and force concessionary deals and detract from the bargaining process. Rather than a check on debtors' ability to reject a collective bargaining agreement, section 1113 has become a blank check for debtors.

Recent bankruptcies in the airline and steel and auto industries have taken broad aim at workers' living standards through deep pay cuts, benefit cuts, cuts in pension and workforce reductions that will send thousands of jobs to lower-cost economies. Court decisions in recent cases show that the court's view of section 1113 is completely dominated by the debtors' perspective, even though Congress designed section 1113 to incorporate labor policies and protect workers in reaching decisions under section 1113.

The bill would remedy these defects through amendments that would rein in overbroad, overaggressive cuts, put an end to contracts that last long after emergence from bankruptcy.

The bill would require courts to consider solutions proposed by the union in addition to the modifications proposed by the debtor and would add several other protections designed to bolster the collective bargaining process and stop debtors from using the courts.

The bill would also clarify what has been a well understood until very recently—what has been well understood until only very recently the unquestioned right of workers to strike when their contracts are rejected.

The bill would also add important protections for retirees. Congress designated retiree health benefits for special treatment in bankruptcy through section 1114, which was intended to limit a debtor's ability to eliminate those obligations. But debtors had been aggressively targeting retiree health benefits in their bankruptcy cases, and even modest programs are slated for total elimination in order to get liability off of the company's balance sheets.

In addition, debtors have tried to avoid the section 1113 process altogether by claiming that nonbankruptcy law allows it to make unilateral changes in these benefits without involving retirees at all. The bill would stop this practice by requiring debtors that seek modifications to use the section 1114 process so that retirees receive the enhanced protection that the process would require.

Other amendments reaffirm Congress's intent that business reorganizations preserve good jobs. For example, a buyer of a debtor's assets that retains the debtor's employees and adjusts the purchase price to do just that would be able to have its bid approved over other bidders who would not keep the workers.

The bill would also place greater restrictions on debtors' ability to implement executive pay schemes in bankruptcy. Despite Congress' effort to crack down on these schemes, under new section 50(c)(3) bankruptcy continues to be a safe haven for executive pay, even as debtors cut pay and benefits for rank and file workers. Section 50(c)(3) has been thwarted through schemes devised through so-called incentive programs, devised with targets that are watered down for bankruptcy or other questionable milestones, practices that are criticized in nonbankruptcy compensation but have become successful strategies for avoiding the section 50(c)(3) standards. The bill would close the loopholes and impose consequences on debtors who implement executive pay enhancement schemes while at the same time using bankruptcy to cut pay and benefits.

In closing, the bill would remedy many harsh, financially devastating defects in the current system; and we urge you to take prompt action on this bill. Thank you again for the opportunity to appear in support of this very important bill.

Ms. SÁNCHEZ. Thank you, and we appreciate your testimony.

[The prepared statement of Ms. Ceccotti follows:]

PREPARED STATEMENT OF BABETTE CECCOTTI

Hearing on H.R. 3652, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007"

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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330 West 42nd Street
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On behalf of the AFL-CIO

June 5, 2008

Statement of Babette Ceccotti

Introduction

Good morning Madame Chairwoman 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. 3652, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007." This bill would amend the Bankruptcy Code to add urgently needed protections for employees and retirees when businesses file bankruptcy cases. I am appearing today on behalf of the AFL-CIO, a labor federation with affiliates representing over 10.5 million workers. Many AFL-CIO affiliates, such as the United Auto Workers, the United Steelworkers, and labor organizations representing workers in the airline industry, including the Air Line Pilots Association, Association of Flight Attendants-CWA, the International Association of Machinists and others have experienced the business bankruptcy process first-hand, some with tragic frequency in recent years.

When the bankruptcy laws were comprehensively revised in 1978, Congress designed the business reorganization system to prevent the liquidation of viable businesses – to preserve jobs and going concern value for all stakeholders.[1] At the heart of the concerns behind our business bankruptcy system is the preservation of jobs, in particular the preservation of jobs worth having. But workers' experience with the bankruptcy system is the opposite of what Congress intended. Business bankruptcy has become a process by which management (and the legions of professionals that support the restructuring process) lower the living standard of employees and enrich themselves in the process. In recent years, we have seen major corporate bankruptcies work very well for powerful, moneyed constituencies, but workers – with no ability to diversify risk, and little ability to absorb losses – end up losing jobs, decent wages, pensions and

healthcare. Indeed, preserving jobs – the first goal Congress cited in its redesigned chapter 11 – can become a tortured rationale for the harsh consequences faced by workers in these cases.[2]

Congress has long recognized that obligations to employees are different from debts owed to other creditors. Early business bankruptcy laws established a payment priority for wages, which has been increased and expanded over the years to take into account different forms of payroll and deferred compensation and the employee benefits plans that pay workers' health, pension and other benefits.[3] In 1984, Congress passed Section 1113 of the Bankruptcy Code[4] to protect collective bargaining agreements when companies blatantly used bankruptcy as a strategic weapon against organized labor. Congress responded again in 1986, when LTV Steel Company, in its first bankruptcy case, stopped paying retiree health benefits for 70,000 retired steelworkers by claiming that these obligations were really bankruptcy debts that could not be paid until all other creditors received their bankruptcy recoveries. In response, Congress passed Section 1114 to require the continuation of retiree health and life insurance benefits and prohibit other companies from taking similar action.[5] Most recently, in 2005, Congress increased the wage priority[6] 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.[7]

It is time for Congress to act again. Comprehensive reform is needed because too many features of bankruptcy law provide too little protection for employees and retirees. The wage priority remains inadequate as applied to earned compensation and pits payroll wages against contributions to employee benefit plans. Section 1113 has been misconstrued and misapplied by many courts almost since its enactment in 1984, and with disastrous results for employees. Debtors are taking aim at retiree health costs notwithstanding Section 1114, in many instances by

trying to evade the statutory requirements altogether. Asset sales in bankruptcy have become pitched battles where buyers pick up distressed assets and leave employees and benefits behind.

As a result of serious deficiencies in the law, workers and retirees are bearing a grossly disproportionate burden of an employer's bankruptcy: more than investors who can absorb a loss in diversified portfolios or trade out of their positions; more than vendors or suppliers, who can take steps to shore up credit or pricing terms or seek new business, and certainly more than the company's top management. Workers are suffering because more can be taken away, much more easily, and with wholly inadequate remedies. Just last year, the Court of Appeals for the Second Circuit ruled that airline workers could be denied their most basic right – to withhold their services – when their contracts were rejected in bankruptcy,[8] an unprecedented ruling that badly subverts established bankruptcy and labor law precedent. And despite the wide-reaching effects of business bankruptcies on workers, their jobs and their retirement security, executive pay continues to flourish, notwithstanding Congress's recent action to reign in executive bonus, severance and other compensation programs in bankruptcy cases.[9] Business bankruptcy cannot function effectively and credibly if workers – vital to any business recovery – are sacrificing their jobs, pay and benefits while executives are treated to generous compensation enhancements and rewards.

H.R. 3652 would correct many deficiencies in current law and establish important protections for workers and retirees. The bill would the amend the Bankruptcy Code in five major ways:

First, H.R. 3652 would increase workers' recoveries for their losses.

Second, the bill would restore a balanced process, principally through collective bargaining, where a debtor seeks to modify a labor agreement.

Third, the bill would enhance protections against losses in retirement security.

Fourth, the bill would enhance the preservation of jobs and benefits as an explicit goal of business bankruptcy.

Fifth, the bill would strengthen restrictions on executive pay schemes.

1. <u>H.R. 3652 would increase workers' recoveries for their losses</u>

As a result of the amendments to the Bankruptcy Code in 2005, the wage priority is now $10,950 per employee for compensation earned within 180 days of bankruptcy, and contributions to employee benefit plans based on those services. But for a long time, courts have limited the amount of the wage priority that can actually be collected through decisions that treat some earned compensation, like vacation, sick leave and severance pay less favorably than wages.[10] In addition, the current wage priority statute pits payroll compensation against pension and health benefits by splitting the wage priority into two sections. Priority payments are made for unpaid contributions to health, pension and other benefit plans only to the extent an employee hasn't used up $10,950 in payroll compensation.[11] Benefit plans are getting the leftovers, if there are any.

H.R. 3652 [Section 3] raises the total amount of the wage priority to $20,000 per employee to take into account the varied forms of payroll compensation and fringe benefits workers now earn and eliminates the court-made distinctions among different types of earned compensation that have prevented workers from collecting the full amount of the priority. The bill also de-links the wage priority from the plan contribution priority and gives unpaid contributions owed to benefit plans a separate $20,000 per-employee priority. In addition, the bill provides that the full amount of severance pay owed to employees (other than insiders or senior management) who are terminated during the bankruptcy qualifies as administrative

expenses of the estate, so that workers can pay their bills and living expenses when they lose their jobs, and can cover continued or replacement health insurance. [Section 5] The bill also allows workers to recover compensation due for preserving a lender's collateral, in the event a debtor waives that right in a lending agreement. [Section 13]

2. H.R. 3652 restores a balanced process, principally through collective bargaining, where a debtor seeks to modify a labor agreement.

A. Why Section 1113 no longer works

In 1984, Congress acted, through Section 1113, to stop the use of bankruptcy as a strategic weapon in collective bargaining. Section 1113 established rules designed to protect the collective bargaining process and apply a more stringent legal standard to rejection of labor agreements than the standard applicable to the rejection of other contracts. But Section 1113 was not well understood by most courts. A legal standard informed by both labor policies and bankruptcy policies was soon rejected by most courts in favor of a bankruptcy-centered standard that disregarded the labor policies Congress took deliberate action to protect.[12] The legal standard that has been predominantly applied by the courts has allowed debtors wide latitude in labor cost cutting despite extreme hardships the courts have acknowledged workers will face. This lenient standard, combined with more expansive use of bankruptcy to address industry-wide problems, has been disastrous for workers.

In recent years, airlines, auto parts suppliers, steel and other manufacturing companies, have filed bankruptcy cases when faced with problems that, to a great degree, cannot be solved merely be filing for bankruptcy because the company's financial circumstances are also shaped by global market conditions, or industry-wide problems indicative of fundamental industry change. Beginning in the late 1990s, approximately 40 steel companies such as LTV Steel, Wheeling-Pittsburgh Steel and others filed bankruptcy cases to try and survive global market

overcapacity and depressed steel prices. In 2002, large airlines began filing chapter 11 cases following the 2001 economic downturn, 9/11, and in response to other industry-wide challenges, such as the growth of low-cost carriers and extraordinarily high fuel prices. Most recently, in the automobile sector, numerous auto supply companies have sought bankruptcy protection in response to industry globalization and the pressures now facing the OEM's.

Many of these companies targeted deep cuts in labor costs, pension funding and retiree health obligations as a principal focus of their bankruptcy cases.[13] Bankruptcy can do little to lower fuel prices or raise fares; bankruptcy cannot reverse trade policies that disadvantage American manufacturers; bankruptcy cannot solve the changing demand for OEM automobiles. But bankruptcy offered powerful tools for rejecting contracts. Even though some sacrifices were needed to weather difficult financial times, debtors aggressively overreached and targeted deep cuts in wages and benefits, pension funding and retiree health benefits. Bankruptcy tools compensated for forces that were uncontrollable. As a result, workers and retirees paid dearly in lost jobs, lower pay and benefits, harsher working conditions and weakened retirement security. The protections Congress intended by enacting sections 1113 and 1114 – to prevent workers and retirees from bearing a disproportionate burden of their employer's bankruptcy – could not stop the broad assault on jobs, labor agreements, pensions and retiree health benefits.

B. Amendments to Section 1113 [Section 8]

H.R. 3652 would remedy serious deficiencies in the operation and application of Section 1113. Some of the amendments address defects in the rejection process and are intended to restore the paramount use of collective bargaining processes when companies seek concessions in bankruptcy. In response to recent court decisions, the new provisions would clarify the remedies available upon rejection. In addition, hearing and scheduling rules that have become

unduly burdensome for the parties – and for the courts – would also be modified. Other changes adopt language from Section 1114 in order to eliminate anomalies between the two statutes that have been cited by the courts.

(1) Changing the contract modification process

The bill addresses two major problems related to the contract modifications process. First, debtors are ignoring the fundamental rule that meaningful bargaining must take place before the debtor initiates a court process seeking contract rejection. Rather than apply to the court as a last resort, which was the original design, debtors are using the court process as leverage and relegating important procedural requirements to perfunctory check lists. Debtors are setting up litigation processes very early on, even before any meaningful negotiations have taken place. Delphi Corporation, for example, asked for a litigation schedule for its section 1113 proceedings against five unions on the very first day of its bankruptcy case – a schedule that was extended repeatedly and then finally suspended so that the parties could take the time needed to negotiate what turned out to be a globally comprehensive, highly complex agreement.[14] Dana Corporation, another automotive supplier, established a litigation schedule for its Section 1113 and Section 1114 motions having tendered its proposals only days earlier.[15]

A so-called "two track" system of litigation and bargaining, now routinely imposed by management and permitted by the courts in large chapter 11 cases, is not what Congress intended in crafting Section 1113, and does not lead to better or earlier negotiated agreements. Instead, it wastes considerable time and money, needlessly consumes court time, and distracts the parties from the serious work of trying to find a negotiated solution. The process has become very lucrative for bankruptcy firms, which get to bill the estate for teams of litigators engaged in expensive and wasteful pre-trial litigation activity and court trials, but little else is accomplished.

H.R. 3652 corrects this misuse of the process by making it clear that a motion to initiate the court process "shall not be filed" unless the debtor has met with the union to confer in good faith "for a reasonable period in light of the complexity of the case" and may only be filed if the parties have reached an irreconcilable stalemate in the negotiations. [Section 8 (1), amending Section 1113 (b)(1) and (c)(1)]

(2) Alternate dispute resolution by a Neutral Panel [Section 8 (4), adding new Section 1113(i)]

In addition, the amendments would permit a dispute over proposed modifications to be resolved by arbitration rather than by the bankruptcy court. Arbitration conducted by a neutral panel of experienced labor arbitrators offers a process that labor and management negotiators are familiar with and one which is recognized and well-regarded as a vehicle for the resolution of labor disputes.[16] Arbitration is also less formal than court litigation and may prove less costly than engaging in litigation in the bankruptcy court. Disputes over contract modification often involve issues that are endemic to the business and best understood by the bargaining parties. Neutral arbitrators selected by the parties are experienced in dealing with such issues and will be respected by both sides. They may also be used as mediators and thus offer another means of resolving a dispute short of litigation.

(3) Making sacrifices that are fair to workers and retirees

The second major deficiency in the Section 1113 process is that there is no effective limit to the concessions that can be sought from workers. Because courts that have addressed Section 1113 have favored a legal standard that permits a debtor wide latitude and virtually ignores labor policies, Section 1113 offers employees little effective protection against broad cost cutting aimed at jobs, pay and benefits that not only affect employees in the near term, but extend to their retirement security, through pension plan terminations and cuts in other retiree benefits.

United Airlines engaged in two rounds of Section 1113 cuts, and also sought Section 1114 relief as well as termination of its defined benefit pension plans.[17] By the time its second bankruptcy case was complete, US Airways had engaged in multiple rounds of Section 1113 proceedings, slashed its retiree health benefits obligations and terminated all of its defined benefit pension plans.[18] Dana Corporation, an automotive supplier that emerged from bankruptcy earlier this year, targeted an ambitious program of plant closures, transfer of work to low-cost economies, elimination of retiree health benefits obligations and rejection of all of its labor contracts in its bankruptcy case. In its Section 1113 proposals, Dana even asked to eliminate modest benefits such as tuition reimbursement programs and perfect attendance awards.[19]

The relief debtors are seeking is both stunningly broad and long-term. Employees must bear the hardships of concessionary agreements for years after a company has emerged from bankruptcy. United Airlines, for example, had money to pay a special, $250 million dividend to its shareholders earlier this year, and awarded generous contracts to its executives, but has resisted the unions' requests to begin their contracts talks early, before the 2009 amendable date of the agreements reached with its labor groups while in bankruptcy.[20] Mesaba Aviation rigidly sought a six-year concessionary agreement and a fixed level of savings in its Section 1113 court case – both approved by the court – even though in private negotiations, the airline agreed to less draconian savings, a shorter agreement and a form of wage increase snapback it emphatically rejected in court.[21]

H.R. 3652 addresses these problems by requiring that a proposal 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.[22] The bill would also limit the scope of employees' sacrifices by getting rid of marathon-length concessionary agreements and limiting the extent of workers' sacrifices to two years following emergence from bankruptcy. [Section 8 (1), amending Section 1113(b)(1)(A)]

H.R. 3652 also requires that proposed modifications "shall not overly burden the affected labor group, either in the amount of the savings sought from such group, or the nature of the modifications, when compared to other constituent groups expected to maintain ongoing relationships with the debtor, including management personnel." [Section 8(1), amending Section 1113(b)(1)(C)] In ruling on a motion under Section 1113, the court must find that the debtor has complied with the new procedural requirements, that the debtor's proposals meet the specified conditions, and must consider the effect of the proposal on the affected labor group. The court must also consider how the modifications will affect the ability of the debtor to retain an experienced and qualified workforce. The court must also consider the effect of a strike. [Section 8 (1), amending Section 1113(c)] Concessions made by the labor group before bankruptcy must be taken into consideration in determining whether the proposed modifications are disproportionate. [Section 8 (1), amending Section 1113(c)]

(4) Information requirements

The amendments maintain the requirement under current law that the debtor provide relevant and sufficient information so that the union can engage in meaningful negotiations. [Section 8(1), amending Section 1113(b)(2)] In order to encourage a broad exploration of solutions, the amendment would require the court to look at the whole of the company's business as well as proposals made by the union that meet the requisite savings standard in evaluating a rejection motion. [Section 8 (1), amending Section 1113(c)(2)]

(5) Contract rejection remedies

H.R. 3652 would correct the Court's ruling in the *Norwest Airlines* case that denied the right of airline employees to engage in economic self-help following rejection of their labor agreement. That decision reflected serious errors in the application of labor law and bankruptcy principles never before questioned in bankruptcy cases. Before *Northwest*, no court had ever questioned that employees whose contracts are rejected in bankruptcy have a right to strike.[23] 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. [Section 8(2), adding a new Section 1113(g)]

In addition, before the *Northwest Airlines* ruling, only one lower court had ruled that contract rejection under Section 1113 did not give rise to a rejection damages claim. The majority of courts held otherwise.[24] The *Northwest* court erroneously concluded that a labor union has no remedy for contract rejection even though it is well established that counterparties to rejected executory contracts are entitled to rejection damage claims. H.R. 3652 makes this remedy explicit for labor agreements. [Section 8(2), adding a new Section 1113(g)] However, the bill does not change current law that rejection of a labor agreement is prospective only. A debtor cannot seek retroactive relief from a labor agreement.[25] Unless and until a labor agreement is rejected under section 1113, it remains in effect. That is the law today and that would be the law under H.R. 3652.

(6) Hearing and scheduling modifications

H.R. 3652 also adjusts the current timeline built into Section 1113 by increasing the required minimum notice of a Section 1113 motion to 21 days from 14 days. [Section 8(2), amending Section 1113(d)(1)] A compressed schedule was originally incorporated into the

statute based on concerns that the newly crafted process not be unduly lengthy.[26] However, the statutory time limits are often ignored (or routinely extended) by the parties and by the courts. And because Congress has now acted to limit the exclusive time for a debtor to propose its plan to 18 months, all stakeholders must adjust to a shorter time line to propose a reorganization plan. There is no purpose to be served by singling out the Section 1113 process for compressed timetables that are routinely extended now any way. Interim relief under Section 1113(e) would continue to be available in the event of an emergency that threatened the business. The bill also clarifies that only the debtor and the affected labor organization may appear and be heard at the hearing.[27] [Section 8(2), amending Section 1113(d)(1)]

(7) Other amendments to Section 1113

Other changes to Section 1113 in H.R. 3652 are designed to address differences in language between Section 1113, enacted in 1984, and Section 1114, enacted in its final form in 1988. Courts have cited these differences, for example, in denying administrative expense status to certain payments arising under labor agreements because, unlike Section 1114, Section 1113 does not explicitly state that payments have the status of an allowed administrative expense. [Section 8(3), amending Section 1113(f)] H.R. 3652 adds other language consistent with provisions of Section 1114 to clarify that, in areas where courts have raised questions, the statutes should operate in the same way. [Section 8(4), adding new subsections (g)("No claim for rejection damages shall be limited by section 502(b)(7)"); (h)(permitting a labor organization to seek relief from a modified agreement or a rejection order based on changed circumstances)][28]

3. H.R. 3652 would enhance protections against losses in retirement security

The third major area addressed by H.R. 3652 is retirement security. When LTV Steel Corporation stopped paying retiree health benefits, Congress stepped in to require continuation

of retiree health and life insurance benefits in bankruptcy. Like Section 1113, Section 1114 established a stringent process to be followed in the event a debtor sought to reduce its retiree benefits obligation. The procedures for seeking to modify those obligations were patterned on the Section 1113 process. Notwithstanding these protections, retiree health obligations are often viewed merely as large numbers on financial balance sheets instead of obligations that reflect hospital, medical, prescription drug and other healthcare expenses that are a lifeline for retirees. As balance sheet numbers, however, they have become irresistible targets for cost-cutters and financial investors.

