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Rejecting Collective Bargaining Agreements Under Section 1113 of Chapter 11 of the 1984 Bankruptcy Code: Resolving the Tension Between Labor Law and Bankruptcy Law

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REJECTING COLLECTIVE BARGAINING AGREEMENTS UNDER SECTION 1113 OF CHAPTER 11 OF THE 1984 BANKRUPTCY CODE: RESOLVING THE TENSION BETWEEN LABOR LAW AND BANKRUPTCY LAW

Daniel S. Ehrenberg[*]

When a corporation files a petition under Chapter 11 of the Bankruptcy Code, it attempts to reorganize and rehabilitate itself. The corporation attempts to work out various consensual arrangements with its creditors and is required to submit a feasible plan of reorganization to a bankruptcy court for approval. At times, the company seeks to reject its collective bargaining agreements. The circumstances under which a company is allowed to reject its collective bargaining agreements are extremely controversial. They are controversial because any rejection may adversely impact the employment relationship of thousands of employees and the surrounding community.

This article will explore the interaction between bankruptcy law and labor law. Specifically, it will examine the circumstances under which a debtor-in-possession in Chapter 11 can reject a collective bargaining agreement under § 1113 of the Bankruptcy Code. The first part of this article will describe the tension which appears to exist between labor law and bankruptcy law. The article will show that the goals and purposes of these two comprehensive bodies of federal law can result in conflict. The second part of this article will recite the decisions by various courts leading up to, and including, the Supreme Court's decision in *NLRB v. Bildisco and Bildisco*.[1] In so doing, this article will articulate the differing

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

standards used by courts to allow debtors to unilaterally reject or modify collective bargaining agreements, and the Supreme Court's attempt to interject uniformity in this area. The third part of the article will depict Congress's reaction to the Supreme Court's decision in *Bildisco* of passing § 1113 of the Bankruptcy Code as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984. This part will also briefly describe the provisions of § 1113. The fourth part of this article will show how courts have construed § 1113 and developed varying interpretations of this section as a result of Congress' poor and ambiguous draftsmanship. The fifth and final part of this paper will discuss the policy issues behind the unilateral rejection of collective bargaining agreements and will attempt to develop a standard for the application of § 1113 that will reconcile the competing interests of bankruptcy law and labor law.

In developing a workable standard, courts need to realize their limited role in being able to settle labor disputes. Therefore, courts should encourage good faith bargaining and negotiations between labor and management, so that a mutually acceptable agreement is reached based on each side's economic power. If courts interject themselves into a labor dispute by either failing to recognize and account for each side's economic power or attempting to tilt that balance artificially in favor of one side, the results can be disastrous. An erroneous court decision to allow a contract to be rejected can lead to a strike by the union and/or a prolongation of the bankruptcy process that will increase the deadweight bankruptcy costs to society.

I. TENSION BETWEEN LABOR LAW AND BANKRUPTCY LAW

Both labor law and bankruptcy law are comprehensive bodies of federal law. Being federal laws, they seek uniformity of application and override the conflicting laws of the 50 states.[2] Yet, a statutory tension exists between the goals and purposes of each

[2] THOMAS R. HAGGARD AND MARK S. PULLIAM, CONFLICTS BETWEEN LABOR LEGISLATION AND BANKRUPTCY LAW 4 (1987) [hereinafter HAGGARD & PULLIAM].

of these laws. These tensions can collide when a debtor[3] under a Chapter 11[4] reorganization attempts to unilaterally reject or modify a collective bargaining agreement.

Labor relations between employers and labor unions are regulated by the National Labor Relations Board (NLRB) as per the National Labor Relations Act (NLRA).[5] The NLRA, enacted to promote industrial peace, states: "It is hereby declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining."[6] The main goals of the NLRA are: to protect employees' rights to engage in or not to engage in union activities, including the right of the majority of the employees of an appropriate bargaining unit to select a union as their exclusive bargaining representative; to require employers to bargain in good faith with the employees' authorized representative (the union) before acting unilaterally on subjects that affect the wages, hours and conditions of the employees' work; to enforce collective bargaining agreements reached as a result of negotiations between unions and employers; to prohibit unfair labor practices by employers and unions; and to disfavor strikes and promote negotiations as the principal method of resolving labor disputes.[7]

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[3] The term "debtor" will be used throughout this paper to refer to the debtor-company after a petition for Chapter 11 reorganization has been filed and will also include the trustee of the debtor's business. This party is usually referred to as the "debtor-in possession."