A. Changes to Section 1114 [Section 9]

H.R. 3652 amends Section 1114 to provide greater protection for retiree health and life insurance benefits with changes similar to those proposed for Section 1113 and for the same purpose: to strengthen the requirements for seeking a negotiated resolution, restrain the debtor's ability to use the court process as heavy-handed leverage, and limit the scope of permissible changes so that retirees do not disproportionately bear the cost of the bankruptcy. In addition, H.R. 3652 aims to stop court-shopping by opportunistic debtors, by providing that the Section 1114 procedures apply whether or not a company thinks it can make changes to retiree health benefits unilaterally by applying non-bankruptcy law that varies widely by jurisdiction. [Section 9(1), amending Section 1114(a)][29]

B. Other retirement security protections

H.R. 3652 also protects retirement security by establishing a contract damages claim for the termination of a defined benefit pension plan in bankruptcy. The claim would be treated as a general unsecured claim. [Section 12] 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. [Section 15, adding a new Section 365(q), restricting assumption of pension plans for insiders or senior management and Section 9 (6), adding a new Section 1114(m), restricting the assumption of retiree health benefits plans for insiders or senior management]

The bill also establishes a priority claim for losses incurred when stock held in a defined contribution pension plan loses value as a result of fraud committed by the employer. [Section 4]

4. H.R. 3652 would enhance the preservation of jobs and benefits as an explicit goal of business bankruptcy

Fourth, H.R. 3652 adds explicit protections for job preservation and the preservation of benefits in key transactions in a bankruptcy case. First, under current law, a debtor that sells all or part of its business must conduct an auction to determine the highest or best offer for the assets.[30] A buyer might offer less in sale proceeds, but hire the debtor's employees and assume responsibility for accrued vacation or other benefit obligations. The bill provides that in approving a sale, the bankruptcy court shall consider the extent to which a bidder will maintain existing jobs, has preserved retiree health benefits or assumed pension obligations in determining whether an offer constitutes the successful bid. [Section 10, adding a new Section 363(b)(3)]

More generally, where a debtor is reorganizing as a going concern, its reorganization plan must reflect that every reasonable effort has been made to maintain existing jobs and mitigate losses to employees and retirees. Where competing plans are presented, the court must take into consideration the extent to which each plan would maintain existing jobs and benefits. [Section 14(2), amending Section 1129(a)] By making explicit that these attributes can be considered in

determining the outcome, the amendment puts prospective investors and other stakeholders on notice that these contributions count towards assessing the success of an offer.

In addition, in order to prevent the recurrence of circumstances where buyers have taken assets but made no provision for continuation of retiree health benefits, leaving those obligations to be wiped out in the bankruptcy, the bill would require a set aside of sale proceeds for retirees to use towards replacement coverage.[31] Alternatively, the buyer could put those funds towards the provision of health benefits coverage in a plan or program already sponsored by the buyer. [Section 10 (2), adding a new Section 363(q)] In addition, where a debtor has proposed a liquidating plan, either through the sale of the business or cessation of operations, the bill clarifies that existing labor law obligations to negotiate an orderly transition of the workforce, including payment of accrued obligations not assumed by a buyer, and other terms related to a sale or closure apply except as otherwise addressed as part of the sale or as part of the Section 1113 process. [Section 8(4), adding a new Section 1113(k)]

5. H.R. 3652 would strengthen restrictions on executive pay schemes

Fifth, the bill would amend the Bankruptcy Code to provide more stringent regulation of executive pay schemes that are put in place in anticipation of bankruptcy, proposed during bankruptcy, or incorporated in reorganization plans for emerging companies.

A. Executive compensation schemes continue to flourish

Under current law, executive compensation schemes have been addressed in a bankruptcy case in the following ways:

Section 363(b). For cases not subject to the 2005 amendments to the Bankruptcy Code, debtors still seek court approval under Section 363(b) of the Code as a use of its property "other than in the ordinary course of business." Through these motions, programs formerly known as

"Key Employee Retention Plans," or "KERPS," severance programs for senior executives and other schemes designed to award cash, stock and other value to management are presented for court approval under a generally lenient "business judgment" legal standard.[32] The rationale is that the programs would prevent key talent from leaving the company, although little hard evidence has been required under the relaxed standard of review, in which the courts look broadly for a "sound business purpose."

Section 503(c). In the 2005 amendments, Congress acted to crack down on "pay to stay" "KERPS" and oversized severance packages through a new Section 503(c), intended to strictly limit the instances in which these programs could be approved. The most specific limits applied to "insiders" (those who are officers, directors, or other persons in control of the debtor). In addition, Congress added a "catch-all" provision that required compensation programs designed for those who are not insiders to be "justified by the facts and circumstances of the case."

The 2005 amendments have not worked as intended. Debtors and their professionals have crafted any number of ways around them (for example, by re-labeling the programs "incentive" plans through the use of difficult to assess financial or "milestone" targets that trigger payments).[33] Some courts have not even required input from independent compensation consultants if the programs are found to be "ordinary course" programs, or programs that were similar to pre-bankruptcy plans.[34] And despite aggressive targeting of labor costs and benefit obligations owed to rank and file workers, debtors have also been able to implement management bonus and other pay schemes at the same time that they are seeking cuts in the pay and benefits of rank and file workers.[35]

Section 1129(a)(5). In order to emerge from bankruptcy, a business must confirm a reorganization plan that meets certain statutory criteria. One of the requirements is that the

debtor disclose "the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider." Courts have not engaged in analysis of the compensation disclosed under this provision because the statute provides only for disclosure and not for review and approval.

B. Reigning in Executive Compensation Schemes

H.R. 3652 would strengthen the current law to reign in executive compensation programs proposed in anticipation of, or during a bankruptcy case. Section 7 of the bill expands the provisions of Section 503(c). The strict criteria that now apply to payments "for the purpose of inducing" an insider to remain with the business would also apply to payments for performance or incentive bonuses of any kind, or other financial returns designed to replace or enhance incentive, stock or other compensation in effect prior to bankruptcy. In addition, the "catch-all" provision would be bolstered to apply to compensation obligations incurred for the benefit of officers, managers or consultants retained before or during bankruptcy, and to impose a more stringent standard. The court would review the proposal without applying the deferential business judgment standard. Instead, the Court must determine whether the proposed payments are essential to the survival of the business (or, in the case of a sale of the business, the orderly liquidation of assets).

The court must also find that the proposed compensation is reasonable compared to persons holding comparable positions in comparable companies in the same industry and not disproportionate in light of economic concessions made by the non-management workforce during the bankruptcy. This standard has been added to counteract the practice of justifying compensation schemes through the use of unrealistic comparables and other flawed compensation consulting practices.[36]

In addition, Section 1129(a)(5) would be amended for insider compensation disclosed as part of a plan of reorganization. Because such compensation will likely include emergence grants of stock and/or cash and other compensation "perks," under the amendment, insider compensation that is disclosed under this section would be reviewed for reasonableness when compared with persons holding comparable positions at comparable companies in the same industry and to ensure that it is not disproportionate in light of economic concessions made by the non-management workforce. [Section 6] To avoid eve of bankruptcy awards that might otherwise escape the scrutiny of the court or creditors, the bill also provides that a transfer made in anticipation of bankruptcy to or for the benefit of an insider or to a former insider who becomes a consultant to the debtor can be recovered as a preferential transfer. [Section 18]

To address circumstances where a debtor proposes an executive compensation scheme in a case that has targeted cuts in labor costs, the bill provides that where a debtor has implemented a bonus program or other financial returns for insiders or senior management personnel during or prior to bankruptcy, the court must apply a presumption that labor concessions sought by the debtor would be overly burdensome to the affected labor group when compared to other constituent groups. [Section 8(1), amending Section 1113(c)(3)] In addition, the estate is granted a claim for the return of a portion of director compensation if a court orders rejection of a labor agreement or termination of a defined benefit pension plan. [Section 16]

Other technical changes

H.R. 3652 also contains other amendments of a more technical nature, generally intended to codify existing practices. The bill adds statutory provisions for two widely accepted practices, the filing of a proof of claim by a labor organization on behalf of its members [Section 11] and an exception to the automatic stay for ordinary course grievances and labor arbitrations pending

at the time of the bankruptcy case.[37] [Section 17] In addition, the bill adds a new Section 1113 (j) permitting the reasonable fees and costs incurred by the labor representative in the Section 1113 process be paid by the debtor. Reimbursement of a labor organization's professional fees incurred during the restructuring has become an accepted practice and fosters informed review and negotiations concerning the debtor's restructuring issues.[38]

Concluding Remarks

Bankruptcy, and chapter 11 in particular, affords debtors broad flexibility to direct the course of their restructuring cases. Management remains in control of the business, has an 18-month "exclusivity" period to file a reorganization plan, and many powerful tools at its disposal. H.R. 3652 will undoubtedly be criticized for encroaching on the broad discretion that management and their restructuring professionals guard very closely. We are under no illusions about the reaction this bill will generate from defenders of the status quo. They will tell you that debtors cannot possibly pay workers more towards their claims, even though they routinely continue their ordinary course payroll and benefits following a bankruptcy filing as part of their efforts to stabilize the business.[39] They will even tell you that changes like those proposed in this bill will doom a reorganization.

We urge you not to fall prey to these types of charges. Perceived threats to vigorously guarded bankruptcy prerogatives will yield all manner of high-pitched exaggerations about the calamities that could befall a company if the law is changed. We are not here to turn reorganizations into liquidations. No groups work harder than labor groups to achieve pragmatic and fair outcomes under the extraordinarily difficult conditions of a bankruptcy case.

We are here to say that workers are sacrificing too much to too many other interests in bankruptcy. Employees *can* and *should* recover more of their losses. Workers' interests *can* and

should be taken into consideration when companies sell assets. The Section 1113 process *can* – indeed was supposed to be – and *should* operate so that management and labor representatives can craft solutions to difficult business and industry challenges without the circus of litigation and the threat of a court process that does not recognize workers' unique role and vital interests. Job preservation should not simply be empty rhetoric. Debtors that use bankruptcy to slash decent wages, send thousands of jobs overseas, and gut workers' retirement security are not fulfilling the obligations Congress established in its design of business reorganizations.

H.R. 3652 will provide long-overdue and much needed protection for employees and retirees in business bankruptcy cases and 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.

[1] *See* 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.").

[2] *See, e.g., In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006) (citing the application of bankruptcy aims, including job preservation, in holding that Kaiser could aggregate the costs of multiple pension plans in meeting the test for approval of plan terminations in bankruptcy).

[3] *See Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, 514 U.S. 651 (2006) (reviewing the expansion of the wage priority to include contributions to employee benefit plans).

[4] The Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, § 541 (1984).

[5] The Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, §2, (1988).

[6] 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).

[7] 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).

[8] *Northwest Airlines Corp. v. Association of Flight Attendants*, 483 F.3d 160 (2d Cir. 2007).

[9] 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).

[10] Most courts distinguish between "length of service" severance pay and "pay in lieu of notice" severance (*see, e.g., In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992); *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. However, the Second Circuit recognizes severance pay as earned in full upon termination of employment, and does not distinguish between pay in lieu of notice and length of service severance. *See Straus-Duparquet, Inc. v. Local Union No. 3, International Brotherhood of Electrical Workers*, 386 F.2d 649 (2d Cir. 1967). H.R. 3652 follows the *Straus-Duparquet* rule so that workers receive meaningful payments if they lose their jobs. 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 Company* , 863 F.2d 1313 (7th Crr. 1988). Under H.R. 3652, the wage priority cap would apply to all earned, unpaid vacation.

[11] 11 U.S.C. § 507(a)(5)(B) (describing calculation of $10,950 per employee priority for unpaid benefit plan contributions, "less (ii) the aggregate amount paid to such employees under paragraph 4 of this subsection....")

[12] 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) (hereafter, *Lost in Transformation*). This article reviews the history of Section 1113, legal developments in key decisions following its enactment, and the application of the statute in recent bankruptcy cases. A copy is submitted with this Hearing Statement.

[13] *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.

[14] 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] and Sixth Amended Order Suspending Further Proceedings on Debtors' Motion for Order Under 11 U.S.C § 1113(c) Authorizing Rejection of Collective Bargaining Agreements and Authorizing Modification of Retiree Welfare Benefits Under 11 U.S.C. § 1114(g) [Docket No. 8880, Aug. 3, 2007], *In re Delphi Corporation*, No. 05-44481 (RDD) (Bankr. S.D.N.Y.).

[15] 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, 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.).

[16] *See* Stipulation and Consent Order Under Bankruptcy Rule 9019 Between Delta Air Lines, Inc. and the Air Line Pilots Association, International, *In re* Delta Air Lines, Inc., No. 05-17923 (PCB) (Bankr. S.D.N.Y.) [Docket No. 1552, Dec. 13, 2005].

[17] *Association of Flight Attendants-CWA v. P.B.G.C.*, No. Civ. A 05-1036 ESH, 2006 WL 89829, at *2 (D.D.C. Jan. 13, 2006) (describing Section 1113 and pension plan termination proceedings in United's bankruptcy).

[18] *See In re USAirways, Inc.*, 329 B.R. 793 (Bankr. E.D. Va. 2005) (describing Section 1113, Section 1114 and pension plan termination proceedings in USAirways' bankruptcy cases).

[19] 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) [Docket No. 6600] (describing labor-related cost savings targeted in Dana's bankruptcy).

[20] Source: UAL Corporation Form 8-K (December 5, 2007) and Press Release (disclosing United's announcement that its Board of Directors approved a special distribution of approximately $250 million to holders of UAL common stock and term loan pre-payment under an amendment to the company's credit agreement). *See also*, "United Workers Join For Fight," Chicago Tribune, March 28, 2007 (describing efforts by United's unions to begin early talks to replace contracts negotiated in United's bankruptcy case).

[21] *In re Mesaba Aviation, Inc.*, 350 B.R. 435 (D. Minn. 2006); 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).

[22] *Lost in Transformation*, 15 ABI Law Rev. at 417-18 (describing use of bankruptcy by companies to achieve "transformation" objectives, *i.e.*, the "strategic use of bankruptcy to bring about broad changes ... largely through substantial cost cutting, to address conditions that are ascribed to fundamental industry change").

[23] *See* Richard M. Seltzer and Thomas N. Ciantra, "The Return of Government by Injunction in Airline Bankruptcies," 15 ABI Law Rev. 499 (Winter, 2007). The article is a comprehensive examination of the *Northwest* decision. The authors represented the Air Line Pilots Association, International in the strike injunction lawsuit. A copy is submitted with this Hearing Statement.

[24] *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).

[25] *See, e.g., Peters v. Pikes Peak Musicians Association*, 462 F.3d 1265 (10th Cir. 2006).

[26] *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).

[27] *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).

[28] *In re Ionosphere Clubs, Inc.*, 22 F.3d 403 (2d Cir. 1994); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992) (noting that when Congress intends to alter the priority scheme it has done so explicitly, as in Section 1114(e)). *See also In re Northwest Airlines Corp.*, 366 B.R. 270 (Bankr. S.D.N.Y. 2007) (citing statutory provision of Section 1114 permitting relief from Section 1114 order, and absence of similar provision in Section 1113).

[29] *See In re Farmland Industries, Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003) (ruling that Section 1114 procedures apply even where debtor asserted the right to make unilateral changes in retiree health benefits).

[30] *See, e.g., In re After Six, Inc.*, 154 B.R. 876 (Bankr. E.D. Pa. 1993) (reviewing factors courts may consider in approval of a sale).

[31] This provision addresses hardships resulting from the bankruptcy case of Horizon Natural Resources, in which the bankruptcy court rejected the labor agreements and eliminated retiree health obligations when the prospective buyer purchased Horizon's assets but did not assume these obligations as part of the sale. *In re Horizon Natural Resources Co.*, 316 B.R. 268 (Bankr. E.D. Ky. 2004).

[32] *See, e.g., In re USAirways, Inc.,* 329 B.R at 797 (describing legal standard for review of "KERP's").

[33] *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).

[34] *E.g., In re Global Home Products, LLC*, No. 06-10340, 2007 WL689747 (Bankr. D. Del. 2007) (approving program as incentive plan in the ordinary course of the debtor's business and not as a KERP; court excused the absence of independent consultant because the program was similar to a pre-bankruptcy plan); *In re Nellson Neutraceutical Inc.*, 369 B.R. 787 (Bankr. D. Del. 2007).

[35] *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.").

[36] *See* "Executive Pay: Conflicts of Interest Among Compensation Consultants," U.S. House of Representatives, Committee on Oversight and Governmental Reform (Majority Staff) (December, 2007).

[37] *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).

[38] *See United States Trustee v. Bethlehem Steel Corporation*, 2003 WL 21738964 (S.D.N.Y. July 28, 2003) (affirming bankruptcy court's approval of debtor's reimbursement of union advisor fees in bankruptcy).

[39] Debtors now routinely seek authority in their initial bankruptcy court filings to pay wages and other forms of compensation accrued as of the date of the bankruptcy filing, either under the bankruptcy court's equitable authority or as a payment under Section 363(b) of the Bankruptcy Code, citing the need 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).

ATTACHMENT 1

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

BABETTE A. CECCOTTI*

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*,[1] unleashed a storm of protest that companies were abusing the bankruptcy process to target collective bargaining agreements.[2] Soon after the *Bildisco* decision, Congress enacted section 1113 of the Bankruptcy Code[3] to impose restrictions on the ability of a company in bankruptcy to reject a labor agreement.[4] Two years later, LTV

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[1] 465 U.S. 513 (1984).

[2] 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'").

[3] References to the Bankruptcy Code are to 11 U.S.C. §§101–1532 (2006).

[4] *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.[5] 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.[6]

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.[7] 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.[8] 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").

[5] *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.").

[6] 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.").

[7] *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].").

[8] *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.[9]

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?[10] Restructuring professionals have denominated these cases "labor transformation" bankruptcies.[11] 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.[12] In these cases, debtors have been able to

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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").

[9] *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)).

[10] 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).

[11] *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).

[12] *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.[13] Many have involved the termination of defined benefit pension plans as well.[14]

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.[15] A principal purpose of both statutes is to protect employees and retirees from bearing a disproportionate burden of their employer's bankruptcy.[16] 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").

[13] *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).

[14] *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).

[15] *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").

[16] *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.[17]

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.[18] 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.[19]

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.[20] But the recent transformation cases have highlighted the extent to which bankruptcy policy, rather than labor policy, prominently influences the application of section 1113.[21] In these cases, seeking relief from labor and benefit costs becomes closely identified with the principal aim of the restructuring case[22] 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

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[17] *See supra* notes 11, 12.

[18] *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.

[19] 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 Fight*, 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).

[20] *See infra* pp. 427–430.

[21] *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* Horsehead Indus., 300 B.R. 573, 585 (Bankr. S.D.N.Y. 2003) (emphasizing ultimate goal of section 1113 should be reorganization of debtor).

[22] *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.'"[23]

I. THE CODIFICATION OF LABOR POLICIES IN SECTION 1113

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

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

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[23] Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., 791 F.2d 1074, 1081 (3d Cir. 1986).

[24] The Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

[25] 465 U.S. 513 (1984).

[26] 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* Rufener 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, Int'l (*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).

[27] *Bildisco*, 465 U.S. at 521–23.

[28] *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.").

[29] *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]."[30] 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.*[31] 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."[32] 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.[33]

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.[34] 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."[35] 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."[36]

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.[37] 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.[38] 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

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[30] *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.").

[31] *REA Express*, 523 F.2d at 172.