[4] Chapter 11 of the Bankruptcy Code regulates corporate reorganizations and is located at 11 U.S.C. §§ 1101-74 (1988). This paper will refer primarily to Chapter 11 of the Bankruptcy Code.

[5] 29 U.S.C. §§ 151-169 (1988). The National Labor Relations Act (NLRA) was enacted as the Wagner Act in 1935, and amended by the Taft-Hartley Act in 1947 and the Landrum-Griffin Act in 1959. The National Labor Relations Board (NLRB) was created by the NLRA. *See* 29 U.S.C. § 153 (1988).

[6] 29 U.S.C. § 151 (1988).

[7] *See* HAGGARD & PULLIAM, *supra* note 2, at 4-5.

Under § 8(a)(5) of the NLRA, it is illegal for an employer "to refuse to bargain collectively with the representative of his employees."[8] While not having a duty to agree, an employer must bargain to "impasse" before making any change in the terms and conditions of employment and in a collective bargaining agreement.[9] Specifically, § 8(d) forbids an employer from rejecting or modifying any terms of a collective bargaining agreement before expiration without obtaining the union's consent.[10] Therefore,

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[8] 29 U.S.C. § 158(a)(5). Specifically, the NLRA states that a refusal to bargain collectively by the employer is an unfair labor practice. An "unfair labor practice" is a specific violation of various provisions of the NLRA. By committing an unfair labor practice, an employer (or a union) can be sanctioned by the NLRB and required to remedy the situation.

[9] An "impasse" is "a state of facts in which the parties, despite the best of faith, are simply deadlocked." NLRB v. Tex-Tan, Inc, 318 F.2d 472, 482 (5th Cir. 1963). *See generally* Peter Guyan Earle, *The Impasse Doctrine*, 64 CHI. KENT L. REV. 407, 411-26 (1988) (discussing factors related to determination whether an impasse exists); Terrence H. Murphy, *Impasse and the Duty to Bargain in Good Faith*, 39 U. PITT. L. REV. 1 (1977) (same) Comment, *Impasse in Collective Bargaining*, 44 TEX. L. REV. 769, 776-82 (1966) (same).

[10] The pertinent portions of § 8(d) state:

> For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: *Provided*, that 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, unless the party desiring such termination or modification-
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> > (1) serves written notice upon the other party to the contract of the proposed termination or modification sixty days prior to the expiration date thereof, or in the event such contract contains no expiration date, sixty days prior to the time it is proposed to make such termination or modification;

under the NLRA, it would be illegal for a company to unilaterally reject or modify any terms of a collective bargaining agreement while that agreement is still in force.

The primary purpose of Chapter 11 of the Bankruptcy Code is to permit a debtor, under court supervision, to rehabilitate and reorganize its business, by allowing a debtor to relieve itself of the burden of oppressive debt and begin with a fresh start. An essential part of the reorganization process is the ability of the debtor to discharge existing obligations, including accrued debts and executory contracts.[11] Bankruptcy law prefers that this reorganization occur in a consensual manner whereby the debtor reaches an agreement with its creditors as to the most appropriate manner to

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> (2) offer to meet and confer with the other party for the purpose of negotiating a new contract or a contract containing the proposed modifications;
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> (3) notifies the Federal Mediation and Conciliation Service within thirty days after such notice of the existence of a dispute. . .; and
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> (4) continues in full force and effect, without resorting to strike or lock-out, 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.
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> The duties imposed upon employers, employees, and labor organizations by paragraphs (2),(3), and (4). . . shall not be construed as requiring either party to discuss or agree to any modifications of the terms and conditions contained in a contract for a fixed period, if such modification is to become effective before such terms and conditions can be reopened under the provisions of the contract.

29 U.S.C. § 158(d) (1988).

[11] *See* HAGGARD & PULLIAM, *supra* note 2, at 5. *See* also, Carlos J. Cuevas, *Necessary Modifications and Section 1113 of the Bankruptcy Code: A Search for the Substantive Standard for Modification of a Collective Bargaining Agreement in a Corporate Reorganization*, 64 AM. BANKR. L.J. 133, 133-38; Judith D. Nichols, *Rejection of Collective Bargaining Agreements by Chapter 11 Debtors: The Necessity Requirement Under Section 1113*, 21 GA. L. REV. 967, 973-75 (1987).

rehabilitate the company.[12] The rationale behind reorganization is to prevent economic waste because "assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap."[13]

Specifically, under § 365(a),[14] a debtor is allowed to reject any executory contracts or unexpired leases to which it is a party and is protected, under § 362(a),[15] from any proceedings to collect, assess or recover any claims that arose before the debtor filed for reorganization. Therefore, a collective bargaining agreement, being an executory contract, may be rejected unilaterally by a debtor under a Chapter 11 proceeding.[16]

The ability to reject a collective bargaining agreement contradicts the provisions of the NLRA, thereby creating a major conflict between these two major pieces of federal legislation:

> Labor law generally favors stability of the collective-bargaining relationship and generally disfavors unilateral actions by employers. Bankruptcy law, on the other hand, often contemplates a radical alteration of existing business relationships and permits changes whether other affected parties consent or not. Whereas labor law attempts to strike a somewhat neutral balance between the rights of employers and the rights of employees, bankruptcy unquestionably

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[12] Brian J. Beck, Marlene B. Hanson, B. Douglas Hayes & Kevin M. Judiscak, Comment, *Bankruptcy Law-The Standard for Rejecting Collective Bargaining Agreements in Bankruptcy: Labor Discovers It Ain't "Necessarily" So*, 63 NOTRE DAME L. REV. 79 n.1 (1988)[hereinafter Beck, Hanson, Hayes & Judiscak].

[13] H.R. Rep. No. 595, 95th Cong., 1st Sess. 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6179.

[14] 11 U.S.C. § 365(a) (1988).

[15] 11 U.S.C. 362(a) (1988).

[16] The Supreme Court in *Bildisco*, 465 U.S. at 522-23, determined that a collective bargaining agreement was an executory contract and, therefore, could be rejected by a debtor under § 365(a) of the Bankruptcy Code.

favors debtors over creditors. And although labor law affords unions certain privileges and immunities that are not enjoyed by others in the business community, bankruptcy law generally disfavors the special or unequal treatment of creditors.[17]

II. STANDARDS USED BY COURTS TO ALLOW THE REJECTION OF A COLLECTIVE BARGAINING AGREEMENT UP TO, AND INCLUDING, THE SUPREME COURT'S DECISION IN *NLRB v. Bildisco* AND *Bildisco*

A. *The Differing Standards of the Circuits before* Bildisco

While all courts have recognized that a debtor can unilaterally reject a collective bargaining agreement under § 365(a) of the Bankruptcy Code, the circuit courts have differed as to what standard should be applied to allow rejection in a Chapter 11 proceeding. Under § 365(a), a debtor could reject an executory contract if it was a burden to the estate, while, under § 8(d) of the NLRA, a collective bargaining agreement could not unilaterally be rejected or modified.[18] Some courts attempted to treat labor contracts differently from other executory contracts by making it