[32] *Id.*

[33] *Bildisco*, 465 U.S. at 525.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] 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.*

[38] *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."[39]

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.[40] 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.'"[41]

Lobbying efforts by labor organizations intensified after the *Bildisco* decision.[42] 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*,[43] in which the Court ruled that the grant of authority to bankruptcy judges lacking the attributes of Article III judges was unconstitutional.[44] The *Marathon* decision was stayed to allow Congress to take corrective action.[45] The legislative solution to the *Marathon* issue thus became the vehicle for enacting Congress' response to *Bildisco*.[46]

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.[47]

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[39] *Id.* at 534.

[40] *Id.* at 535–54 (Brennan, J. dissenting).

[41] *Id.* at 553–54 (Brennan, J. dissenting) (citation omitted). *See id.* at 548 (noting central role of collective bargaining in conflict resolution).

[42] 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").

[43] 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).

[44] *Id.* at 87.

[45] *Id.* at 88.

[46] *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*).

[47] *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.[48] The Rodino proposal was incorporated into H.R. 5174, the omnibus bankruptcy bill passed by the House.[49] 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.[50] This proposal was "'reluctantly' accepted by the business community but rejected by labor."[51] 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 . . . ."[52]

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.[53] 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.[54]

(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.

[48] *See, e.g.*, Baxter, *supra* note 47, at 721; Charnov, *supra* note 46, at 946; Rosenberg, *supra* note 2, at 313.

[49] *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.

[50] *See* Charnov, *supra* note 46, at 950–51 (describing introduction of Thurmond amendment); Daniel S. Ehrenberg, *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).

[51] *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).

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

[53] *See* Baxter, *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).

[54] 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.[55]

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.[56] 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.[57] 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.[58] Specifically, the statute requires the submission

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[55] *See, e.g., In re Royal Composing Room*, 848 F.2d at 353 (Feinberg, J. dissenting) (describing current version as "tak[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").

[56] *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).

[57] 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)).

[58] 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[.]"[59] 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."[60] These requirements were incorporated to "place[ ] the primary focus on the private collective-bargaining process and not in the courts."[61]

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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.'").

[59] 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.

[60] 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.").

[61] 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."[62] 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.[63]

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).[64] Another provision permits the debtor to implement modifications unilaterally if the court fails to issue a decision in a

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[62] 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.").

[63] 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).

[64] 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.[65] Opponents of the labor provisions also opposed the application of the new law to pending cases.[66]

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."[67] Senator Packwood also expressed concern about these provisions but felt they would have only limited application.[68] 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).[69]

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.[70] 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.[71] This statutory test

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[65] 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).

[66] 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] . . . .").

[67] 130 CONG. REC. S8988 (daily ed. June 29, 1984) (statement of Sen. Kennedy).

[68] *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").

[69] *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").

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

[71] *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 Trasp., Inc., 816 F.2d 82, 89 (2d Cir. 1987).

reflects the incorporation of labor policies[72] and has been a key determinant in the outcome of a rejection motion.[73]

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.[74] 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."[75] 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,"[76] 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.'"[77] 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."[78] 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."[79] 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."[80]

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.[81] 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

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[72] *See supra*, notes 61, 62.

[73] 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).

[74] *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1082–84.

[75] *Id.* at 1086.

[76] *Id.* at 1089.

[77] *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).

[78] *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1081.

[79] *Id.* at 1089.

[80] *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").

[81] *Id.* at 1093.

the debtor's pessimistic projections.[82] 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."[83] 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."[84]

The Second Circuit Court of Appeals took up the "necessary" and "fair and equitable" standards in *Truck Drivers Local 807 v. Carey Transportation.*[85] 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.[86] 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.[87] 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.[88] 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."[89] In addition, the court compared the requirements of section 1113(b)(1) to the interim relief provision of section 1113(c) 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.[90] 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

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[82] *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.").

[83] *Id.*

[84] *Id.* at 1090–91 (critiquing district court's failure "to appreciate Congress' substantial modification of the standard for rejection").

[85] 816 F.2d 82 (2d Cir. 1987).

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

[87] *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).

[88] *Id.* at 88–90 (addressing "necessary" and "fair and equitable" language as separate elements of section 1113(b)(1)(A) standard).

[89] *Id.* at 89.

[90] *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."[91]

A year later in *Royal Composing Room*,[92] 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.[93] The majority opinion cited tactical considerations for this ruling.[94] 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."[95] 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."[96] 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.[97]

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

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[91] *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.*

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

[93] *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").

[94] *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'").

[95] *Id.* at 351 (Feinberg, J., dissenting).

[96] *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.").

[97] *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.[98] 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.[99] 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.[100]

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,[101] 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).[102] Labor policies were further weakened by the *Royal Composing* decision, where the court added a limitation on the union's bargaining options to an analysis of the "necessity" standard.[103]

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[98] *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").

[99] *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.").

[100] *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*").

[101] *See* Gilson, *supra* note 46, at 428–29 (observing that court's interpretation is based on plain language of statute).

[102] *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.").

[103] *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.[104]

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.[105] 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 . . . ."[106] The test applied by the court looked to "the long-term economic viability of the reorganized debtor . . . ."[107] 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.[108] 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.[109] 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."[110]

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

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

[105] *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).

[106] *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.")

[107] *Id. at* 477.

[108] *Id.* at 478.

[109] *Id.* at 488.

[110] *Id.*

'providing for the long-term rehabilitation of distressed businesses.'"[111] 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.[112] The carrier sought fixed six-year agreements with its unions and refused to negotiate a snap-back or reopener provision.[113] Mesaba's case was premised on attaining an 8% profit margin as a means of attracting exit financing.[114]

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."[115] 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.[116] 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."[117] 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.[118]

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 that the proposals on which the debtor based its litigation case. The aggregate savings was estimated by the debtor at less than 16%.[119] 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.[120] In defending the settlement, the debtor asserted that the resulting agreements were "consistent with the assumptions in the

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[111] Ass'n of Flight Attendants-CWA, v. Mesaba Aviation, Inc., 350 B.R. 435, 449 (D. Minn. 2006).

[112] *Id.* at 445.

[113] *Id.*

[114] *Id.*

[115] *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).

[116] *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").

[117] *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.

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

[119] *See Mesaba Aviation*, 350 B.R. at 443 (noting Mesaba's new agreement).

[120] *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."[121]

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.[122] 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,[123] 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.[124] 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.[125] 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,[126] 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

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[121] 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).

[122] *Mesaba Aviation*, 341 B.R. at 740–41.

[123] *Id.* at 741 n.64.

[124] *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.").

[125] *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).

[126] *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.[127] Unable to address these factors through bankruptcy, the airline debtors turned to substantial cost-cutting.[128] 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.[129] 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.

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[127] *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).

[128] *See supra*, note 12.

[129] *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

THE RETURN OF GOVERNMENT BY INJUNCTION IN AIRLINE BANKRUPTCIES

RICHARD M. SELTZER & THOMAS N. CIANTRA*

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."[1] In the Second Circuit's recent decision in *Northwest Airlines Corp. v. Association of Flight Attendants ("AFA")*,[2] 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.[3] Faced with a labor dispute triggered by Northwest's resort to contract rejection under section 1113 of the Bankruptcy Code,[4] 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.[5] 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.

[1] N. Sec. Co. v. United States, 193 U.S. 197, 364 (1904) (Holmes, J., dissenting).

[2] 483 F.3d 160 (2d Cir. 2007).

[3] *N. Sec. Co.*, 193 U.S. at 364. Certain bankruptcy commentators do not limit their rationale to 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 Bordewieck & 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).

[4] 11 U.S.C. § 1113 (2006).

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

impracticality,[6] 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"),[7] which governs labor relations in the air transport industry, the Norris LaGuardia Act ("NLGA"),[8] which limits federal jurisdiction to enter injunctive relief in labor disputes, and section 1113,[9] 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.[10] 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

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[6] 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 T.W.A. 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).

[7] 45 U.S.C. §§ 151–188 (2000).

[8] 29 U.S.C. §§ 101–115 (2000).

[9] 11 U.S.C. § 1113 (2006).

[10] 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 Disposals 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.[11] 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.[12]

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.[13] 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.[14] Under settled RLA law a union may therefore also strike when a carrier implements new terms before exhausting the RLA process.[15] Given the jurisdictional limits of the NLGA, and in the face of the

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[11] *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.").

[12] *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 . . . .").

[13] *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 § 113 are prohibited").

[14] *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.

[15] *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 *AFA*.

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.[16] Under the RLA, bargaining is purposefully long and drawn out—"virtually endless"[17]—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").[18] 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.[19] When the NMB concludes that further

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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.")

[16] 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. Ne. 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).

[17] 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").

[18] *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).

[19] *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.[20] 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).[21] At the conclusion of such further cooling-off period the parties may resort to self-help.[22] 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).

[20] *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); Nat'l R.R. Passenger Corp. v. Transp. Workers Union of Am., 373 F.3d 121, 124 (D.C. Cir. 2004).

[21] *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.

[22] *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.[23]

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.[24] 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.[25] 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.[26] 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.

[23] *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.").

[24] 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.

[25] 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).

[26] *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,[27] 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.[28] Agreements were reached with several smaller unions.[29] 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).[30]

Northwest continued to negotiate with ALPA, PFAA and the IAM after filing the section 1113(c) motion.[31] 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.[32] Northwest also reached tentative agreements with IAM, the last of which was ratified in July 2006.[33]

PFAA reached a tentative agreement with Northwest on March 1, 2005 subject to membership ratification.[34] The tentative agreement was turned down by a margin of four to one.[35] 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

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[27] *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).

[28] *Nw. Airlines*, 346 B.R. at 313–14.

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

[30] *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").

[31] *Id.* at 317–19.

[32] *Id.* at 318.

[33] *Id.*

[34] *Id.* at 317.

[35] *Id.* at 318 (indicating reasons for rejection were unclear).

days.[36] 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.[37] Immediately thereafter, in an attempt to reach a consensual agreement between the parties, AFA engaged in round-the-clock negotiations with Northwest.[38]

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.[39] 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."[40] 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.[41]

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.[42] In response, AFA gave Northwest notice of its intent to engage in self-help in 15 days.[43] AFA said it would use its trademarked CHAOS strategy,[44] 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.[45]

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[36] *Id.* at 315.

[37] *See In re* Representation of Employees of Nw. Airlines, Inc. Flight Attendants, 33 N.M.B. 289 (2006).

[38] *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).

[39] *Id.* at 336–337.

[40] *Id.*, 346 B.R. at 343. As noted *infra* p. 511, these findings were ignored on appeal.

[41] *Id.* at 337.

[42] *Id.*

[43] *Id.* at 336–37 (stating that the PFFA previously agreed to provide 15-day notice of its intent to take self-help and AFA honored that commitment).

[44] 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.

[45] 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.[46] While recognizing that the NLGA did not deprive it of jurisdiction to enjoin compliance with a "mandate" of the RLA,[47] the court concluded there was no such mandate here.[48] 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."[49]

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,[50] noting clear precedent holding that a contract is breached, not eliminated, when rejected in bankruptcy.[51] 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.*"),[52] did not support an injunction under section 2 (First) of the RLA.[53] In this respect the

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[46] *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.").

[47] *In re Nw. Airlines.*, 346 B.R. at 339.

[48] *Id.* at 344–45

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

[50] *See Aircraft Mechs. 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 Americandos, 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).

[51] *In re Nw. Airlines*, 346 B.R. at 340.

[52] 402 U.S. 570 (1971).

[53] *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."[54] 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."[55]

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"[56] 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."[57] 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.[58]

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.[59] Engaging in what it described as a "long and complex" analysis,[60] 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.[61]

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,"[62] 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")[63]), whether considered "individually or in tandem," was to prevent strikes.[64] The district court concluded that the RLA precluded a right to strike, and,

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[54] *Id.* at 343.
[55] *Id.* at 344.
[56] *Id.* at 337.
[57] *Id.*
[58] *Id.* at 344.
[59] 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).
[60] Nw. Airlines Corp. v. Ass'n of Flight Attendants (*In re* Nw. Airlines Corp.), 349 B.R. 338, 344 (S.D.N.Y. 2006).
[61] *Id.* at 384–85.
[62] *Id.* at 346.
[63] 29 U.S.C. §§ 101–115 (2006).
[64] *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.[65]

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."[66] After initial questioning the court ultimately appeared to accept this principle.[67] 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,[68] 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*,[69] which did not discuss the right to strike, the district court found RLA precedent inapplicable here.[70] 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.[71]

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]."[72] 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.[73]

Finally, in reviewing a party's obligations under section 2 (First) of the RLA to exert every reasonable effort to make and maintain agreements,[74] 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 . . . ."[75] 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).

[65] *In re Nw. Airlines*, 349 B.R. at 383–84.

[66] *Id.* at 359.

[67] *Id.*

[68] *Id.* at 360.

[69] 465 U.S. 513 (1984).

[70] *In re Nw. Airlines*, 349 B.R. at 362.

[71] *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.

[72] *Id.* at 368–70, 380.

[73] *Id.* at 369.

[74] *Id.* at 377–79.

[75] *Id.* at 382.

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

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,[78] and (4) self-help by the union was incompatible with its section 2 (First) duty.[79]

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.[80] 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."[81] 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

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[76] *Id.* at 377–79.

[77] *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").

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

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

[80] *Id.* at 170–73.

[81] *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,[82] and "the union would be correspondingly free to seek damages or strike . . . ."[83]

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.[84] 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.[85] The panel failed to explain how AFA could meet its duty other than by agreeing to Northwest's demands.[86]

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."[87] The Chief Judge found himself unable to "possibly explain" to the flight attendants the majority's reasoning.[88] 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.[89] 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).[90]

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

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[82] *In re Nw. Airlines*, 483 F.3d at 171.

[83] *Id.* at 172.

[84] *Id.* at 173–75.

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

[86] *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.

[87] *Id.* at 183 (Jacobs, D., concurring).

[88] *See id.* at 177.

[89] *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.

[90] *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.[91] 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.[92]

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.[93]

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,[94] a bankruptcy filing creates an estate which consists (with exceptions) of "all legal or equitable interests of the debtor in property."[95] The "fountainhead of U.S. executory contracts doctrine is largely a single English case"[96] decided in 1818, *Copeland v. Stephens*,[97] involving a suit over real property.

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[91] *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.").

[92] *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.").

[93] *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, L.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).

[94] 11 U.S.C. § 541(a) (2006).

[95] 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.

[96] 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.[98] 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.[99] Stephens argued that because he was no longer in privity of estate with Copeland he could not be held liable for the unpaid rent.[100]

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 . . . ."[101] Otherwise, the assignment was to remain in "suspension" unless and until the bankruptcy assignees accepted the lease.[102]

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.[103] 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.[104] This would permit the trustee in bankruptcy to assume economically advantageous agreements while declining to take on burdensome ones.[105]

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

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[97] 106 Eng. Rep. 218 (K.B. 1818).

[98] *Copeland*, 106 Eng. Rep. at 218.

[99] *Id.* at 218–19.

[100] *Id.*

[101] *Id.* at 222.

[102] *Id.* at 222–23.

[103] *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.

[104] *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).

[105] *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.").

[106] Andrew, *supra* note 93, at 858 ("Copeland's conceptual approach did not endure in England . . . .").

[107] *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* Houghton, 12 F. Cas. 584, 585 (D. Mass. 1871); *see also Journeay 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.[108] 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.[109] Courts responded by permitting assignees to exclude contracts and leases from the bankruptcy estate.[110] 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.[111] 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.[112] 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 . . . ."[113]

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."[114] 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 . . . ."[115] "Even though the trustee was charged with the ultimate duty to accept

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[108] *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*).

[109] *See* Andrew, *supra* note 93, at 860; Guynn, *supra* note 105, at 230.

[110] *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 . . . .").

[111] 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 [] the 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.").

[112] *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).

[113] 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).

[114] 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).

[115] 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."[116]

b. The Rule of Chicago Auditorium

In *Central Trust Co. v. Chicago Auditorium Ass'n*,[117] 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.[118] *Chicago Auditorium* involved a debtor who agreed to provide livery services to a hotel.[119] When the bankruptcy trustee declined to assume the agreement the hotel asserted a claim for breach of the agreement.[120] 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.[121] 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.[122]

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.[123] A creditor whose

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[116] 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).

[117] 240 U.S. 581 (1916).

[118] *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.").

[119] *Chicago Auditorium*, 240 U.S. at 586.

[120] *Id.* at 587.

[121] *Id.* at 591.

[122] *Id.* (citations omitted).

[123] *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.[124] 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.[125]

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 . . . ."[126] 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 . . . ."[127] 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 . . . ."[128]

Along with section 70(b), Congress implemented Bankruptcy Rule 607, requiring court approval for assumption of leases and executory contracts.[129] However, the rule did not expressly state whether the requirement applied to rejections, which led to much debate among court and commentators.[130] 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.").

[124] *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 . . . .").

[125] *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").

[126] Chandler Act of 1938, 75 Cong. Ch. 575, § 70(b), 52 Stat. 840, 880 (1938).

[127] Chandler Act of 1938, 75 Cong. Ch. 575, § 63(c), 52 Stat. 840, 874 (1938).

[128] Chandler Act of 1938, 75 Cong. Ch. 575, § 63(a)(9), 52 Stat. 840, 873 (1938).

[129] Fed. R. Bankr. P. 607 (1982) (repealed 1983).

[130] *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 aquatinted 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.[131] Other courts found that the text of the rule itself made clear that court approval was not required to reject a lease or contract.[132]

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.[133] 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.[134]

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."[135] 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[.]"[136] Not surprisingly, every court of appeals has held that rejection of an executory contract entitles the creditor to an unsecured claim against the estate.[137] As one prominent commentator notes, "[r]ejection does not . . . cause

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[131] *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.").

[132] *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) ("[T]hat 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.").

[133] *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); Guynn, *supra* note 105, at 231.

[134] H.R. Doc. No. 93-137 pt. I, at 198 (1973). *See* Guynn, *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).

[135] 11 U.S.C. § 365(a) (2006).

[136] 11 U.S.C. § 365(g) (2006).

[137] 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."[138]

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.[139] The decision in *NLRB v. Bildisco & Bildisco*[140] 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.[141] 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 Kopolow 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.S. § 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.")

[138] Andrew, *supra* note 93, at 888.

[139] *See* O'Neill v. Cont'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.").

[140] 465 U.S. 513 (1984).

[141] *See id.* at 523–26.

benefits or security provisions like seniority rights" under section 502(c) of the Code.[142]

3. Where in Section 1113 Does Rejection Become Abrogation?

The *AFA* 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.[143] 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."[144] 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,[145] it cited no authority for its suggestion.[146] As the First Circuit has concluded, Congress did not enact section 1113 to eliminate damages in

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[142] *Id.* at 530 n.12.

[143] Nw. Airlines Corp. v. Ass'n of Flight Attendants (*In re* Nw. Airlines Corp.), 483 F.3d 160, 166 (2d Cir. 2007).

[144] Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 563 (1990). *See* Dewsnup 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.").

[145] *In re Nw. Airlines*, 483 F.3d at 171–72.

[146] 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.[147] 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.[148]

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.[149] 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.[150] 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.[151] In so doing, Congress made clear

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[147] *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.").

[148] *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).

[149] 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).

[150] 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").

[151] *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.[152] 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.[153]

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.[154] 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]."[155] 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."[156]

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.[157]

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.[158] This is certainly how the Second Circuit understood

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[152] *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").

[153] *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").

[154] 11 U.S.C. § 365 (2006) (stating trustee's power, with bankruptcy court's permission, to reject executory contracts).

[155] 11 U.S.C. § 1113(a) (2006). *See* 11 U.S.C. § 1113(f) (2006).

[156] O'Neill v. Continental Airlines, Inc. (*In re* Continental Airlines, Inc.), 981 F.2d 1450, 1459 (5th Cir. 1993).

[157] *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).

[158] *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,"[159] a formulation followed in *Maxwell Newspapers*.[160] 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.[161] Similarly in *Royal Composing*, the court expressed hope for a negotiated agreement to "replace the rejected contract . . . ."[162] 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.[163] 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.[164] 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.[165]

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[159]Century Brass Prods., Inc. v. International Union *(In re* Century Brass Prods., Inc.), 795 F.2d 265, 272 (2d Cir. 1986).

[160] 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))).

[161] Truck Drivers Local 807 v. Carey Transp. Inc., 816 F.2d 82, 88 (2d Cir 1987).

[162] 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).

[163] *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.

[164] *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).