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[17] HAGGARD & PULLIAM, *supra* note 2, at 5-6. For example, labor organizations, including unions, are generally exempted from coverage under federal antitrust laws because of Congress's enactments of sections 6 and 20 of the Clayton Act, 15 U.S.C. § 17 (1988) and 29 U.S.C. § 52 (1988), and the Norris La-Guardia Act, 29 U.S.C. §§ 101 *et. seq.* (1988). *See* United States v. Hutchinson, 312 U.S. 219 (1941). For more information regarding labor's exemption from the scope of the antitrust laws, *see* generally Edward B. Miller, *Antitrust Laws and Employee Relations* (1984) (describing the labor exemption of the antitrust laws while focusing on employer concerns); ABA COMMITTEE REPORTER, ANTITRUST AND LABOR RELATIONS LAW, 405 (1992) (updating case law dealing with antitrust and labor law); Daniel J. Gifford, *Redefining the Antitrust Labor Exemption*, 72 MINN. L. REV. 1379 (1988) (providing an overview of and arguing for a narrowing of the exception only to apply to collective bargaining agreements that do not involve unions that control the industry or oligopolistic-structured industries).

[18] Bruce H. Charnov, *The Uses and Misuses of the Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 925, 931-32 (1989).

more difficult for a debtor to reject these type of contracts. Yet, other courts argued that a labor contract should be treated the same as any other executory contract.

The courts developed three different standards for allowing the unilateral rejection of a collective bargaining agreement in a Chapter 11 proceeding. Each standard reflected a different balancing of the policies of the NLRA and the Bankruptcy Code.

The first standard, the business judgment test, was delineated in *In re Klaber Bros.*[19] The court treated a collective bargaining agreement as any other executory contract and allowed the debtor to reject the contract, under the traditional standard of rejection of executory contracts, by determining if the contract is a "burden on the estate."[20] Under the business judgment test, a debtor has only to show that rejection of the executory contract will benefit the estate, regardless of whether the contract is burdensome in any other manner or if rejection is economically unjustified.[21] The *Klaber Bros.* court held that there was no difference between NLRA-governed collective bargaining agreements and other commercial contracts, that the language of the Bankruptcy Act did not conflict with the NLRA, and that once a debtor has filed under the Bankruptcy Act, the NLRA has no jurisdiction over the debtor's actions.[22] In effect, the court decided that the Bankruptcy Act took precedence over the NLRA.[23]

The second standard, the balancing of the equities test, was

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[19] 173 F. Supp. 83 (S.D.N.Y. 1959). Rejection in *Klaber Bros.* was allowed under § 313(1) of the Bankruptcy Act, the equivalent predecessor to § 365(a).

[20] *Id.* at 85.

[21] HAGGARD & PULLIAM, *supra* note 2, at 19. *See also* Nichols, *supra* note 11, at 980 (describing the business judgment test as one in which "directors of a corporation needed only to exercise their duties with loyalty and due care in order to be protected from personal liability for honest mistakes of judgment").

[22] Mark S. Pulliam, *The Rejection of Collective Bargaining Agreements Under Section 365 of the Bankruptcy Code*, 58 AM. BANKR. L.J. 1, 14 (1984).

[23] Charnov, *supra* note 18, at 935.

adopted by the Second Circuit in *Shopman's Local 455 v. Kevin Steel Prods., Inc.*[24] The court realized that a collective bargaining agreement was different than other commercial executory contracts and attempted to reconcile the conflict between the NLRA and the Bankruptcy Act. Arguing that a decision to permit rejection should not be based solely on "the financial status of the debtor," the court espoused the following test, permitting rejection:

> Only after thorough scrutiny, and a careful balancing of the equities on both sides, for, in relieving a debtor from its obligations under a collective bargaining agreement, it may be depriving the employees affected of their seniority, welfare, and pension rights, as well as other valuable benefits which are incapable of forming the basis of a provable claim for money.[25]

The *Kevin Steel* court created a three-part test which included an examination of the motivation for the bankruptcy, proof of financial difficulty of the debtor to justify a proceeding in bankruptcy, a showing that rejection would bring beneficial results and a balancing of equities concerning the benefits derived from contract rejection compared to the loss of intangible employee rights. By rejecting the business judgment test, the *Kevin Steel* court interjected a great degree of uncertainty in the law because the balancing of equities test cannot be specifically defined.[26]

In *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*,[27] the Second Circuit adopted a strict standard for rejection of collective bargaining agreements that has been referred to as the "failure of the business" or survival test.[28] Under

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[24] 519 F.2d 698 (2d Cir. 1975)

[25] *Id.* at 707.

[26] *See* HAGGARD & PULLIAM, *supra* note 2, at 33.

[27] 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017.

[28] Charnov, *supra* note 18, at 938.

this test, rejection of a collective bargaining agreement would only be allowed, "[w]here, after careful weighing of all of the factors and equities involved, including the interests sought to be protected by the . . . [debtor], a district court concludes that an onerous and burdensome executory collective bargaining agreement will thwart efforts to save a failing [company] in bankruptcy from collapse."[29] The court continued by stating that, "in 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."[30] The *REA Express* standard, requiring the debtor to prove that liquidation would occur unless rejection of its collective bargaining agreements is allowed, was seen as an extremely pro-labor test.[31]

Most court decisions followed one of these three standards.[32] Because of these differing standards, a lack of uniformity developed between the various circuits as to the rejection of collective bargaining agreements. As a result, the Supreme Court attempted to define the proper standard and create uniformity.

B. The Supreme Court's Decision in NLRB v. Bildisco *and* Bildisco*: An Attempt to Unify the Circuits*

In *Bildisco*, the Supreme Court answered the following two questions:

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[29] *Id.* at 169.

[30] *Id.* at 172.

[31] Nichols, *supra* note 11, at 980.

[32] *See, e.g.*, In re Brada-Miller Freight Sys., 702 F.2d 890 (11th Cir. 1983) (applying the *Kevin Steel* balancing of the equities standard and rejecting *REA Express*); In re Bildisco, 682 F.2d 72 (3rd Cir. 1982) (same), *aff'g*, 465 U.S. 513 (1984); Local Joint Executive Bd., AFL-CIO v. Hotel Circle, Inc., 613 F.2d 210 (9th Cir. 1980) (applying a business judgment test); Truck Drivers Local Union No. 807 v. Bohack Corp., 541 F.2d 312 (2d Cir. 1976) (applying a quasi-*REA Express* standard), *cert. denied*, 439 U.S. 825 (1978).

> (1) [U]nder what conditions can a Bankruptcy Court permit a debtor-in-possession to reject a collective-bargaining agreement; (2) may the National Labor Relations Board find a debtor-in-possession guilty of an unfair labor practice for unilaterally terminating or modifying a collective bargaining agreement before rejection of that agreement has been approved by the Bankruptcy Court.[33]

Under the first question, the Supreme Court unanimously ruled that § 365(a) of the Bankruptcy Code allowed rejection of collective bargaining agreements, basing their decision on the fact that none of the parties denied that a collective bargaining agreement was an executory contract and that Congress had not expressly exempted collective bargaining agreements from the scope of § 365.[34] The Court also unanimously ruled that the *Kevin Steel* balancing of the equities test was the proper standard under which a debtor could reject a collective bargaining agreement.[35]

The Court recognized that a collective bargaining agreement was different than a commercial executory contract because of its status in this country's national labor policies and thereby required greater protection than would be afforded under the business judgment test.[36] Yet, the Court also realized that the standard enunciated in *REA Express* was too strict and was, "fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code."[37] Emphasizing that a bankruptcy court must focus on the goals of Chapter 11 -- namely, the rehabilitation of a distressed enterprise -- the Court adopted the balancing of the equities test. In announcing this test, Justice Rehnquist, speaking for the Court, stated that the following factors

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[33] *Bildisco*, 465 U.S. at 516.

[34] *Id.* at 522-23.

[35] *Id.* at 526-27.

[36] *Id.* at 524.