[165]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* ABRAM, *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.[166] 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[.][167]

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.[168] 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*,[169] 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.").

[166] *See In re* Nw. Airlines Corp., 346 B.R. 307 (Bankr. S.D.N.Y. 2006).

[167] 11 U.S.C. § 365(g)(1) (2006) (emphasis added).

[168] *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).

[169] 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.[170]

Other courts have reached the same result.[171] 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.[172] 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."[173]

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,"[174] Section 1113 has no provisions dealing with assumption.[175]

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 AIA 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.*[176]

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[170] *Id.* 137 F.3d at 798 (citation omitted).

[171] *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.").

[172] 144 B.R. at 78–79.

[173] *Id.* at 78.

[174] 11 U.S.C. § 1113(a).

[175] *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).

[176] *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.[177] 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.[178] Bankruptcy policy favors equality in treatment of creditors,[179] 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.

[177] 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 *AFA* 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.

[178] *Blue Diamond Coal*, 147 B.R. at 730. *See generally* Baxter, *supra* note 168.

[179] 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.[180]

As noted above, the Fourth Circuit subsequently reached this same conclusion in *Adventure Resources*.[181] *Blue Diamond Coal* was wrongly decided and the *AHA* majority's reliance on it misplaced.[182]

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*,[183] 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."[184] 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.[185] 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,[186] the portion of *Carey Transporation* recognizing rejection damages claims, albeit, as the concurrence

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[180] Baxter, *supra* note 168, at 729.

[181] Adventure Res. Inc. v. Holland, 137 F.3d 786, 797 (4th Cir. 1998).

[182] *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).

[183] Truck Drivers Local 807 v. Carey Transp. Inc., 816 F.2d 82 (2d Cir. 1987).

[184] *Id.* at 93.

[185] *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 . . . .").

[186] *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,[187] based on the mistaken belief that *Carey Transportation* involved issues under the RLA.[188]

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.[189] 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,[190] 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.[191] 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

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[187] *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.").

[188] *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[]." *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.").

[189] *See* Int'l Union v. Gatke 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).

[190] *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).

[191] 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 ("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.[192] 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.[193] 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.[194] That tool may be eaten away by the *AFA* decision.[195]

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."[196] 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.[197]

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,[198] Congress in the NLGA took the "extraordinary step of divesting the

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[192] United Retired Pilots Benefit Protection Ass'n v. United Airlines, Inc. (*In re* UAL Corp.), 443 F.3d 565, 568 (7th Cir. 2006).

[193] 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.

[194] *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.

[195] *See In re* Nw. Airlines, Inc., 366 B.R. 270, 276 (Bankr. S.D.N.Y. 2007) (sustaining objection to AFA's bankruptcy claims bases on holding of the panel majority).

[196] 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.

[197] *Compare* Int'l Union v. Gatke 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).

[198] 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.[199] The NLGA took "the federal courts out of the labor injunction business"[200] 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."[201] 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."[202] 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.[203] 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."[204]

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*."[205]

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.").

[199] Burlington N. R.R. Co. v. Bhd. of Maint. of Way Employes, 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 desireability [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.").

[200] Marine Cooks & Stewards, AFL v. Panama S.S. Co., 362 U.S. 365, 369 (1960).

[201] 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).

[202] United States v. Hutcheson, 312 U.S. 219, 232 (1941).

[203] *Burlington N.*, 481 U.S. at 434, 441–43.

[204] 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 It's 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).

[205] 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.[206] A debtor cannot both reject an executory contract and demand continued performance by the creditor.[207] 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 nation-wide strike of all railroads.[208] 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.[209] In sum, there is nothing in section 1113

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).

[206] *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.").

[207] *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. 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.").

[208] *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.").

[209] United Retired Pilots Benefit Protection Ass'n v. United Airlines, Inc. (*In re* UAL Corp.), 443 F.3d 565, 569–70 (7th Cir. 2006)]"*UAL I*"] (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.[210] 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.'"[211] 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."[212] 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.[213] 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").

[210] *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 mandated 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.").

[211] *Burlington N.*, 481 U.S. at 446 (quoting Int'l Ass'n of Machinists v. S. B. St., 367 U.S. 740, 773 (1961)).

[212] 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).

[213] *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,[214] 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).[215] 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.[216]

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.[217] 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."[218] *Shore Line* teaches that the major dispute process is "an *integrated, harmonious scheme* for preserving the status quo . . . ."[219] 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*,[220] 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).[221] 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").

[214] *In re Nw. Airlines*, 483 F.3d at 175 (stating that AFA had not yet fulfilled its duty to exhaust dispute resolution process).

[215] *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).

[216] The *AFA* majority faults the AFA 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.

[217] *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.").

[218] *In re Nw. Airlines*, 483 F.3d at 172.

[219] Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union, 396 U.S. 142, 152 (1969).

[220] Order of R.R. Telegraphers v. Chicago & N. W. R. Co., 362 U.S. 330 (1960) (*rehearing denied*).

[221] *Id.* at 359–60.

cannot be expected to hold back its economic weapons, including the strike."[222] 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.[223] Congress established in section 1113 a mandatory and exclusive process for rejection of a CBA.[224] "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."[225] 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 (e) (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

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[222] *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.").

[223] *See* Busic v. United States, 446 U.S. 398, 406 (1980); Greene v. United States, 79 F.3d 1348, 1355 (2d Cir. 1996).

[224] *See* ALPA v. Cont'l Airlines (*In re* Cont'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 113 "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.").

[225] *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).[226]

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.[227]

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 . . . ."[228] Under section 103(h), "Subchapter IV of chapter 11 of this title applies only in a case under such chapter concerning a railroad."[229]

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,"[230] 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 *AFA* decision is a 21st 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

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[226] *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).

[227] Detroit & Toledo Shore Line R.R. Co. v. United Transp. Union, 396 U.S. 142, 149 (1969).

[228] 11 U.S.C. § 1167 (2006).

[229] 11 U.S.C. § 103(h) (2006).

[230] *Shore Line*, 396 U.S. at 152.

decisions limiting the right to self-help prior to the negotiation of a first CBA.[231] 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.[232]

[231] Nw. Airlines Corp. v. Assoc. of Flight Attendants (*In re* Nw. Airlines Corp.), 483 F.3d 160, 173 (2d Cir. 2007).
[232] *See id.* at 164.

Ms. SÁNCHEZ. At this time, I would invite Mr. Migliore to please begin his testimony.

TESTIMONY OF MARCUS C. MIGLIORE, ESQUIRE, AIR LINE PILOTS ASSOCIATION, INTERNATIONAL, WASHINGTON, DC

Mr. MIGLIORE. Thank you, Madam Chair.

Good morning, Madam Chairwoman and Members of the Subcommittee. I am Marcus Migliore, managing attorney with the Air Line Pilots Association, International, a labor union representing 55,000 pilots who fly for 40 airlines in the United States and Canada.

The proposed legislation before the Subcommittee is urgently needed to restore balance and fairness to the 1113 process in bankruptcy which has been hijacked by employers who use the courts to assist in the rapid execution of workers' wages, working conditions and retirement benefits achieved over years of collective bargaining.

The one-sided nature of the pressure put upon workers under 1113 has prevented the parties from reaching superior negotiated solutions, contrary to the statute's intent. Instead, airline and other employees have been locked into long-term, harsh and unwarranted concessions going well beyond those needed for reorganization, while at the same time multi-million dollar payouts for the debtors' corporate executives have been routinely approved.

This legislation will stop these outrageous dictated abuses, ensure the concessions are necessary and proportionate to those of corporate executive and other stakeholders and restore balance on the issue of breach damages and the right to strike, thereby supporting superior negotiated solutions.

Pilots and employees of United, US Airways, Northwest, Delta, Comair and Mesaba have already seen their long-term wages and working conditions slashed through the 1113 process. Just this year, ATA, Kitty Hawk Air Cargo and Aloha pilots have been added to the growing list of airline employees caught in the vise of the bankruptcy process. And given the price of jet fuel, as Madam Chairwoman noted, there will very likely be more airline bankruptcies in the coming year. The bill before you is therefore more relevant and important than it ever has been.

Here are examples of why the legislation is urgently needed:

Pilots at United had their defined benefit pension plan terminated and were locked into a 7-year concessionary agreement. Pilots at both United and Northwest suffered wage cuts of approximately 40 percent and had working conditions reduced or eliminated. At the same time, the CEOs of both carriers were rewarded with huge salary increases, bonuses and stock options worth many millions of dollars.

A profitable Hawaiian Airlines used section 1113 to wrest employee concessions to improve its competitive position and profitability. This was after the pilots had previously made in the recent past pre-petition concessions to avoid the 1113 filing.

Comair used the 1113 process because the operation simply was not profitable enough for corporate parent Delta, which, at the same time, Delta was claiming to have plenty of money on hand to fight off US Airways and America West when they tried to take

over the airline. The Comair bankruptcy judge in fact ignored evidence that the company's demands for a 22 percent pay cut would qualify junior pilots for Federal welfare and food stamp assistance. He simply dismissed it on the basis it wasn't relevant to the economics.

However, the most extreme example of the one-sided nature of the current processes is in the Second Circuit's Northwest Airlines' decision. That decision allows management to reject with impunity binding collective bargaining and impose greatly reduced rates of pay and working conditions without having to face contractual breach damages from the employees or the possibilities of a responsive strike.

The Second Circuit justified this amazingly one-sided result under the theory that the labor agreement is not actually being breached but is being abrogated with judicial permission in 1113, ignoring the Supreme Court's view in Bildisco that rejection in bankruptcy is a breach. The Northwest court's holding represents a radical departure from existing law and leaves wronged employees with no recourse for a bankruptcy breach claim, while they remained under the threat of contempt if they ceased to work under the imposed conditions, unlike all other creditors who with rejected agreements are allowed to refuse to perform under the circumstances.

This decision will have lasting consequences as companies will file 1113 petitions in New York. Therefore, the standards of the Second Circuit will effectively govern most of the 1113 practice in this country.

Congress must overrule this decision with the proposed corrective legislation. The legal flaws of the Second Circuit's approach under the status quo provisions of the Railway Labor Act and the anti-strike injunction mandates of the Norris-LaGuardia Act are spelled out in my written testimony. However, I wish to emphasize here the practical import of this decision.

The willingness of the courts to enjoin a strike in response to management imposition of unilateral terms under section 1113 has taken away any incentive for airlines to negotiate in good faith rather than dictate terms to employees in bankruptcy, leaving employees powerless, chained to the railroad tracks as the 1113 Express bears down upon them.

By making it clear that a rejection is a breach of contract and that such a rejection can trigger a lawful strike, the bill will end the situation where the courts unfairly single workers out and restore them to the position that all other providers of services are under in the bankruptcy laws. Balance will be restored, and management will be forced to act responsibly and fairly in bankruptcy toward its employees and negotiate consensual solutions only if it is faced with a real possibility of a responsive strike.

In sum, Madam Chairwoman, while I also recognize that substantial economic sacrifices may be necessary and we have led the effort to save many airlines, the courts have moved the 1113 process far from where it was intended to be in 1984. The bill is proper restorative legislation that is urgently needed to fix the misinterpretation and abuse of the 1113 process that has taken place over the last 7 years. This Congress must act to protect employees from

unfair dictated sacrifices made while the corporate chieftains reap huge pay offs.

Madam Chairwoman, I appreciate very much the opportunity to testify here today; and I will be happy to answer any questions you or the Subcommittee may have.

Ms. SÁNCHEZ. Thank you very much for your testimony.

[The prepared statement of Mr. Migliore follows:]

PREPARED STATEMENT OF MARCUS C. MIGLIORE

Good morning Madame Chairwoman and members of the Subcommittee. I am Marcus Migliore, Managing Attorney with the Air Line Pilots Association, International ("ALPA"). ALPA represents 55,000 professional pilots who fly for 40 airlines in the United States and Canada. On behalf of our members and the hundreds of thousands of other airline employees whose lives have been turned upside down by the machinations of the bankruptcy process, I want to thank you for the opportunity to testify today about how ALPA's experiences in the bankruptcy courts show why the proposed legislation before this body—the Protecting Employees and Retirees in Business Bankruptcies Act—is urgently needed to restore balance and basic fairness for workers under the Bankruptcy Code.

Section 1113 of the Bankruptcy Code sets forth the procedures 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 Section 1113's enactment in 1984, the Supreme Court ruled in NLRB v. Bildisco, 465 U.S 513 (1984) that an employer could walk away from a binding collective bargaining agreement after a bankruptcy filing without first making any showing of need to reject the terms of the agreement. In response, Congress, at the urging of ALPA and other unions, acted swiftly to establish procedures in the Bankruptcy Code—the so-called 1113 process—to protect the rights of employees to prevent such harsh and unfair results. The 1113 process requires labor and management to bargain in good faith over concessions sought by the debtor. Under Section 1113, only after failure to reach a consensual agreement through such good faith bargaining and a determination by the court that the concessions are truly necessary to the survival of the employer can management impose dictated terms on its employees.

However, instead of safeguarding employees, the 1113 process has been hijacked by employers and is now used as a 51-day countdown to threaten a court-assisted execution of the long-term wage and working condition achievements of airline and other employees. The one-sided nature of the pressure brought through the swift 1113 process by employers has led to cataclysmic results for airline and other employees. These same employers have also used the bankruptcy process to rubber stamp multi-million dollar payouts for the corporate executives who led the carriers into these financial problems and who decimated the employees' working conditions.

Over the past seven years, the employee-protective purpose of Section 1113 has simply been gutted by bankruptcy and federal court judges overly sympathetic to debtor corporations. Airline managements, with the approval of the bankruptcy courts, have been able to easily achieve in case after case precisely the contract-destroying results that Congress originally sought to prevent in 1984. The courts have paid little heed to the mandates of Congress in Section 1113 to take into account the contract rights and personal financial security of employees called upon to sacrifice to help save their employers, essentially doing away with the required demonstration of the necessity of concessions limited in scope and time to those required to ensure the survival of the business.

Pilots and other employees of United, US Airways, Northwest, Delta, Comair and Mesaba have all seen their wages and working conditions slashed through the 1113 process, while corporate chieftains often received huge bonuses, blessed by the bankruptcy courts.

Just this year, ATA, Kitty Hawk Air Cargo, and Aloha pilots have been added to the growing list of airline employees caught in the vise of the bankruptcy process. Given the astronomical, continually rising price of jet fuel, and our weak economy, these airline employees almost certainly will not be the last to face this severe prob-

lem. There will very likely be more airline bankruptcies in the coming year, and the bill before you is therefore more relevant and important than ever.

Some of the most extreme examples of the one-sided nature of the current process are found in recent court decisions such as *Northwest Airlines v. AFA,* 483 F.3d 160 (2d Cir. 2007), a decision of the Second Circuit which allows management to reject with impunity binding collective bargaining agreements and impose greatly reduced rates of pay and working conditions without having to face contractual breach damages from workers. At the same time, the court prohibited those employees from withdrawing their services under those agreements, as other parties facing such rejection are routinely allowed to do under bankruptcy law. The corrective legislation before this Subcommittee is urgently needed to restore the original intent and purpose of Section 1113 to ensure that the impact of the bankruptcy process on honest and innocent workers is balanced and fair.

Because the 1113 process has been significantly eroded and undermined in the courts, broad restorative legislation is necessary. This bill properly attempts to restore the employee-protective purpose of the Section 1113 process by: (1) tightening the standards governing what concessions management may fairly ask for in required, good-faith negotiations with the employees' representative prior to being able to seek to reject their contractual obligations to workers, so that a breach of a collective bargaining agreement can be permitted only when truly necessary, and only to provide the employer with no more than is truly necessary to ensure the competitive survival of the business for a limited period of time; (2) ensuring fair treatment and equitable sacrifices from *both* executives and workers in the bankruptcy process so as to prevent further outrageous abuse by corporate officers lining their own pockets while their employees disproportionally sacrifice to help save the company; and (3) making it clear that employees have the right to strike and seek contract damages in response to a breach of their collective bargaining agreements if a consensual agreement between the parties cannot be reached and the contract is rejected. These clarifications are all desperately needed to restore balance to the 1113 process and to help foster superior, mutually acceptable labor-management solutions to bankruptcy crises through collective bargaining.

I will now describe in greater detail a number of examples of what has gone wrong from ALPA's recent experiences in the administration of the 1113 process in the courts, and illustrate how the bill before you will bring to an end the abuse of employees which has flourished in the current environment.

I. THE REFORMS TO 1113 IN THE BILL ARE NECESSARY TO STOP BANKRUPTCY COURTS FROM ALLOWING EMPLOYERS TO USE THE BANKRUPTCY PROCESS AS LEVERAGE TO GUT LABOR CONTRACTS ON A LONG-TERM BASIS WITHOUT REQUIRING EMPLOYERS TO SHOW THAT SUCH LASTING CONCESSIONS ARE NECESSARY OR PROPORTIONATE.

The courts, egged on by opportunistic employers, have progressively undermined the "necessity" standard for granting employer relief in Section 1113. Congress adopted this standard in 1113 to ensure that only those changes in working conditions that are truly "necessary to permit the reorganization" of the employer would be permitted. In practice, these limits have all but been ignored by both employers and the bankruptcy courts. The bankruptcy process has been used as leverage to simply jam long-term and draconian wage and benefit cuts down employees' throats. These scorched-earth tactics of using the short 51-day period in the current 1113 procedures to force extraction of protracted, multi-year concessions that are not truly necessary or otherwise achievable in consensual bargaining have led to widespread tension and resentment among airline employees, creating lasting damage to labor relations in a labor-intensive industry critical to the national economy.

ALPA's experience has shown that circumstances where consensual solutions have been reached by the parties have led to far superior outcomes for airlines, their employees and the flying public. Congress needs to take steps to restore support for consensual negotiations in such circumstances and to rein in employers from overreaching in bankruptcy.

ALPA has even 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. This was the case in the bankruptcy of Hawaiian Airlines, where 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. This scheme by Hawaiian was an outrageous abuse of the process.

Similarly, in the Comair bankruptcy, pilots were forced into Section 1113 litigation because the operation was simply deemed *not profitable enough* to its corporate parent, Delta, while at the same time Delta proclaimed that it had plenty of money on hand as a justification to creditors for fighting a hostile takeover attempt by America West/US Airways.

In the case of Delta Airlines, even after many months of litigation before the bankruptcy court, management continued to demand extreme concessions. Only after the establishment of a special neutral mediation-arbitration tribunal, which took the matter out of the hands of the bankruptcy court and had the power to make a binding determination of the dispute if the parties did not reach agreement, did management finally reduce its demands and, in response to ALPA's demands, offer the pilots a bankruptcy claim and corporate notes in exchange for substantial concessions. After a consensual agreement was reached on this basis, the Company completed its successful reorganization and returned to profitability. Section 1113(i) of the bill attempts to build off this demonstrated success at encouraging consensual solutions and would allow the bankruptcy court to appoint, at the request of the authorized representative, an expert arbitration panel versed in the industry as an alternative to court proceedings in 1113, and whose rulings would have the same effect as those of the bankruptcy court. This system would lead to a superior outcome for everyone.

Additionally, testimony at the hearings on Comair's Section 1113 motion established that the Company's demands for a 22% pay cut 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 economic terms. In fact, in his decision granting Comair's Section 1113 motion, the judge failed to take into consideration the impact the Company's 1113 proposal would have on the pilot group and its families. 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, even if they were no longer actually required for the survival of the business. After the federal district court agreed with ALPA that such overreaching amounted to bad-faith conduct and an abuse of the bargaining process, and subsequent consensual negotiations, the Company finally agreed to a contract that, while definitely concessionary, provided a significantly smaller, shorter-term pay cut that did not prevent the Company from successfully reorganizing under a plan that is expected to provide close to a 100% recovery for all creditors.

All of these circumstances show that the 1113 process as currently interpreted and applied by the bankruptcy courts does not impose effective limits on the "necessity" of employer concession demands, is open to employer abuse and grants inappropriate leverage for employers to wrest long-term, unwarranted concessions from employees. These examples also clearly show that consensual solutions to financial crises are superior to the imposed alternatives. The 1113 process today undercuts employees and undermines consensual, legitimate solutions to financial crises. Necessary modifications to that process must be enacted to correct these imbalances and foster superior consensual solutions. As we will explain, the bill before you does just that.

A. The Bill's Key Substantive 1113 Reforms

Section 8 of the bill makes a number of necessary changes to Section 1113 to ensure that workers are not forced to make unnecessary, unfair and overly-lengthy concessions. It requires that specific provisions and requirements be followed in order for an employer to obtain relief from a collective bargaining agreement. It retains the general principle that labor cost relief should be limited to the minimum necessary and not be disproportionately burdensome. The information-related requirements of the current statute remain, but added are specific standards and time limits for concession requests in the 1113 process designed to foster good-faith negotiated solutions and counteract open-ended, long-term labor cost relief that under today's system can be "locked in" by employers for an unreasonable period that well outlasts any justifiable need.

Subsection (b) of 1113 would be amended to require a clearly-defined, reasonable and time-limited "ask" for concessions on the part of the company, which must be made to the employees' authorized representative over a course of good-faith bar-

gaining that must be at reasonable times over a reasonable period before the debtor may apply to the court to reject an agreement.

In addition to requiring good-faith bargaining as a prerequisite to seeking court rejection of a labor agreement, Subsection b(1) would require the concessions to be: (1) limited to achieve a total aggregate financial contribution for the affected labor group for a period of up to two years after the effective date of the plan; (2) be no more than the minimal savings necessary to permit the debtor to exit bankruptcy such that the confirmation of the plan or reorganization is not likely to be followed by the debtor's liquidation; and (3) not overly burden the affected labor group in either the amount of savings sought from each group or the nature of the modifications, when compared to other constituent groups expected to maintain ongoing relationships with the debtor, including management personnel. In addition, Subsection (b)(2) would require that the proposal be based on the most complete and reliable relevant information available, which must be shared with the employees' representative.

The amendment to Section 1113(c) would tighten the standards for the court to approve the rejection of a collective bargaining agreement. As amended, Section 1113(c) provides that a debtor may file a motion seeking to reject a collective bargaining agreement if, after a period of good-faith negotiations, the debtor and the authorized representative have not reached agreement over mutually-satisfactory modifications and the parties are at an impasse.

Section 1113(c)(1) would further provide that a court may grant a rejection motion only if it finds that: (1) the debtor complied with the substantive requirements of Subsection 1113(b) (pertaining to the concession proposal for modification of the agreement); (2) the debtor has conferred in good faith with the authorized representative regarding such proposal and the parties were at an impasse; (3) the court has considered alternative proposals by the authorized representative and has determined that such proposals do not meet the substantive requirements for relief of up to two years duration, no more than is necessary for the employer to avoid liquidation and not be unduly burdensome compared to other stakeholders and management; and (4) further negotiations are not likely to produce a mutually satisfactory agreement. In addition, the court must first consider: (1) the effect of the proposed financial relief on the affected labor group; (2) the debtor's ability to retain an experienced and qualified workforce; and (3) the effect of a strike in the event that the collective bargaining agreement is rejected.

Amended Section 1113(c)(2) would require bankruptcy judges, in making their burden and proportionality analyses, to also take into account recent concessions made by employees within 24 months of a rejection petition, and to aggregate these recent concessions with any new ones made or demanded by the employer.

B. The Bill's Key Procedural 1113 Reforms

Employees are currently severely disadvantaged by the 51-day countdown to the rejection of collectively-bargained rights which begins after a debtor files an 1113 rejection motion. The bill amends Section 1113(d)(1) to require the court to schedule a hearing on such motion on not less than 21 days notice, unless the parties agree to a shorter period, and the amendment also deletes section 1113(d)(2), which now requires the court to rule on such motion within 30 days. The amendment also specifies that only the debtor and the authorized representative may appear and be heard at the rejection hearing. All of these improvements, taken together, will help lessen the timeline panic that management as well as other creditors now take advantage of in the current highly compressed process, and help foster reasonable consensual solutions instead.

New Section 1113(h) would also ensure that workers are not locked into concessions that once struggling but now profitable companies no longer need. It allows an authorized employee representative, at any time after the court enters an order authorizing rejection or upon reaching an agreement providing mutually satisfactory contract modifications, to apply to the court for an order increasing wages or benefits or providing relief from working conditions, based on changed circumstances. The court must grant such request as long as the increase or other relief is consistent with the standard set forth in Section 1113(b)(1)(B), pertaining to the minimal savings necessary to permit the debtor to exit bankruptcy without liquidating. New Section 1113(j) would allow for procedures for an employee representative to request that it be reimbursed for costs and fees associated with the 1113 process, after notice and hearing. This provision would, in our view, properly help incentivize employers to bargain in good faith for consensual solutions and motivate debtors to move quickly to reach negotiated solutions.

II. THE BILL ALSO WILL END THE CURRENT DOUBLE STANDARD UNDER CHAPTER 11: DEEP SACRIFICE FOR WORKERS, HUGE PAYOUTS FOR THOSE AT THE TOP.

The bill also provides urgently needed modifications to ensure that economic relief sought from employees not be disproportionate to the treatment of executives and other groups. These changes are required to restore basic fairness and credibility to the 1113 process. The current system has led to outrageous unfairness, with workers absorbing huge, long-term cuts in pay, work rules, 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. 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 rounds of Section 1113 litigation, and were locked into a nearly seven-year deeply concessionary agreement, saw the injustice of the United Board of Directors raising the pay of Chief Executive Glenn Tilton 40% just months later. This staggering increase is on top of stock grants to Mr. Tilton and other United executives worth in excess of $20 million, as well as stock options worth millions more, made as part of United's plan of reorganization.
- 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 $1.6 million in salary and bonus payments last year. The revelation that he will also be rewarded with more than $26 million in stock-related compensation over the next few years under a court-approved management equity plan further demonstrates the basic unfairness and abuse of the 1113 process.
- Pilots at Hawaiian Airlines faced demands for concessions despite a plan 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 bill properly requires the bankruptcy courts to ensure that concessions by employees are not disproportionate in light of the state of compensation provided to and concessions made by other employees and stakeholders during bankruptcy, including management. First, the bill applies a desperately needed "unfair burden" test in Section 1113(b)(1)(C) to determine whether the proposed modifications would overly burden the affected labor group compared to management or other stakeholders. This provision will help ensure that employees do not comparatively suffer while management, advisors and other are given large bonuses. Furthermore, Section 8(1) of the bill would amend Section 1113(c)(3) to require the court to presume that the debtor failed this undue burden test if the debtor implements a program of incentive pay, bonuses, or financial returns for insiders or the debtor's senior management during the pendency of the bankruptcy case, or within 6 months of the filing of the 1113 petition. ALPA believes that these provisions are absolutely necessary to stop any future court-assisted looting of employees by greedy executives and advisors so as to restore credibility and basic fairness—airline and other executives must be reined in from massively profiting as a result of their employees' misery in the 1113 process.

III. THE BILL WILL ALSO END THE BLATANT UNFAIRNESS OF AIRLINES BEING ALLOWED TO USE 1113 TO AVOID BINDING EMPLOYEE OBLIGATIONS WHILE BEING IMMUNIZED FROM EMPLOYEE SELF-HELP.

The last item I wish to highlight for the Subcommittee is what ALPA perceives as the most egregious of the many aspects of unfairness that exist in the court's administration of the current 1113 system. As I have explained, airlines have used the compressed timeline and largely unchecked judicial authority of the 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 employers have not stopped there, they have gone to the bankruptcy and federal courts and asked them to declare that (1) an 1113 rejection is not a compensable breach of contract for employees, and (2) employees do not have the right to respond to these fundamental

breaches of labor agreements by withholding their services, as other creditors whose agreements are rejected can do.

Employers have succeeded with the courts on both counts, requiring broad restorative legislation. Three bankruptcy courts, two federal district courts, and the Second Circuit Court of Appeals have ruled that under Section 1113, airline employees can be forced to accept the utter destruction of their fundamental rates of pay and working conditions in binding agreements by the bankruptcy process, but may not strike in response. In fact, a split panel of the Second Circuit in the *Northwest Airlines* case could only justify 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 wholly at odds with settled bankruptcy doctrine, and one that would leave wronged employees with no recourse for a bankruptcy breach claim, as other creditors are allowed.

We believe that under a proper reading of the mutual, status quo requirements of the Railway Labor Act, the law that governs airline employees, workers have a right to strike after a bankruptcy court grants an employer motion to reject the status quo—defining collective bargaining agreement under Section 1113 and imposes new inferior rates of pay, benefits, job security and/or working conditions. Further, under the Norris-LaGuardia Act, 29 U.S.C. ◆101 *et seq.* (which was enacted in the 1930's to generally preclude injunctions against strikes after egregious abuse in railroad reorganization cases), bankruptcy judges and U.S. District Court judges do not have jurisdiction to issue injunctions against lawful strike activity when management has acted unilaterally to destroy the contractual status quo and tear up a binding labor contract outside of the elaborate negotiations and mediation process mandated by the status quo provisions of Section 6 of the Railway Labor Act, 45 U.S.C. ◆156.

Additionally, from a practical perspective, the willingness of the courts to enjoin a strike in response to management imposition of unilateral terms under Section 1113 has taken away any incentive for airlines to negotiate in good faith rather than dictate terms in bankruptcy. The current situation leaves employees powerless, chained to the railroad tracks as the 1113 Express bears down on them. Airline employees are being singled out unfairly by being denied the right to take self-help and withhold future services after their contract is rejected and in the absence of a consensual agreement, which is a right that every other party to a rejected contract has under the current bankruptcy code. For example, aircraft lessors are free to stop performance of their agreement and take back their aircraft from the debtor airline upon rejection of their lease, but airline employees are, in the view of the Second Circuit and other courts, required to continue to perform under penalty of contempt and under judicially-dictated terms even though their binding labor agreements are rejected.

Given this blatantly unfair treatment of workers today under 1113, it is therefore essential that any reform legislation explicitly conclude that a rejection of a binding labor agreement is a compensable breach of contract and also preserve the right of employees to strike after a Section 1113 contract rejection. This bill does that. By making it clear that a rejection is a breach of contract and that such a rejection can trigger a lawful responsive strike, the bill will end the situation where the courts unfairly single workers out and restore workers to the position that all other providers of services are in under the bankruptcy laws—ensuring that they can attempt to collect damages for the employer's breach of their agreement, and be allowed to withhold services if their contracts with the debtor are rejected. New section 1113(g) would therefore restate what had been well understood before the *Northwest* case—that like rejection of other executory contracts in bankruptcy, the rejection of a collective bargaining agreement constitutes a breach of such agreement. It further provides that no claim for rejection damages may be limited by Section 502(b)(7). Section 1113(g) also establishes that an authorized representative may engage in economic self-help if the court grants a motion rejecting a collective bargaining agreement or the court authorizes interim changes pursuant to Section 1113(e) and that no provision of the Bankruptcy Code or of any Federal or State law may be construed to the contrary.

This provision is essential to restoring 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." *Brotherhood of Trainmen v. Chicago R & I. R.R.,* 353 U.S. 30, 40 (1957). 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 possibility of a responsive strike.

In sum, while ALPA recognizes that substantial economic sacrifices may be necessary by employees during severe economic disturbances, and 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 and one-sided process that is used to destroy workers' lives. ALPA believes the bill is proper restorative legislation that is urgently needed to fix the misinterpretation and abuse of the 1113 process that has taken place in the last seven years. All of these proposed changes to Section 1113 are necessary to ensure that the sacrifices extracted from employees are truly fair, reasonable and necessary. The Congress must act to restore the original intent of this legislation and protect employees from unfair, dictated sacrifices made while the corporate chieftans reap huge payoffs.

Madame Chairwoman, I appreciate the opportunity to testify here today, and I would be happy to answer any questions you have.

Ms. SÁNCHEZ. At this time, I would invite Mr. Bernstein to please proceed with his testimony.

TESTIMONY OF MICHAEL L. BERNSTEIN, ESQUIRE, ARNOLD & PORTER LLP, WASHINGTON, DC

Mr. BERNSTEIN. Good morning, Madam Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee. Thank you for inviting me to appear before your Subcommittee today.

I am a partner in the law firm of Arnold & Porter LLP and chairman of the firm's national bankruptcy and corporate restructuring practice group. However, I am appearing today at the invitation of the Committee in my individual capacity and not on behalf of my law firm or any of its clients.

Chapter 11 of the Bankruptcy Code is intended to enable financially troubled businesses to restructure their obligations and operations so that they are able to emerge as viable, going concerns. A debtor that achieves this objective benefits its creditors, its suppliers, its customers, its employees, its local community and other constituencies.

H.R. 3652 would modify many provisions of the Bankruptcy Code. Some of these modifications are difficult to reconcile with the fundamental goal of Chapter 11 and would be likely to impair the ability of Chapter 11 debtors to reorganize.

I want to make five points in this regard.

First, some of the proposed modifications in this bill would increase the cost of Chapter 11 reorganizations, including by creating substantial new administrative and priority expenses. Debtors that would be unable to pay such expenses would be forced to shut down and liquidate.

Second, the legislation would create additional hurdles for a business that needs to modify its labor and retiree costs in order to remain viable. It would do so in several ways. First, it would raise the already very stringent standard for obtaining 1113 or 1114 relief. Second, it would effectively preclude labor cost modifications where a debtor is paying incentive-based compensation to management even if such management compensation is at a market-competitive level. Third, it would slow down the court process. Fourth, it would allow unions to strike in retaliation for a debtor's implementation of court-approved modifications, even if such a strike would destroy the company. Finally, the bill would limit cost modification proposals to a 2-year period, which makes it much more

likely that the company would have to file bankruptcy again 2 years down the road. It would also prohibit creditors and other interested parties from even participating in the 1113 hearing. So the court would be precluded from even hearing their views, notwithstanding the fact that the outcome of the proceeding may have a profound impact on their recoveries.

If these provisions are implemented, it is almost certain that some Chapter 11 debtors who truly need to modify burdensome and above-market labor costs would be unable to do so. Such companies would be unable to attract new capital and instead would be forced to liquidate. 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 management employees. Managers with the skill necessary to navigate a company successfully through the Chapter 11 process are in great demand and tend to have many opportunities available to them. Indeed, competitors of a Chapter 11 debtor often see the bankruptcy filing as an opportunity to cherry-pick the best management talent from the debtor.

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. The 2005 amendments compounded this challenge by effectively precluding debtors from paying stay bonuses to management employees. The further restrictions in this proposed legislation would make it even more difficult for a Chapter 11 debtor to attract and retain management employees.

Several provisions in the bill would directly link the wages and benefits paid to managerial employees with the wages and benefits to hourly employees. While there may be a superficial appeal to this linkage, it fails on take into account the economic reality that there are different labor markets for different types of employees.

Fourth, certain of the proposed provisions would substitute inflexible, one-size-fits-all rules for judicial discretion that exists under existing law. For example, the bill would tax any asset sale that results in the termination of retiree benefits at the flat right of $25,000 per employee, regardless of the magnitude of the transaction or the magnitude of retiree benefits that are being lost and regardless of any other facts or circumstances. It would also limit 1113 relief in all cases to 2 years of cost savings, regardless of the actual cost savings that would be necessary to attract investment capital which would merge as a viable company.

In any case, where there are competing plans of reorganization proposed, it would require the court automatically to favor the one that benefits employees, regardless of the merits of the plans or the impact they may have on any other constituency in the case.

Because each company and each industry in 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, the proposed provisions would create potentially substantial new priority claims, including a new and apparently un-

limited priority claim for diminution in the value of debtor stock in the defined contribution plan. Viewed in isolation these new priority claims may not seem particularly problematic. However, in evaluating the extent to which such priority 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 for companies to reorganize. Second, the new employee priorities will leave less money for the holders of other types of claims. Thus, while it may be appealing to say we are giving greater priority to employee claims, it is important to keep in mind that by doing so you are likely to be diminishing the recovery of other types of creditors such as, for example, taxing authorities, trade creditors, individual customers or tort victims injured by a debtor's products.

In conclusion, 30 years ago when it enacted the Bankruptcy Code, Congress observed that the goal of Chapter 11 would promote reorganization because it was the best way to maximize value for creditors and preserve jobs. Over 30 years of Chapter 11 history, this has proven to be true.

If H.R. 3652 is enacted, it will make reorganization more difficult to achieve, particularly for companies that have substantial labor forces and substantial labor costs. The likely result will be that more companies end up in liquidation. This will be damaging to all stakeholders including employees, and it is inconsistent with the purpose of Chapter 11.

Ms. SÁNCHEZ. Thank you very much.

[The prepared statement of Mr. Bernstein follows:]

PREPARED STATEMENT OF MICHAEL L. BERNSTEIN

Madam Chairman Sμnchez, Ranking Member Cannon, and members of the Subcommittee, thank you for inviting me to testify at your hearing on H.R. 3652, the *"Protecting Employees and Retirees in Business Bankruptcies Act of 2007."* My name is Michael Bernstein. I am a partner in the law firm of Arnold & Porter LLP and the chair of the firm's national bankruptcy and corporate restructuring practice.[1] 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 have also written various books and articles. For example, I am co-author of *Bankruptcy in Practice,* a comprehensive treatise on bankruptcy law and practice published by the American Bankruptcy Institute.

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. 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, from hourly workers to administrative and clerical employees, to mid-level management and senior executives.

H.R. 3652, the *"Protecting Employees and Retires in Business Bankruptcies Act of 2007,"* would modify many provisions of the Bankruptcy Code. Some of these modifications are difficult to reconcile with the fundamental goals of chapter 11, and would be likely to impair the ability of chapter 11 debtors to reorganize.

[1] 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.

First, some of these proposed modifications would increase the already substantial cost of chapter 11, making reorganization more difficult to achieve.

Second, certain of the proposed modifications 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 labor costs is precluded from doing so, it will likely be unable to attract new capital and unable to reorganize. This is detrimental to all constituencies, 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 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 talent. The 2005 modifications to the Bankruptcy Code, as part of the *Bankruptcy Abuse and Prevention and Consumer Protection Act of 2005* (BAPCPA), compounded this problem by effectively precluding debtors from paying "stay 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. 3652 would make it materially more difficult for a chapter 11 debtor to attract and retain managerial employees.

Several provisions in the bill would link, in a direct way, 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 must 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, some of the proposed provisions would create potentially substantial new 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, or perhaps impossible, for some 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 benefits claims," it is important to keep in mind that, by doing so, you are likely to be diminishing the recovery of other types of creditors, such as taxing authorities, trade vendors, customers, or tort victims.

I will now address some specific provisions of the proposed legislation, and point out some of the consequences that I believe would be likely to result if these provisions were enacted.

SECTIONS 3-5: *Priorities*

These provisions would increase the existing wage priority and create new types of priority claims, including a priority for diminution in the value of equity securities in a defined contribution plan,[2] and an administrative expense priority for severance pay. Some of these new priority claims could be substantial, and would have to be paid in full in order for a debtor to confirm a plan of reorganization and

[2] This would turn what is now an equity interest into a claim, and then give that claim priority over general unsecured claims as well as certain other priority claims.

emerge from bankruptcy. If these new priorities are established, there are likely to be some cases in which the debtor will not be able to confirm a reorganization plan because it will not be able to pay its priority claims in full. Instead, these debtors would be forced to liquidate.

In addition, as I noted above, claim priorities pit one creditor group against another. The new proposed employee priorities will, except in those relatively rare cases in which there is enough money to pay all claims in full (in which case the priorities are largely irrelevant), diminish or 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.

SECTIONS 6 AND 7: *Limitations on Executive Compensation*

These sections of the bill would make it substantially more difficult for a debtor to pay bonus or other incentive-based compensation to management employees. By doing so, it will make it more difficult for chapter 11 debtors to attract and retain management talent. The job of managing a debtor through the chapter 11 process is quite challenging and requires substantial skill. The people who can do this job well tend to be in great demand, and have many opportunities. 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.[3] If debtors are precluded from paying market-competitive compensation, including incentive and bonus compensation, their best managers are likely to find alternative employment, thereby imperiling the debtor's reorganization efforts.

The requirement in section 6 of the bill (relating to compensation upon emergence) and section 7 of the bill (relating to compensation during the chapter 11 case) that management compensation be "not disproportionate in light of economic concessions by the debtor's nonmanagement workforce during the case" could be problematic, depending on how it is interpreted. If it is interpreted to mean that hourly workers should not be paid materially below market while management is paid materially above market, that would be reasonable and should not unduly interfere with the reorganization process. However, if this provision were interpreted to preclude a debtor that has obtained labor cost reductions through the § 1113 or § 1114 process, or through negotiations, from paying market-competitive wages and benefits (including incentive compensation) to management employees, that would be problematic because it would essentially punish management for undertaking difficult but necessary cost-cutting measures, and would interfere with the debtor's ability to retain management employees.