[37] *Id.* at 525.

need to be taken into account before a collective bargaining agreement can be rejected:

> The Bankruptcy Court must make a reasoned finding on the record why it has determined that rejection should be permitted. Determining what would constitute a successful rehabilitation involves balancing the interests of the affected parties -- the debtor, creditors, and employees. The Bankruptcy Court must consider the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors' claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees. In striking the balance, the Bankruptcy Court must consider not only the degree of hardship faced by each party, but also any qualitative difference between the types of hardship each may face.[38]

The Court also stressed that, before authorizing rejection, the Bankruptcy Court must be convinced that the debtor has made reasonable efforts to negotiate voluntary modifications with the union.[39]

Under the second question, the Court, by a five to four vote, ruled that a debtor did not commit an unfair labor practice by unilaterally rejecting a collective bargaining agreement, although its rejection had not been approved by the bankruptcy court.[40] The majority reasoned that a debtor's filing of a Chapter 11 petition made its contracts unenforceable and allowed modifications of contracts and property by virtue of law. Therefore, § 8(d) of the NLRA would not apply because the contract is already unenforceable as per the bankruptcy laws.[41] In making its ruling, the Court

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[38] *Id.* at 527.

[39] *Id.* at 526.

[40] *Id.* at 533-34.

[41] *Id.* at 532-33.

declared that the Bankruptcy Code took precedence over the policies of the NLRA.[42]

Justice Brennan, in dissent, argued that bankruptcy and labor policies would be better reconciled if the debtor was required to seek prior authorization from the bankruptcy court before rejecting a collective bargaining agreement.[43] He reasoned that unilateral rejection and modifications of collective bargaining agreements prior to bankruptcy court approval would discourage interim negotiations and would lead to increased labor strife, which could hinder the debtor's reorganization.[44]

While the Supreme Court unanimously and noncontroversially ruled that a debtor could reject a collective bargaining agreement under the balancing of the equities test, the second part of the decision, which allowed a debtor to unilaterally and without prior bankruptcy court approval reject such an agreement, created a storm of protest from organized labor and Congress. The Supreme Court's decision left employees without,"any significant procedural protection regarding the rejection of a collective bargaining agreement."[45]

III. CONGRESSIONAL REACTION TO *Bildisco*: THE PASSAGE OF SECTION 1113

Congress reacted immediately to the Court's decision in *Bildisco*. They were already considering bankruptcy legislation because of the jurisdictional crisis created by the Supreme Court's decision in *Northern Pipeline*.[46] Congressman Rodino, Chairman

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[42] *Id.* at 527.

[43] *Id.* at 535-53 (Brennan J., concurring in part, dissenting in part).

[44] *Id.* at 548-49.

[45] Cuevas, *supra* note 11, at 161.

[46] Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), held that Congress' grant of jurisdiction to non-article III judges to resolve all bankruptcy and bankruptcy-related matters pursuant to the Bankruptcy Reform Act of 1878 violated article III of the Constitution. *See also*, Cuevas,

of the House Judiciary Committee, introduced a bill that would have completely overturned *Bildisco* by disallowing unilateral rejection of a labor contract without bankruptcy court approval under the *REA Express* standard.[47]

Senators Packwood and Thurmond both introduced different proposals in the Senate. Thurmond's proposal would have incorporated the *Bildisco* decision and the balancing of the equities test into the new Bankruptcy Code, and would have allowed a thirty-day waiting period from the time of filing a motion by the debtor to reject a collective bargaining agreement with the bankruptcy court in order to give the court the opportunity to hold a hearing concerning rejection.[48] Packwood's proposal would have required the debtor to propose the minimum modifications to enable a successful reorganization, provide the union with the information necessary to evaluate the proposal, require reasonable attempts at negotiation, allow an expedited hearing and decision by the bankruptcy court, and have this proposal apply retroactively.[49]

A debate ensued as to which proposal should be enacted. Because of the need to quickly enact a Bankruptcy Code to allow the bankruptcy courts to continue to function, a compromise was agreed on which differed from each of the proposals that had previously been introduced. On June 29, 1984, Congress enacted

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supra note 11, at 162-63 (discussing the *Northern Pipeline* crisis).

[47] *Id.* at 946-47.

[48] Joseph L. Cosetti and Stanley A. Kirshenbaum, *Rejecting Collective Bargaining Agreements Under Section 1113 of the Bankruptcy Code-Judicial Precision or Economic Reality?*, 26 DUQ. L. REV. 181, 191 (1987).