SECTION 8: *Rejection of Collective Bargaining Agreements*

Section 1113 of the Bankruptcy Code deals with the modification and rejection of collective bargaining agreements. Unlike other contracts that can be rejected by a debtor if doing so is found to be a reasonable exercise of the debtor's business judgment, the rejection of a collective bargaining agreement is evaluated using a far more stringent standard.[4] In order to reject a collective bargaining agreement under present law:

(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;

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[3] This is true not only because bonus and incentive compensation is a typical component of executive pay, but also because, unlike their competitors, debtors ordinarily cannot offer their management employees compensation in the form of equity (stock or options), since equity is most often out-of-the-money.

[4] *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.").

(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.[5]

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.[6]

The additional requirements in the proposed bill would make it more difficult to modify or reject a collective bargaining agreement. For example, under existing law any proposed modifications must be "necessary to permit the reorganization of the debtor." In *Truck Drivers Local 807 v. Carey Transp. 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 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."[7] The proposed bill, among other things, would replace "necessary to permit the reorganization" with "no more than the minimal savings necessary to permit the debtor to exit bankruptcy, such that confirmation of such plan is not likely to be followed by the liquidation of the debtor or any successor to the debtor." Depending on how it is interpreted, this standard might be nearly impossible to satisfy. It may 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. The "necessary" standard under present law is sufficient to assure that modifications are achieved only where they are needed in order for the debtor to reorganize and emerge as a viable enterprise. A more stringent standard would be likely to impede successful reorganizations. The more stringent standard would also be likely to reduce the number of negotiated resolutions because, if the rejection standard is nearly impossible to satisfy, the unions will have great leverage and therefore less incentive to negotiate. Such a change in the standard could upset the delicate balance that exists under present law, which in the vast majority of cases has resulted in negotiated rather than litigated resolutions.

The bill would also amend § 1113(d) to slow down the § 1113 process. This provision is not in any constituency's interest. Resolution of § 1113 issues is often a prerequisite to obtaining commitments for new investments or exit financing and negotiating and implementing a plan of reorganization. As a general matter, the faster this can be achieved, the lower the costs of chapter 11 and the greater the debtor's prospects for success. Thus, slowing down the § 1113 process would be counterproductive. The bill would also prohibit creditors and other interested parties from

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[5] 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. 884 (B.A.P. 8th Cir. 2001).

[6] *See, e.g., 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 (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 (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 (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.").

[7] *But 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).

participating in a § 1113 hearing, even though their recoveries could be substantially affected by the outcome.

The proposed legislation would also add a requirement that the debtor's proposal "not overly burden the affected labor group, either in the amount of savings sought from such group or the nature of the modifications, when compared to other constituent groups expected to maintain ongoing relationships with the debtor, including management personnel," and would create a presumption that a debtor who implemented any incentive compensation or similar plan for management employees during the case or within 180 days before the filing fails to satisfy this requirement. 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. Seeking to create some sort of more precise equivalence between the treatment of hourly employees and other constituencies, without regard to market factors, would be counterproductive. The guiding principal should not be that every group must take the exact 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 the resulting overall cost structure should be manageable for the debtor.

In addition to the foregoing modifications, the proposed bill would add six new provisions to § 1113. Some of these provisions would likely undermine the purpose of chapter 11 or make reorganization significantly more costly. For example, proposed § 1113(g) would 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.[8] If a labor union, after the court finds that it unjustifiably refused to accept a fair and equitable modification proposal that is necessary for the debtor's reorganization, and therefore grants § 1113 relief, is able to torpedo the 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 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.[9]

Another newly proposed section, § 1113(j), would require a debtor to pay the union's fees and expenses. Chapter 11 is already quite expensive, and this would create an additional administrative burden, to the detriment of creditors and other constituencies.

Finally, the bill would preclude a debtor from making a § 1113 proposal that would achieve cost savings for more than a two-year period. This is a particularly short-sighted provision. A chapter 11 debtor should restructure its costs and obligations in a manner calculated to make it economically viable for the foreseeable future, not only for two years. If a debtor were to look only two years in the future, the probable result would be repeat bankruptcy filings.[10] As noted in the *CRS Report for Congress,* "limiting the duration of modifications to a CBA may limit the debtor's ability to successfully reorganize."[11]

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[8] Similarly, proposed § 1113(c)(1)(D)(iii) would require the court to consider the threat of a strike by a union in evaluating whether to grant relief to the debtor in the first place. In my opinion, this provision would be a mistake. A union should not, by threatening to strike, be able to compel a court to deny relief that is necessary for a successful reorganization. This would give the union too much leverage, to the detriment not only of the debtor, but also all of its creditors and other stakeholders who would benefit from a reorganization.

[9] Under existing law, courts have suggested that in cases governed by the National Labor Relations Act 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 NLGA's protection of right to strike); *see also Northwest Airlines Corp. v. Assn. of Flight Attendants—CWA, AFL—CIO (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 Railway Labor Act (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.

[10] This would be inconsistent with § 1129(a)(11), which requires that, in order to confirm a chapter 11 plan, a debtor must show that it is not likely to be followed by the subsequent need for further restructuring or liquidation.

[11] The Report further provides that: "Modifications that can, in just two years, provide significant economic relief for the company's survival may necessarily require economic concessions that are too burdensome to be acceptable because of the effect on paychecks is too great. Conversely, modifications that last no more than two years but also have a smaller effect on pay-

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SECTION 9: *Payment of Insurance Benefits to Retired Employees*

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 previously with regard to § 1113. Current law is sufficient to guard against any modification in retiree benefits other than in those cases where such modification is essential for the company to be able to reorganize and emerge from bankruptcy.

SECTION 10: *Protection of Employee Benefits in a Sale of Assets*

This section would impose a flat $20,000 per retiree charge upon all § 363 sales that result in a cessation of retiree benefits. This flat charge apparently does not take into consideration the value of the transaction, the number of retirees, or the magnitude of lost benefits. Indeed, in some cases $20,000 per retiree could be greater than the entire value of the asset sale transaction, rendering the sale impossible to consummate even if it were the best transaction available to the bankruptcy estate and its creditors. This is an example of an attempt to create a one-size-fits-all rule without regard to the facts of a particular case.[12]

SECTION 13: *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.

The proposed modifications to § 506 would treat postpetition wages and other benefits as necessary costs and expenses, for surcharge purposes, regardless of any waiver of the surcharge right. The proposed modifications to § 506 are likely to decrease the availability, and increase the cost, of secured credit, including postpetition financing. Particularly in a tight credit environment, such as we are currently facing, this surcharge provision could be problematic for companies seeking secured financing.

SECTION 14: *Preservation of Jobs and Benefits*

This provision would mandate that in a situation where competing chapter 11 plans were proposed, the court must confirm the plan that better serves the interests of retirees and employees. It seems reasonable for a court to consider the interests of retirees and employees in evaluating which competing plan to confirm. However, to consider only the interests of employees and retirees, while ignoring the interests of creditors and other constituencies, would be inconsistent with the approach historically taken in chapter 11 cases, which is to take into account and balance the interests of all stakeholders.[13]

SECTION 15: *Assumption of Executive Retirement Plans*

Section 15 would preclude a debtor from assuming a management deferred compensation plan if the debtor has terminated its defined benefit plans during or within 180 days prior to bankruptcy. There are many cases in which it is necessary to terminate a defined benefit plan in order for a company to be able to remain a viable going concern. Under these circumstances, termination of the plan is consistent with the fiduciary duty of officers and directors. This provision would punish man-

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checks may not provide sufficient economic relief to allow the debtor company to survive, effectively forcing the company into liquidation." *See* C. Pettit, *CRS Report for Congress,* Rejection of Collective Bargaining Agreements in Chapter 11 Bankruptcies: Legal Analysis of Changes to 11 U.S.C. Section 1113 Proposed in H.R. 3652—The Protecting Employees and Retirees in Business Bankruptcies Act of 2007, at CRS-5 (May 9, 2008).

[12] This provision also does not address the situation in which the assets sold are subject to a lien securing a debt that is greater than the sale proceeds, meaning that there are no unencumbered proceeds. The intent may be, in this situation, that the $20,000 per retiree would be a forced "carve-out" from the secured lender's lien. This would likely have implications for the availability and pricing of secured credit to companies that have retiree medical obligations.

[13] As a hypothetical, if two plans were proposed, one of which would not require any job cuts while the second would require cutting five percent of the workforce, but the second plan would result in an 80% recovery to creditors rather than a 10% recovery under the first plan, it would be more equitable to consider the interests of creditors as well as employees, rather than to consider only the interests of employees and ignore the interests of creditors.

agement 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 two 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 16: *Recovery of Executive Compensation*

This provision would 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. This provision apparently seeks to create a disincentive for a company to seek to modify collective bargaining agreements or retiree benefits by threatening the personal compensation of some of the 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. Where such circumstances exist, and yet the negotiation process has failed to generate an agreement, 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, and the 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.

In enacting chapter 11, Congress observed that , "[i]t is more economically efficient to reorganize than liquidate, because it preserves jobs and assets." H. Rep. 95–595, 95th Cong.,1st Sess. 220 (1977). 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 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. 3652 is likely to impede chapter 11 reorganizations. It will increase costs. It will make attracting and retaining talented management much more difficult. It will 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 will make financing less available and, where available, more expensive. And it will, 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.

Ms. SÁNCHEZ. At this time, I would invite Ms. Friedman to please begin her testimony.

TESTIMONY OF KAREN FRIEDMAN, ESQUIRE, PENSION RIGHTS CENTER, WASHINGTON, DC

Ms. FRIEDMAN. Madam Chairwoman, Ranking Member Cannon and Members of the Subcommittee, thank you for the opportunity

on testify today. I am Karen Friedman, the policy director of the Pension Rights Center; and we are the only consumer rights group in the country that works exclusively to promote and protect the pension rights of workers, retirees and their families.

In today's economic environment, where companies are restructuring, cutting back benefits, it is more important than ever to provide strong safeguards for American families. I am going to focus my comments today on the important pension protections in the Protecting Employees and Retirees in Business Bankruptcy bill, H.R. 3652.

The bill will provide critical retirement protections to employees and retirees when their companies go bankrupt. While companies once used bankruptcy proceedings only when they were truly in trouble as a tool of last resort, they now commonly view bankruptcy as a viable business strategy that allows them to unfairly eliminate long-standing pension obligations to their workers and retirees.

United Airlines is a case study of how a giant corporation used the bankruptcy system to shed billions of dollars in pension obligations with devastating consequences for tens of thousands of American families. By going into bankruptcy, United was able to transfer its pension liabilities to the PBGC, which, as you know, is the Federal private pension insurance program. United then paid its creditors. It gave multimillion dollar pay packages to its executives, and it emerged profitable from bankruptcy. But who were the losers? The hard-working middle-class flight attendants, the mechanics, the ticket agents, the pilots and other airline employees whose pensions were reduced by $2 billion collectively.

This corporate strategy is the subject of Fran Hawthorne's new book called Pension Dumping, which traces how companies have moved from honoring pension promises as sacrosanct to viewing them as a burden to eliminate.

The PBGC was created as a backstop to protect workers' pensions when a company goes belly up. The agency ensures that those who spent a lifetime working for a company would not lose their retirement security. And the majority of workers and retirees in terminated plans will indeed get all of the benefits owed to them. And this is a great part of the PBGC. But there are limits on how much the PBGC can guarantee. The agency does not insure all the benefits workers are promised. For instance, it does not guarantee certain subsidized early retirement benefits or benefits improvements made within 5 years of a plan's termination. These are benefits that were earned in exchange for other compensation. In addition, shutdown benefits are now only partially guarantied.

H.R. 3652 recognizes that many individuals are left without recourse when the PBGC pays them only partial benefits. The bill would enable active workers and retirees whose benefits are not fully insured by the PBGC to file a claim in bankruptcy court for the full amount they earned. Under current law, individual workers and retirees are precluded from making such a claim for the difference between what the PBGC provides and what the plan had promised.

This provision will make a world of difference to employees across the country who give up wage increases for the promise of

a full pension. When the pension plan is terminated through no fault of their own, employees experience, in essence, a retroactive pay cut, losing benefits they earned and can never ever get back.

H.R. 3652 also includes provisions to ensure that executives cannot enrich themselves while employees suffer benefit cuts in bankruptcy. The bill provides that if an employer terminates a plan, the executive compensation arrangements have to be terminated as well. The provision would put an end to such an unfair situation such as when Glen Tilton paid himself over $25 million in executive compensation after the company's restructuring.

Finally, the bill provides important protections to employees in 401(k) plans. At a time when defined benefit plans are being replaced by do-it-yourself savings plans, employees need to know that their money is protected. H.R. 3652 provides individuals with a new priority claim in bankruptcy court when the value of their company stock in a 401(k) plummets because of corporate misdeeds or fraud.

Enron is the most notorious example of such corporate abuse. The ending of that story is well-known. Thousands and thousands of workers lost their retirement money because they were misled by Enron executives. And who better to have a claim for their money? But while the Enron collapse may have occurred 6 years ago, its lessons are still valid and similar situations could happen today.

In closing, we thank the Subcommittee for holding this hearing on this important bill and taking steps toward protecting American workers and their families' retirement security.

I will be happy to answer any questions.

Ms. SÁNCHEZ. Thank you for your testimony.

[The prepared statement of Ms. Friedman follows:]

PREPARED STATEMENT OF KAREN FRIEDMAN

Madame Chairwoman, Members of the Subcommittee, thank you for the opportunity to testify today. I am Karen Friedman, Policy Director of the Pension Rights Center, a 32-year-old consumer rights organization dedicated to promoting and protecting the retirement security of workers, retirees, and their families.

In today's economic environment, where increasingly companies are restructuring and cutting benefits, it is more important than ever to provide strong safeguards for American families. I will focus my comments today on how corporate practices are affecting employees' and retirees' retirement security and discuss the important pension protections included in the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007," (H.R. 3652).

H.R. 3652 will provide critical retirement protections to employees and retirees when their companies fail or restructure under the bankruptcy code. While companies once used bankruptcy proceedings only when they were truly in trouble, as a tool of last resort, they now commonly view bankruptcies as a viable business strategy that allows them to unfairly eliminate long-standing pension obligations to their workers and retirees.

United Airlines is a case study of how a giant corporation used the bankruptcy system to shed billions of dollars in pension obligations—leading to devastating and irreversible losses to tens of thousands of American families. By going into bankruptcy, United was able to transfer its pension liabilities to the Pension Benefit Guaranty Corporation (PBGC), the federal private pension insurance program. United then paid off its creditors, gave multimillion-dollar pay packages to its executives, and emerged profitable from bankruptcy. The losers were the hard-working middle-class flight attendants, mechanics, ticket agents, pilots, and other airline employees, whose pensions were reduced by $2 billion.

This corporate strategy is the subject of Fran Hawthorne's new book *Pension Dumping,* which traces how companies have moved from honoring pension promises

as "sacrosanct, stronger perhaps than any other business contract," to viewing them as a burden they want to eliminate.

Hawthorne says that even companies that are reluctant to cut benefits are often forced to terminate the plan by so-called "vulture investors," who will only provide financing to a company if the pension obligations disappear.

While some of these companies emerge financially healthy—at least in the short-term—the workers and retirees often lose hundreds of thousands of dollars of the earned benefits that they were relying on to make it through retirement. In short, pension dumping is a short-term strategy with devastating long-term consequences.

The PBGC was created as a backstop to protect workers' pensions when companies go belly-up, in order to ensure that those who spent a lifetime working for a company would not lose their retirement security. And the majority of participants in terminated plans will, indeed, get all the benefits owed to them. But there are limitations created by Congress on how much the PBGC can guarantee. For instance, the PBGC pays a maximum age-65 benefit of $4,312.50 per month (or $51,750 annually) for plans terminated in 2008. This amount is adjusted for inflation every year. The agency, however, does not insure all the benefits on which workers' rely. The PBGC does not guarantee certain subsidized early retirement benefits or fully insure benefit improvements made within five years of a plan's termination, benefits that were gained in lieu of other compensation. In addition, under the most recent amendments to federal law, shutdown benefits, negotiated by unions, are now only partially guaranteed if the shutdown occurs within five years of the plan termination.

H.R. 3652 recognizes that many individuals are left without recourse when the PBGC only pays them partial benefits. This bill would enable active workers and retirees whose benefits are not fully insured by the PBGC to file a claim against the plan sponsor in bankruptcy court for the full amount they earned. Under current law, individual workers and retirees are precluded from making such a claim for the difference between what the PBGC provides and what the plan had promised.

This reasonable provision will make a world of difference to employees in hundreds of corporations and industries across the country, employees who meet their end of the bargain by working throughout their career with the promise of getting a pension based on all their years of work. Employees give up wage increases in exchange for the company contributing to the defined benefit pension plan on their behalf. When the pension plan is terminated—through no fault of their own—employees, in essence, experience a retroactive pay cut, losing benefits they earned and can never get back. And unlike other creditors who know they are taking risks in lending money to a corporation, workers—at least in the past—assumed their money was safe in the pension plan.

H.R. 3652 also includes provisions to ensure that executives cannot enrich themselves while employees suffer benefit cuts. The bill fairly provides that if an employer terminates a plan, the executive compensation arrangements must be discontinued as well. This provision would put an end to such unfair situations as when United CEO Glen Tilton, after the restructuring, paid himself $4.5 million in pension and other benefits—an astounding $25 million worth of stock and $6 million in stock options—not to mention his more than $3 million in salary and bonuses.[1] It is unjustifiable for executives to pay themselves lavish compensation packages while terminating their employees' pension plan as well as reducing their salaries and other benefits.

Finally, the bill provides important protections to employees in 401(k) plans. At a time when defined benefit plans are being replaced by do-it-yourself savings plans, employees need to know that their money is protected. H.R. 3652 provides individuals with a new priority claim in bankruptcy court when the value of their company stock in a 401 (k) plan plummets because of corporate misdeeds or fraud. Enron is the most notorious example of such corporate abuse. Although Enron executives Ken Lay and Jeffrey Skilling were well aware the company was tanking, they persuaded their employees to continue to invest their 401(k) money in Enron stock—at the same time they were selling their own company stock. The ending of that sad story is well-known, as thousands of workers lost all their retirement money. But while the Enron collapse may have occurred six years ago, its lessons are still valid. Employees still are permitted to invest all their 401(k) money in company stock. If company executives breach their fiduciary duty by misleading individuals as to the value of that stock, then employees should have their day in court.

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[1] Hawthorne, Fran, *Pension Dumping: the Reasons, the Wreckage, the Stakes for Wall Street,* pp. 143–144 (2008)

The Pension Rights Center thanks the Subcommittee for holding a hearing on this important bill that takes some important steps towards protecting American workers' and their families' retirement security. This bill recognizes that workers have upheld their end of their bargain—giving their labor and loyalty to companies—and at the very least they should have their day in court to protect what they have earned.

Ms. SÁNCHEZ. We are now going to begin our first round of questioning; and I believe our Chairman, who has another hearing, must leave, so I am going to allow him the opportunity to question first.

Mr. CONYERS. Is it okay with Mel Watt if I go first?

Ms. SÁNCHEZ. Sure. I am sure Mr. Watt has no objection.

Mr. WATT. If she lets me go second.

Mr. CANNON. Which I have no objection.

Ms. SÁNCHEZ. Mr. Conyers, you are recognized if you like.

Mr. CONYERS. Thanks so much.

Look, there isn't much secret about this. I only wish we had more people like Mr. Bernstein who we can talk to about this.

For your homework, I want you to read all of your fellow panelists' statements and then report back to me and Chris Cannon and we will give you a—it won't be part of your final grade, but we will test you out on this.

Because you are not representing your company or your clients. This is you talking to us. And so we want to try to sort our way through this in a reasonable way.

I mean, workers are getting screwed big-time, massively. We have got 51 sponsors of this, more than half a dozen in the Senate. Everybody is clamoring for this legislation to get some kind of reasonable control.

So, Mr. Bernstein, in all fairness to you—because we could have a panel next time, if somebody wants it, on the Committee. We will have three witnesses against the bill and one witness for it and see how it comes out then. It may be different, but it may not be. But, look, let's get down to this thing.

What would you want the Chairwoman, Linda Sánchez, the Ranking Member, Chris Cannon, Mel Watt and me to do to make this at least easier for you to swallow? It may be like taking medicine. You are going to have to take it. Do you want tap water or you want a Coke light? How can we make this more palatable to you? That is I want to do today.

Mr. BERNSTEIN. Congress, in enacting 1113, sought to encourage negotiated solutions. That was the stated objective. And it is in fact what has happened.

Although we all hear about the very few cases that some of my other witnesses here have mentioned that result in litigation, there are very, very few cases that result in litigation compared to the enormous number that are resolved. So what Congress sought to do by drafting a bill that gave some leverage to companies in bankruptcy and considerable leverage to unions as well is to give each side the incentive to bargain. And it has worked exactly as it should.

Now I understand that the representatives of labor unions would like more leverage. And they say that negotiations are very difficult for us and the company runs over us and makes the threats. And if you had a bunch of managers here of Chapter 11 debtors, they

would tell you that the union has a lot of leverage and the union always threatens to strike and the statute as it exists sets such a high standard that it is very difficult to satisfy. So everybody would like more leverage, and everybody would like a better bargaining position. But Congress really achieved what it sought to achieve here in leveling the playing field, and the best evidence of that is the number of negotiated solutions that have arisen.

Now, I recognize that the cuts in pay and benefits that employees have been asked to take in Chapter 11 cases are significant and very difficult. The question in these cases is whether it is better to implement the necessary cuts so that the company can survive and emerge from bankruptcy or whether it is better instead to say, well, labor doesn't want to take cuts and the standard is so high we can't force them to so we will just shut down the company and all the creditors get nothing and all the union employees lose their jobs. And I think it is because survival of the company is so important that the unions have recognized this and in the overwhelming majority of cases have worked together with management to come up with a solution that is less than ideal but saves the company.

Mr. CONYERS. Well, I have more work on my hands than I thought originally. Let me close down by having the other three witnesses help us move this toward some reality here. Ms. Ceccotti?

Ms. CECCOTTI. Yes. Well, I would certainly agree that negotiated solutions are preferable. I think that that is a hallmark of labor negotiations generally and certainly the bankruptcy process.

But I think the problem that I have with the witness' answer is that even though there may be negotiated solutions eventually, in many cases, first, debtors in Chapter 11 are simply using the litigation process as a lever to get there. It is not the situation where there are so few court cases that, you know, we can count them on the fingers of one hand. Debtors routinely start litigation processes. They spend enormous time and money, creditors' money I might point out, starting these expensive litigations over contract rejection when really what Congress intended in 1113 is for the parties to engage in negotiations over a proposed solution.

The problem with this two-track approach, which is very common now, is that it is distracting, it is expensive, and the union very quickly gets the idea that the court process is going to work against it. Once that mindset sets in, it makes the search for genuine and fair solutions extremely difficult for the union and for the rank and file members to swallow. So I would say that we cannot simply look at the number of negotiated solutions versus the number of court decisions, because that will give you a very distorted view of how the process works.

Mr. CONYERS. I will ask the Chairwoman to get both the people to your right and left's view to my question, because I am out of time. But let's continue this discussion.

I will just leave asking you, Mr. Migliore, what do you think of the proposed Northwest/Delta merger?

Mr. MIGLIORE. Well, the merger itself, you know, obviously has to be worked out between the pilots; and we always have internal issues between that.

But in terms of the general issue of mergers, I mean, there is definitely increased pressures on almost all of the employees when you are in a scrunching situation. When two groups are being put together into a smaller group, there is going to be pressures applied. And there is no question that the merger situation, in addition to all of this that we are talking about in terms of bankruptcy, is this is going to raise the pressure on employees further, as a whole, looking at the industry as a whole, looking at it broadly.

But I have to tell you, you know, the biggest thing that I see right now in the bankruptcy sphere that we are talking about right here is what the Second Circuit did in that case. Regardless of what Mr. Bernstein said, that is going to be—the theory of that case is going to be too powerfully attractive for management to resist at this point. They are going to use it to jam things down the employees' throats.

They don't have a right to get damages when their contracts are cut in half. They don't have the right to respond to even say, hey, if you break my binding agreement, if you breach my agreement which the court says you can't breach anymore, I am going to strike you. They say you can't do that either.

So if you are put in that situation as an employee and as a manager, what do you think the managers are going to do? They are going to steamroll these guys, and they are doing it, and they are going to do more of it.

So I want everybody to realize, regardless of how this has played out before, going forward this is going to get a whole lot worse. Because these employers are all going to come to New York. Almost anybody can file an 1113 in Manhattan. They are all going to go there, and they are all going to take advantage of that case, and they are going to steamroll the employees.

Mr. CONYERS. We four are going to be following this carefully. And I thank you, Chairwoman Sánchez.

Ms. SÁNCHEZ. Thank you. The gentleman yields back his time.

I will recognize myself for 5 minutes of questions, and I want to start out with a little anecdote, because I think it sort of highlights the problem that we are talking about here today.

I tend to fly quite a lot for work, for obvious reasons. And I was on a plane recently, and I won't say what carrier, but I was sitting in the front seat, and I was listening to the flight attendants talk with the mechanics and the folks that were loading things onto the plane. And I overheard a discussion that they were talking about, which was this bonuses incentive pay that they were promised if they could keep their record on on-time departures at a certain percentage. There was an incentive program that some CEO sitting at the top had thought would really motivate folks to get the planes cleaned and stocked and ready to go for their departure times, and so these employees had really put themselves out to make sure that each flight left on time as often as possible.

And then the guy said, yeah, and when the bonuses came, when it came time to hand out the bonuses, the people that got the bonuses were the managers, not the people that are doing the work on the ground.

And I think that sort of illustrates the problem that we are seeing here with bankruptcy. We are seeing Chapter 11 bankruptcy

and CEOs who, when there is pain, when there have to be cuts, it is not being shared equally in the way that when things that are good that are happening that are helping the airline are not being shared with the people who are really responsible for them. And it is the people who are on, you know, the front line doing the grunt work to make sure that these businesses continue to run.

And so I am very pleased that you are all here, and I understand there are difference of opinions, but I think what I am seeing is that things are skewed in one side's favor. And I think what we are trying to get at is how do we balance that playing field.

My first question is for Ms. Ceccotti. Section 8 of this bill would limit the effect of a labor group's concessions to no more than 2 years, and I am interested in knowing why that limitation is necessary.

Ms. CECCOTTI. Well, I think we heard—I think we have heard already about the United situation. I guess I will use that as an example. But it is by no means the only example.

What happens is that in an 1113 negotiation the proposals that can be made by the debtor are supposed to be limited by economic proposals that are supposed to be clearly necessary. But duration, the duration of the length of time the agreement is going to be in effect is always something that it is part of these negotiations.

And United, for example, was very successful in this effort and got 7-year contracts, almost unheard of. These were negotiations that occurred very early on in the case. No one obviously foresaw how the case would turn out. When United finally did emerge from bankruptcy, of course with its balance sheet much improved by the plan terminations and all, something like $11 billion in labor costs savings, it did very well. It did so well in fact that it was able to make a special dividend payment to shareholders of $230 million just earlier this year.

We have already heard about the executive pay awarded to CEO Tilton and others. So the workers, seeing that the company was doing very well, asked the company to begin talks early on its 7-year agreement; and the company has said, no, the amendable date of those agreements is not for another year. Those workers are going to be working under cuts in pay and all of the onerous working conditions that they undertook to get the company out of bankruptcy for another year before United will even start to talk to them about a replacement contract, even though United has been able to pay shareholders extra money. It has prepaid part of its term loan to its exit lenders. It is clearly doling out money that it has reaped based on the successes of its very successful bankruptcy case to other constituencies, and workers are left to left to live under these harsh contracts.

Ms. SÁNCHEZ. So, to clarify, when companies who unusually file bankruptcy return the profitability like the United case, there is no renegotiation of these concessionary agreements?

Ms. CECCOTTI. There certainly could be. And there is nothing, absolutely nothing preventing United or any other carrier or any other company that has emerged from bankruptcy from saying, hey, we are doing much better than we thought. We will—like our shareholders, we will give you an extra bonus or we will snap back your wages. But the whole snap-back issue becomes a real light-

ning rod in these bankruptcy negotiations because workers rightly believe that if the company actually does better than anticipated, they should share in the gains.

In fact, the anecdote that you told goes right really to the heart of this issue. Because really the reason that the company turned around, in addition to the concessions, is the fact that workers were showing up and doing exactly the types of tasks that you witnessed. They are the vital lifeblood of the business' recovery.

The limitation that is in the bill is intended to say to companies, look, you are going to have to be much more measured in what you take out of workers during this process. Because we have seen what happens when duration clauses and contract lengths are simply left open-ended. There is nothing that would force a company to share the gains that it has reaped from bankruptcy. So this is an effort to say, in that case, you are only going to take but so much.

Ms. SÁNCHEZ. Thank you. My time has expired, so I will recognize Chris Cannon for his 5 minutes of questions.

Mr. CANNON. One is tempted looking at the dais to yield back, except that I know the Chairwoman has questions that will go on, so I thought I would take a few minutes and get to the core of some of these issues.

Let me say, first of all, bankruptcy is not a partisan issue. It is a philosophical issue. It is a control issue, a State control issue versus a market control issue, but it is not a partisan issue. And it is complicated. The issues that Ms. Friedman raised about pensions are complicated issues of which a small piece is before us and to solve those problems I think we need a broader forum.

And I might add that it also has tended here to be a union versus management issue.

Let me just say that I was a member of a union. I earned my way through college by being a teamster, and I believe there is a constitutional right to organize unions.

The question when we deal with bankruptcy becomes much more difficult. It becomes how do you balance the context for continuing jobs against some of the other priorities. And I think, Mr. Bernstein, you laid out those issues very, very well. Thank you.

I note that the Chairman of this panel and the Chairman of the full Committee and two of our panelists used the term "outrageous", and I would just say that there are outrageous profits to be made or compensation to be made if you become a business leader, and therefore we hope that more people move into that field and bid down the cost of leadership. Because the amounts that are made are actually really outrageous, but they are outrageous in the context of a market. It is not a very fluid market; and, in fact, the bankruptcy itself takes out some of that fluidity and distorts some of the decisions that are made by people.

On the other hand, we can take out some of the risk that goes along with that in what we do in bankruptcy or how we deal with bankruptcy so that there are—there is more fluidity, more openness to the market.

I have followed one bankruptcy where all the creditors were paid off. The pensions were—it was a defined benefit or—pardon me—it was a defined contribution pension plan, and therefore the em-

ployees were all thrilled at the end because they took pensions that were more significant than their defined benefits would have been.

But after coming through a remarkably difficult, complex set of proceedings, with everyone paid off, the managers were attacked by the trustee and ended up settling for a small portion of the compensation that I think they earned in the process.

So the uncertainty of bankruptcy clearly adds to the value proposition that a manager needs when he looks forward to making a decision that could be a career-ending decision or it could be a profitable phase of his life.

With all of those things in mind, it seems to me that what we need to be looking for here is not sort of the extreme positions of this is outrageous, but rather what can we do to actually make some adjustments.

So let me ask Ms. Ceccotti and Mr. Bernstein because you differ very clearly on section 1113, is there a way we draft the section in your minds that would get closer to where we each want to go without creating this destabilizing of what I think has been historically a fairly good balance?

I might preface my question by saying I started practicing law about the time we did the last bankruptcy reform in 1978. I was actually working in a law firm and got my law degree in 1980 and thrust into a really nasty bankruptcy. I was disgusted by the process. I thought there were a bunch of leeches that lived off the bankruptcy process. But in the last 30 years I have been amazed how we have taken it from an awful system that very few people understood to a system that has actually worked to preserve many companies and many, many jobs.

In that context are there some narrow things that we can do with the language before us that would help us balance without destroying what I think we have achieved where more jobs stay in place as opposed to destroying more jobs, Ms. Ceccotti? Is there such language?

Ms. CECCOTTI. Sure. I think I understand your question.

I think what has happened here is that the courts have really not—the courts really didn't take Congress' direction in 1984. Some courts got it. But many courts simply didn't, or didn't like it, and the judges found not enough guidance, frankly, in the language that was drafted in 1984.

So watching that development, and I have attached actually to my testimony which you might find interesting an article that was just published in the ABI law journal that really does track with some degree of specificity what has happened, what happened very soon after the enactment of 1114 with the courts and what they did with the language and how it is reflected in the decisions today.

So in looking in just having to accept the fact that the courts simply didn't know what to do with the statute, the notion would be here, and what the bill I think tries to do is to say to the courts, okay, we, Congress, will have to give you better guidance and that means more specific guidance on exactly how the two elements that I think are reflected in 1113 and have been completely distorted beyond recognition must operate.

First, you must have a good chunk of time to do the bargaining. So where we have perhaps more provisions or more words used,

more language that has to be brought to bear on defining what that means, the intent I think is to say to the courts you really cannot let companies start litigation early. So there are certain changes that are in here now that are really geared toward process. They are really geared toward giving the parties the time to function in a serious way to figure out what is wrong and what would be the labor group's fair share.

The second piece of this that 1113 was designed to do that the courts have simply been terrible at figuring out how to apply is what is the labor group's fair share. So here again, while I understand that there are more words and more provisions and some might consider this, the current iteration to be, the way the bill does it, to be less flexible, really the intention here is again to do the same thing, which is to say to the courts okay, here is what we mean when we say that labor's share must be proportionate.

So I am afraid that by starting to tweak the language and so forth we would just be back to the situation that spectacularly failed with section 1113, which is absent clearer guidance the courts didn't know what to do and have simply let the debtors run away with the store.

Mr. CANNON. Ms. Ceccotti, let me follow up with one aspect of what you said. You would like more time for bargaining, but isn't time a critical factor in many of these bankruptcies?

Ms. CECCOTTI. Well, I am very glad that you asked that question, actually. In fact, one of the concerns in drafting 1113 originally was that Chapter 11 practice was—the modern Chapter 11 practice was much newer then. The Code had been revamped in 1978. There really wasn't that much time for companies to be operating under the new rules, and there were still companies who were waiting too long, getting too close to the brink of liquidation before filing bankruptcy cases. And that was one of the things that the 1978 Code tried very hard to correct. Obviously if a company can go into Chapter 11 sooner, there are better chances to save the business.

Now in 2008, particularly with the more recent round of cases involving entire industries, or what seem like entire industries, they need all of the time that they can get, frankly, because really bankruptcy for them can only solve but so much. Bankruptcy can't bring the fuel prices down or deal with the trade situation which caused the glut of the drop in steel prices and can't deal with changing demands for OEM cars.

It can do certain things, but these problems are so complicated that now in 2008, as opposed to in 1984, companies actually do need a fair amount of time. Adelphi Corporation, for example, started its 1113 process virtually the day it filed for bankruptcy, and it took years to reach agreements with five unions simply because the case was that complex.

So while I do think that the statute does deal with time exigencies, there is an emergency relief provision which provides stopgap measures so workers and the company can work on the bigger picture.

I think that the time element now has vastly changed with the complexity of the cases that are being filed, and I want to note that Congress in the 2005 amendments has said to all stakeholders that the debtor only has 18 months to figure out how it wants to come

out of bankruptcy, so everybody really does have to kind of put their shoulders to the wheel and figure out in a very timely way how to get to a plan that is going to work.

Ms. SÁNCHEZ. The time of the gentleman has expired, but there is tremendous interest in receiving more information from the witnesses. So we are going to move to a second round of questions. I will recognize myself for 5 minutes.

Mr. Migliore, I am interested in hearing from you what bankruptcies mean to the typical pilot, for example, in terms of their wage cuts and pension cuts, et cetera.

Mr. MIGLIORE. At least at United and Northwest, which are recent examples we had, both pilot groups lost about 40 percent of their pay.

The United pilots lost their pensions, and so they went to the PBGC, and they basically will get at most a third what they expected to get. Mr. Tilton got his 40 percent bonus and in the tens of millions of dollars worth of stock options and benefits. The pilots are certainly looking at this and saying we have lost 40 percent of our pay and we have lost two-thirds of our retirement. The CEO gets 40 percent more pay and he gets some $20 million worth of a golden parachute.

The reactions from these people is what you would expect. It is total outrage. And if I was in their shoes, I would be more outraged.

I understand there are market forces at issue here, but why we are here is to try to put a brake on this so people will get a fair break and have an opportunity to have a living standard that they have built up. Pilots have built this up over 20-30 years, and these people are seriously being knocked out of the middle class today.

Ms. SÁNCHEZ. With respect to bargaining, and I have some familiarity with negotiating for employment contracts, and it has been my experience and I am interested in knowing if it is yours as well, that oftentimes employees will agree to no increases in pay so that they can retain their pensions or other types of benefits. So they are willing to sacrifice in increased wages, they are willing to sacrifice increased wages so that they can retain a safety net through pension benefits or health care benefits.

So it seems to me, and I am interested in your comments, that it is almost, in a sense, sort of an illusory promise that if you are going to take the wage cuts or no wage increases so that you can have a pension that will be there when you need it, and then you go through something like this and see it completely wiped out, it is almost an illusory promise to the employees.

Mr. MIGLIORE. That is exactly what happened to the pilots of U.S. Airways. They had multiple 1113 rounds, as did United, and they made some significant wage cuts to try to save their pension plan, their defined benefit plan, and then they ended up losing it in the last round they had. I am sure that they felt that way. They were very angry about it because again the pension vehicle, the defined benefit plan, really was a primary vehicle for moving people into the middle class in this country, to have retirees not be, you know, struggling on a small Social Security check, and that has been removed from lots and lots of pilots and all sorts of other employees, too.

You think of pilots that are highly paid, but there they are all not. Some fly for the feeder carriers and make $22,000 a year. A number of them took wage cuts, too. For example, Comair and other feeders we have. Some of them were knocked back down to the level where their families would qualify for welfare and food stamps.

The market is great, but we have to decide whether there is a role to try to tame the excesses of the market so people have a chance not to be destitute basically, and that is really what we are talking about in this legislation. The system has gotten so far out of whack where if management can come in and say we are free to cut your pay in half and we are free to your take your pension but you can't strike in response and you can't come after us after we breach your agreement, that is about the most one-sided thing that I have seen in the 23 years I have practiced labor law. That is all I can say about it.

Ms. SÁNCHEZ. I am interested in getting your thoughts about the ramifications of the Second Circuit's recent ruling that enjoined airlines employees from striking.

Mr. MIGLIORE. Legally I think it is wrong, and I have stated in my written testimony why under section 6 of the Railway Labor Act we think the Second Circuit got it 100 percent incorrect and under the Norris-LaGuardia Act.

Putting aside the technicalities of it, the practical import of that decision I cannot state more clearly how much that is going to negatively affect going forward the ability to get anything done consensually in 1113. That is what 1113 was designed for in 1984. The Congress looked at the Bildisco decision and said that looks pretty one-sided and we need to fix it. So they put the 1113 procedures in effect. Perhaps they were not as specific as they could have been and should have been. We are trying to deal with that. But now the Second Circuit comes along and says going forward in 1113, employees won't have the right to strike. It has been unquestioned when someone tears up the agreement saying you have to come to work, you have the right to respond by saying I'm not going to work because you just tore up my agreement. Now the Second Circuit says no, you have to go to work, and when they tore up your agreement, you don't get any breach damages for them breaching. It wasn't really a breach. The court bailed you out with an abrogation, so we are going to let that go. The bottom line is management has no intent of negotiating in light of that decision because they can say they can't come after us. They can't threaten to strike or come after us to try to get compensation for breaching their labor agreement, so why should we do anything other than tell you this is what you are going to take and you are going to take it or we are going to—you know, and do the typical threat routine that they do.

Everybody on this Committee, that decision is going to totally decimate any ability to negotiate anything under 1113.

Ms. SÁNCHEZ. Mr. Bernstein, in 2005, the Bankruptcy Code was amended to stop CEOs and other top executives from giving themselves lucrative bonuses and other compensation at the same time that they are using the bankruptcy process to slash wages and benefits and jobs for rank and file workers. And from the testimony

and some of the examples we have heard today, it appears some of those abuses are still continuing. I am interested in knowing whether you think Congress should tighten the law to stop those kinds of abuses from happening, or do you not think they are abuses?

Mr. BERNSTEIN. I would question the premise as to whether the system is rife with abuse. I think the reality is that the system is rife with very difficult problems to solve, and each side having some leverage and bargained solutions being the result.

Ms. SÁNCHEZ. Do you think there is leverage in the case that Mr. Migliore talked about where they can basically say, "We don't have to honor this collective bargaining agreement; and, by the way, you still have to come to work and you can't strike and, by the way, you don't get damages for us not upholding our end of the collective bargaining agreement?" Do you think there is leverage there?