[49] *Id.* The reason that Packwood's proposal was to apply retroactively was so that it would apply to the Continental Airlines Bankruptcy which had been filed by Frank Lorenzo in September, 1983. *See* In re Continental Airlines Corp., 50 Bankr. 342 (S.D. Tex. 1985). During that bankruptcy, Continental used its bankruptcy status to unilaterally reject its collective bargaining agreements with its unions and hired non-unionized replacement workers at 50% pay-cuts. *See, e.g.*, Douglas B. Feaver, *Continental Airlines Is Struck; Most Flights Continue Operating*, WASH. POST, Oct. 2, 1983, at A3; *Business News: Dateline Houston*, Reuters, Sept. 30, 1983, *available in* LEXIS, News Library, ARC-NWS File.

the Bankruptcy Amendments and Federal Judgeship Act of 1984,[50] which was later signed into law by President Reagan.

Included within those amendments was § 1113,[51] the proposal

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[50] Pub. L. No. 98-353, 98 Stat. 333 (1984).

[51] 11 U.S.C. § 1113 (1988). Section 1113 states:

(a) The debtor in possession, or the trustee if one has been appointed under the provisions of 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 assume or reject a collective bargaining agreement only in accordance with the provisions of this section.

(b)(1) Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section 'trustee' shall include a debtor in possession), shall-

> (A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
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> (B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.

(2) During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.

(c) The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that-

> (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection

(b)(1);

(2) the authorized representative of the employees has refused to accept such proposal without good cause; and

(3) the balance of the equities clearly favors rejection of such agreement.

(d)(1) Upon the filing of an application for rejection the court shall schedule a hearing to be held not later than fourteen days after the date of the filing of the application. All interested parties may appear and be heard at such hearing. Adequate notice shall be provided to such parties at least ten days before the date of such hearing. The court may extend the time for the commencement of such hearing for a period not exceeding seven days where the circumstances of the case, and the interests of justice require such extension, or for additional periods of time to which the trustee and the representative agree.

(2) The court shall rule on such application for rejection within thirty days after the date of the commencement of the hearing. In the interests of justice, the court may extend such time for ruling for such additional time as the trustee and the employees' representative may agree to. If the court does not rule on such application within thirty days after the date of the commencement of the hearing, or within such additional time as the trustee and the employees' representative may agree to, the trustee may terminate or alter any provisions of the collective bargaining agreement pending the ruling of the court on such application.

(3) the court may enter such protective orders, consistent with the need of the authorized representative of the employee to evaluate the trustee's proposal and the application for rejection, as may be necessary to prevent disclosure of information provided to such representative where such disclosure could compromise the position of the debtor with respect to its competitors in the industry in which it is engaged.

(e) If during a period when the collective bargaining agreement continues in effect, and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court after notice and a hearing, may authorize the trustee to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by a collective bargaining agreement. Any hearing under this paragraph shall be scheduled in accordance with the needs of the

concerning the rejection of collective bargaining agreements. Unfortunately, the compromise was reached in a joint conference committee that did not produce a conference report. As a result, no definitive legislative history exists and legislative intent can only be inferred from inconsistent statements by various Congresspersons contained in the Congressional Record.[52]

Section 1113 details the procedural and substantive requirements a debtor must fulfill before a bankruptcy court will approve a petition for rejection of a collective bargaining agreement. Subsequent to the filing of a petition and prior to filing an application to reject a collective bargaining agreement, the debtor must propose "those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor."[53] The proposal must "assure[ ] that all creditors, the debtor and all of the affected parties are treated fairly and equitably."[54] The debtor must also provide the union with "such relevant information as is necessary to evaluate the proposal."[55] After making the proposal, the debtor must "meet, at reasonable times" with the union and bargain "in good faith in attempting to reach mutually satisfactory modifications of such agreement."[56]

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trustee. The implementation of such interim changes shall not render the application for rejection moot.

(f) No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provision of a collective bargaining agreement prior to compliance with the provisions of this section.

11 U.S.C. § 1113 (1988).

[52] Charnov, *supra* note 18, at 954; Cosetti, *supra* note 48, at 193.