Mr. BERNSTEIN. Let me provide a little background and context about the Northwest Airlines case which our firm represented the airline in because the full story hasn't come out.

Northwest had negotiations like all other airlines do with all of its labor unions. It made a deal with all but one of its labor unions. They all negotiated solutions and those were approved. I am leaving out some of the details. It then made a deal with the flight attendants union as well. The members of the flight attendants union then rejected their own union's deal. So there was briefing and litigation filed with respect to that one union. The flight attendants also made a deal, but twice their own membership rejected their union's agreement. The union in its own brief referred to its own members as recalcitrant employees because they wouldn't accept the negotiated solution. It was clear, I think it is fair to say, to everybody in that case that if the flight attendants union had struck the airline it would have destroyed the airline. It is in that context that the strike was enjoined where the airline made a deal with all of its unions. With respect to the flight attendants, it met an extraordinarily high standard showing that the modifications that is implemented were essential for the airline to survive and reorganize, that it had made a good faith, fair and equitable proposal, and that the union had wrongfully refused the proposal. Those were all the findings that were made.

Ms. SÁNCHEZ. Let me follow up with a question. Do you think there are instances in which it would be appropriate for people to be able to strike, or do you think—do you agree that it is a good thing that employees be forbidden from striking?

Mr. BERNSTEIN. There is a difference in the law between NLR cases and RLA cases. The Second Circuit case was only an RLA case, so it involves railways and airlines, and the law is different for other airlines.

But in terms of the policy question that you asked, my personal view is that the bankruptcy court, the way to achieve balance here is that the bankruptcy court should be able to enjoin a strike but only in those situations where the court finds that the strike would be likely to destroy the reorganization and therefore destroy the company.

Ms. SÁNCHEZ. Let me ask you this sort of fundamental question. Why shouldn't all participants in Chapter 11 cases, including CEOs

and other managerial types, share the pain that the line workers have to endure over the course of a company's financial restructuring? And my second question is with respect to what we talked about earlier with respect to time deadlines and once a company has returned to profitability, why there is no sort of renegotiation of the concessions that were made to help the company out while it was struggling?

Mr. BERNSTEIN. On the first question, the sharing the pain issue, there are many cases where not only senior management but mid-level management and salaried employees have suffered substantial pay and benefit cuts. The way to structure compensation——

Ms. SÁNCHEZ. A follow-up question, sorry. Were their pensions wiped out entirely? Has that happened to middle managers where a whole class of middle managers' pensions were wiped out completely in a restructuring? Are you aware of any cases where that has happened?

Mr. BERNSTEIN. I can't think of a case offhand, but there are many cases I know of where the middle level managers didn't have any pension benefits.

Look, I understand it is appealing to say that labor took a 20 percent pay cut and so management should take a 20 percent pay cut or something like that, but it ignores economic reality. What you have to do is pay every employee group at as close as possible to a market competitive level. So you should not pay union workers below market because otherwise they will leave and get jobs elsewhere. Similarly, you cannot pay middle level management materially below market, or they will get another job. And the same is true for the chief executive officer. If you pay him half of what the market is, and he has the risk of working for a Chapter 11 debtor, he will get a job somewhere else. So for every employee group, from the assembly line worker to the accountant to the clerical employee to the CEO, you need to pay that employee as close as the company can to a market-competitive wage, and then you have to look at the aggregate and make sure that it is not beyond the ability of the company to survive.

Ms. SÁNCHEZ. I understand where you are coming from. I am not sure that I necessarily agree 100 percent with what you have just said. What about the issue of companies that return to profitability and employees are stuck in the same concessions and there is no renegotiation to try to help restore them a little bit to where they were since they are working hard to make sure that the company got back to profitability?

Mr. BERNSTEIN. So this goes to the 2-year limitation provision in the bill that is intended to address the issue that you have identified. The problem is that when a company is undertaking a restructuring in Chapter 11, it typically needs new capital, new debt financing and new investment, new equity financing. And in order to do that, it needs to make projections about its future cost structure and it can't make those projections over only a 2-year period. Nobody is going to put hundreds of millions of dollars into a company based on a cost structure that is only going to exist for the next 2 years without the slightest notion what is going to happen after the next 2 years. So a company in order to reorganize and attract new capital is going to have to make a business plan that in-

cludes its cost structure, one part which is the labor cost structure, over a much longer period of time than 2 years in order to be able to reorganize.

Ms. SÁNCHEZ. Do you think 7 years is fair?

Mr. BERNSTEIN. Under some circumstances it may well be necessary to have a 7-year cost structure, including 7 year labor cost structure, in order to attract the new capital that is necessary in order to reorganize a company.

These new outside investors who put money into Chapter 11 have a lot of choices on what to do with their money. And unlike the creditors who are already stuck in the case, they have no obligation to this company. They have a choice whether they want to make an investment or not. And they are only going to make an investment if the company looks like it has a reasonable prospect of being profitable, and not only for a 2-year period.

Ms. SÁNCHEZ. Thank you. My time has long since expired, and I recognize Mr. Cannon.

Mr. CANNON. Thank you. What Mr. Bernstein has said was eloquent and right to point on all factors, and direct to the fact that what we do here is actually complicated and we need to be thoughtful as we move forward.

Let me just say as a matter of summary that what we really want in Congress on this Committee and what we do on this Committee as part of all Congress is create an environment in which a robust economy emerges, less regulation, less interference, more market control. I think we have proved that out over a long period of time in American history. When that happens, everyone in the system, and Mr. Bernstein eloquently pointed out, you can't pay labor, the union members, less than market because people will leave. What we really want is a robust market so people have jobs. The reason that middle managers tend not to get the outrageous benefits that we talked about earlier is because there are a lot more of those people and it is easier to fill those jobs. It is hard to fill the senior jobs. What we need to do is have a robust market and create a legal context in which we can have continuity of businesses that get in trouble, but a robust economy so that other companies can emerge.

Much of the discussion we had here today is about two really troubled industries, the airline industry and the auto industry. And we have had minor discussions about some other companies like Enron. But basically they are troubled industries, and they are troubled for reasons that are way beyond bankruptcy, and yet we are looking at those cases as though they can tell us something about how the whole market can work, recognizing that these are huge dislocations that are happening in the airline industry and the automobile industry. We as Congress need to step back and say what do we do so we optimize the opportunity for entrepreneurial, innovative people to come in and save those industries, and what can we do in the environment to create more opportunity for more jobs. It seems to me that is where we need to go.

I think that in this case with bankruptcy reform we need to be very, very thoughtful because companies plan long into the future, and capital has many, many choices. One of the really disturbing things about our oil imports and the money we are spending on oil

coming to American is the depreciation of the American dollar, and in the process the benefit that countries that have the oil and other currencies are benefiting and drawing capital away from what we would be doing here.

If we are going to retain our status as the premier economy in the world, we need to do it by attracting capital, and what we do on this panel with this bill is remarkably important in that regard. I yield back.

Ms. SÁNCHEZ. I do have two last questions that I would like to ask, and so we will start the third round. I wanted to give Ms. Friedman an opportunity to answer some questions.

It appears to me that there are circumstances when bankruptcy seems to be inevitable for certain companies, but if I am not mistaken, I also heard testimony that companies sort of look prospectively to the threat of bankruptcy at least to exact concessions from their labor force.

Ms. Friedman, why are more and more companies seeking to shed their pension obligations in Chapter 13?

Ms. FRIEDMAN. More and more companies are trying to shed their pension responsibilities in general.

Before you said this seemed to be a union versus management issue. The Pension Rights Center hears from thousands of white-collar employees throughout the country whose pensions are also being cut back. And I would like to say there is going to be a pension revolution, as I like to say, among green pants wearing, Izod-wearing, golf toting people, too, because they are equally angry about this.

Mr. CANNON. Madam Chair, if the witness will yield, let me just point out, when I was talking about the conflict between union and nonunion, that was not related to pensions, which you are clearly right. They are way beyond that issue.

Ms. FRIEDMAN. I think a lot of this is both through shareholder pressure but also creditor pressure. There has been pressure on companies to shed pension obligations. And in this book which I would highly recommend called "Pension Dumping" by Fran Hawthorne, who is a New York Times reporter, formerly a reporter with Institutional Investor, she points out that in some situations you have companies that don't want to necessarily terminate the plan and what they call "vulture investors" are forcing them to do so.

Ms. SÁNCHEZ. I am going to interrupt. Can you explain that phenomenon about vulture investors?

Ms. FRIEDMAN. Just in terms of creditors and probably—and Babette can do a better job, but creditors in bankruptcy court who put pressure on the judge saying we are not going to give financing to this company unless these billions of dollars of pension obligations are eliminated. The reality is both companies and employees used to look at pensions as being sacrosanct. It is not just that employers are providing these pensions, workers give up wages so that employers can put money into these defined benefit plans with the expectation of getting a certain benefit.

It has only been in the last 10 years or so where we have seen this restructuring mania where suddenly companies have recognized that they can walk into a bankruptcy court, dump their pen-

sion liabilities onto the Pension Benefit Guaranty Corporation, and so basically the PBGC gets stuck with this huge bill. And in its defense, PBGC does the best job possible. Congress has authorized them to pay certain benefits, and some of them are not paid out. So there is a maximum benefit and because of that workers who either their pensions go beyond that maximum—and there are other benefit levels that I talk about in my statement that are not insured. Basically who gets hurt in this situation? The creditors get paid off. The employers can emerge at least in the short term from bankruptcy as a profitable company. But who is getting hurt? It is the workers. The workers, who have no other chance of getting these benefits. And I think a good point to make in this is when creditors lend money to a corporation they know there are risks involved. But when employees in good faith take a job and are told hey, you meet your end of the bargain, you work for us and in exchange for doing your work we give you wages, but not just wages but also deferred compensation in the form of pensions, they rely on that. They have been loyal to the company and expect loyalty in return.

They are not expecting that one day, because a company wants to restructure, the company will go into the bankruptcy court and just be able to dump these liabilities. So it is really unfair to workers, which is why I think the bill we are discussing today has reasonable provisions to allow an individual to go back, to have a claim in bankruptcy court, and this is basically just a very modest provision, just to allow them to say hey, I didn't get all that I was promised that I worked for all of these years, so I have a chance to get back the difference between what the PBGC provides and what I earned. I think that is a highly reasonable provision.

But again, as I said before, and there was also a quote in this from David Walker, who is the former Government Accountability Office Executive Director, who said there used to be a stain on bankruptcy and it is just not there any more.

So we have to go back to respecting workers and we have got to go back and say if people are giving themselves to companies, they should get what they expect.

I have a lot that I wanted to say. Two more things. We have to keep in mind that defined benefit plans are the most efficient and best way of providing guaranteed adequate income to workers when they retire. And as much as 401(k) plans are a good supplemental source of income, they were never meant to be the whole enchilada. And in the context of bankruptcies, a defined benefit plan has the backup of the PBGC, so even in the worst situation people will get something.

But in an Enron where you have this corporate abuse that could happen again, and we are looking at all of these situations like Bear Stearns, which could be the next one to go, those workers are plum out of luck.

I just wanted to makes those points.

Ms. SÁNCHEZ. Thank you. My time has expired. Mr. Cannon.

Mr. CANNON. Creditors have rights and a certain role in bankruptcy which you have referred to as vulture capital, and that is free capital. That is something that has no obligation in bank-

ruptcy and it only comes in if the conditions are appropriate; is that right?

Ms. FRIEDMAN. I am quoting from this book that was written by Fran Hawthorne as one example of this. I think there are a lot of pressures on companies to be able to restructure. We understand that there is pressures on companies. I think where the Pension Rights Center would come down on this is to say are there any other places where a company can cut costs besides getting rid of the long-term pension plan and hurting workers.

Mr. CANNON. Clearly that is the objective to cut costs all of the way around, and a company that wants to come out of bankruptcy is going to put together a plan that does that. I don't think of them as vulture capital. The fact is that if you are in trouble and in bankruptcy, you are going to pay a higher rate. And the people who want to take on that kind of risk are willing to do it.

What I want is an environment where you minimize the regulatory risk or the court's discretionary risk so that more capital comes in and we reduce the cost and so reduce the program.

My other point is if a company goes out of business, then there is no pension funding. If it liquidates whatever assets are available go to the creditors in priority and the pension ends up with whatever assets it has and whatever incremental obligations that are owed to that pension fund by the company, either assets remaining, that goes to the pension fund. But generally speaking, there are few assets available to fund an underfunded pension; isn't that the case?

Ms. FRIEDMAN. When a company terminates that is in distress, when the Pension Benefit Guaranty Corporation takes over that company, it will have a claim against the company to make sure that PBGC pays a certain level of benefits that have been authorized by Congress to do so. When there is additional money, the PBGC will go after that money. And in some situations, it is not very often, the PBGC is able to collect enough money to pay everybody all of their benefits.

Mr. CANNON. Pensioners are much better off if that company can come out of bankruptcy and fund its pension liabilities, and is better for the PBGC. The purpose of bankruptcy is in part to protect pensions.

Ms. FRIEDMAN. In most cases what the companies have done is terminate the plan. There are situations like in United where they were able to set up a multi-employer plan after they terminated the first plan. But in many cases after a company terminates its plan, it is just going to set up a 401(k) plan. Every study shows that there is no way that a 401(k) plan in any situation is going to be able to make up the difference of what is lost in the defined benefit plan, particularly for older employees.

Mr. CANNON. Clearly if you have older employees who end up with a 401(k), they have less time to build that 401(k). But I will just tell you that in the long term I think that it is pretty clear that 401(k)s where people have control of that 401(k) are going to be happier. The problem with Enron is you had people that didn't—the whole pension fund was the company stock. So if you had individuals with the ability to choose their own risk profile,

typically then we would be better off, I believe. But that transcends the scope of this hearing, I think.

Ms. FRIEDMAN. Knowing that, in all deference, I would like to talk to you more about that, Congressman. But just so you know, right now half of all 401(k) accounts have about $27,000 in them. And even for people between 45 and 65, the median account balance is about $60,000.

So going back to my white-collar employees, I think most people that we deal with actually think that 401(k)s are a poor substitute for defined benefit.

Mr. CANNON. Society is evolving dramatically. In many cases 401(k)s worked very well, but it is an evolution.

If I were young and just starting a career, I would probably be very chary of a corporate defined benefit plan as opposed to my own directed 401(k).

But that is it, Madam Chair. I yield back.

Ms. SÁNCHEZ. The gentleman yields back. I think that one of the points that should not get lost here is that defined benefit pension plans can be wiped out, whereas other CEOs and top executives walk away with significant bonuses and other types of compensation that I think really illustrates some of the problems that we have been talking about today.

I do have two opening statements that I am going to ask unanimous consent to insert into the record. One was the Chairman's opening statement and one was from Ms. Sutton who is a Member of the full Judiciary Committee. So without objection, those are entered into the record.

[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 JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

Bankruptcy—and Chapter 11 in particular—is intended to give all participants an opportunity to work out their economic differences with the shared goal of maximizing the return for all.

So much for theory. Now here's the reality.

It is abundantly clear that the rights of workers and retirees have greatly eroded over the past two decades, particularly in the context of Chapter 11. Let me just cite three reasons.

First, it is no secret that some of our courts interpret the law to favor the reorganization of a business over all other priorities, including job preservation, salary protections, and other important interests. Part of the problem is that the law is simply not clear, leading to a split of authority among the circuits.

This is particularly true with respect to the standards by which collective bargaining agreements can be rejected and retiree benefits can be modified in Chapter 11.

Businesses are aware of this, and take advantage of their venue options and file their Chapter 11 cases in employer-friendly districts. According to the American Bankruptcy Institute, this is among the reasons that Delphi, a Michigan-headquartered company, filed for bankruptcy in New York.

Second, some businesses are using Chapter 11 to bust unions, or to at least give their management unfair leverage in its negotiations with unions. These companies also use Chapter 11 to take advantage of section 1114, which allows employers to modify retiree benefits.

Let me be specific here. What we are talking about is terminating retiree health care benefits, medical benefits, prescription drug benefits, disability benefits, and death benefits, among other protections.

Remember that these benefits were bargained for by Americans who gave their all to their employers and now are in retirement. Jettisoning them in Chapter 11,

for the sake of allowing the company who made these commitments to shed them and go on its merry way, is a travesty.

Third, as a result of Chapter 11's inequitable playing field, the top company executives are all too often not making the same sacrifices.

As the Subcommittee was told at a hearing last year, while a company is using Chapter 11 to extract drastic pay cuts and benefit reductions from workers and retirees, or take away their jobs and benefits entirely, company executives may receive extravagant multi-million-dollar bonuses and stock options.

Even though we tried to stop excessive executive compensation in Chapter 11 by amending the Bankruptcy Code in 2005, creative practitioners have already found loopholes to exploit, and the problem still continues.

And this disparity is not limited to companies who are actually in bankruptcy. As many of you know, the Ford Motor Company reported a record $12.7 billion loss for 2006. But what many of you may not know is that Ford paid $28 million to its new CEO, Alan Mulally, in his first four months on the job.

Enough is enough. In response to these problems, I introduced H.R. 3652, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2007," to guarantee that workers and retirees are treated more fairly in Chapter 11 cases. It does that by:

- requiring greater oversight and approval of all forms of excessive executive compensation;
- ensuring earned wages and severance payments are accorded their proper payment priority;
- requiring the bankruptcy court to take into account a company's foreign assets before allowing the debtor to break its collective bargaining agreements with its American workers, or to modify its retirees' health benefits.

Most importantly, H.R. 3652 restores procedural and substantive balance with respect to how employees and retirees are treated in Chapter 11.

In the last nine years, Congress went to great lengths to grant advantages to creditors and big business interests over ordinary Americans. It is time that we return to including the interests of working families in the bankruptcy law, and consider how we can add a measure of fairness to a playing field that is overwhelmingly tilted against workers.

[The prepared statement of Ms. Sutton follows:]

PREPARED STATEMENT OF THE HONORABLE BETTY SUTTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO, AND MEMBER, COMMITTEE ON THE JUDICIARY

Madam Chairwoman, I was proud to introduce H.R. 3652 with you and Chairman Conyers last fall. Thank you for holding this important hearing today and thank you to our distinguished witnesses for appearing before us to testify about inequities in our nation's bankruptcy laws.

Before coming to Congress, I served as a labor lawyer in Northeast Ohio where I represented workers fighting for fair wages and benefits. I have seen firsthand the toll that blatant disregard for workers' rights can take on our families and communities.

We introduced this bill last fall during a turbulent time for our nation's working families and our economy, which sadly continues to this day.

From the mortgage foreclosure crisis and skyrocketing energy and food prices to unfair trade practices, American workers are under siege. They face cuts to their wages and healthcare, all while facing the constant fear that their jobs will be shipped overseas.

When executed fairly, bankruptcy allows companies in distress to reorganize and successfully continue in business. But too often, companies have commandeered the bankruptcy process as a business strategy to achieve labor parity with competitors at the expense of American workers.

Republic Technologies International (RTI), a steel company located in my district, filed for bankruptcy in 2001. Its pension benefit plan was underfunded, resulting in the Pension Benefit Guarantee Corporation (PBGC) stepping in to become the trustee of the fund in 2003.

The pension benefits that were promised by RTI exceed the legal amounts that can be assumed by PBGC, and now PBGC is recouping overpayments that were errantly made by reducing each worker's monthly pension benefits.

This is a troubling example of how the bankruptcy process is failing to protect American workers when their companies are struggling or are forced out of business.

In its current form, the bankruptcy code allows businesses to sign collective bargaining agreements and then abrogate them at will, slashing wages and benefits. This tactic contradicts reason, and exhibits utter disregard for the welfare of American working families and it should be stopped.

H.R. 3652 provides a new model for bankruptcy that works for American workers and businesses. Businesses on the verge of collapse will be able to recover, while workers, the backbone of the American economy, will still be treated honestly and fairly.

I hope we are able to move forward on this bill in the near future.

Ms. SÁNCHEZ. I want to thank all of the witnesses for their thoughtful testimony today.

Without objection, Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer them as promptly as you can so they will be made part of the record. And without objection, the record will remain open for 5 legislative days for submission of additional materials.

Again, I want to thank everyone for their time, and this Subcommittee on Commercial and Administrative Law is adjourned.

[Whereupon, at 11:09 a.m., the Subcommittee was adjourned.]

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