[53] 11 U.S.C. § 1113(b)(1)(A).

[54] *Id.*

[55] 11 U.S.C. § 1113(b)(1)(B).

[56] 11 U.S.C. § 1113 (b)(2).

The union may not reject the proposal "without good cause."[57] After making a satisfactory proposal which complies with subsection (b)(1), conferring with the union, and having the union reject it without good cause, the court must "find[ ] that the balance of the equities clearly favors rejection of such agreement" in order for the rejection to be approved.[58] The bankruptcy court is to schedule a hearing on the debtor's proposed application within fourteen days after the application has been filed and is to rule on the application within thirty days, unless certain circumstances occur or both parties agree to a postponement.[59] A debtor may also obtain interim relief to modify a collective bargaining agreement if it can demonstrate that such relief is "essential" to prevent the estate from suffering "irreparable damage."[60] Section 1113 prohibits a debtor from "unilaterally terminat[ing] or alter[ing] any provisions of a collective bargaining agreement prior to compl[ying] with [its] provisions."[61]

The procedural requirements of § 1113 are relatively straightforward and overturn that part of *Bildisco* which allowed a debtor to unilaterally reject a collective bargaining agreement without obtaining bankruptcy court approval.[62] Under § 1113, the only time that a debtor can unilaterally reject an agreement is when the bankruptcy court fails either to rule on an application within thirty days or postpones the ruling on an application in accordance with its statutory mandate.[63]

Yet, the substantive standards lack clarity and show the

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[57] 11 U.S.C. § 1113(c)(2).

[58] 11 U.S.C. § 1113(c).

[59] 11 U.S.C. § 1113(d).

[60] 11 U.S.C. § 1113(e).

[61] 11 U.S.C. § 1113(f).

[62] Cosetti, *supra* note 48, at 192-93.

[63] Nichols, *supra* note 11, at 987.

unskillful manner in which the amendment was drafted.[64] Terms, such as "necessary," "good faith," "fairly and equitably," and "good cause" are not defined in the statute.[65] Section 1113 is riddled with ambiguity as to its proper meaning and has, therefore, become a nightmare to interpret.[66]

In construing a statute, the Supreme Court has suggested that where the language of the statute is "plain," no duty of interpretation arises.[67] If the statute is ambiguous, one can resort to a statute's legislative history. But, the Supreme Court usually relies upon a committee report as the "authoritative source for finding the Legislature's intent . . . [because it] . . . represents the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation."[68] In contrast, the Supreme Court generally refuses to rely on the comments of various Congressional members or casual statements made during floor debates.[69]

Since § 1113's legislative history is merely composed of contradictory statements made by various Congressional members, it will be difficult to use legislative history as a guide to interpret-

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[64] Cosetti, *supra* note 48, at 182, 193.

[65] *Id.*

[66] *See, e.g.*, HAGGARD & PULLIAM, *supra* note 2, at 76-121; Cuevas, *supra* note 11, at 166-88; Charnov, *supra* note 18, at 956-1002; Nichols, *supra* note 11, at 988-1001; Cosetti, *supra* note 48, at 193-220. *See also infra* notes 71-107 and accompanying text.

[67] *See* Caminetti v. United States, 242 U.S. 470, 485 (1917) ("[w]here the language [of the statute] is plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion.").

[68] Garcia v. United States, 469 U.S. 70, 76 (1984) (quoting Zuber v. Allen, 396 U.S. 168, 186 (1969)).

[69] *See, e.g.*, Weinberger v. Rossi, 456 U.S. 25, 35 (1982); Consumer Product Safety Comm'n v. GTE Sylvania, 447 U.S. 102, 108 (1980); United States v. O'Brien, 391 U.S. 367, 385 (1968).

ing the statute's true meaning.[70] Yet, the courts have availed themselves of the Congressional Record and the specific wording of the statute to interpret the ambiguities within § 1113. As a result, § 1113 has been interpreted in an inconsistent manner by the various circuits.

IV. JUDICIAL INTERPRETATIONS OF SECTION 1113: INCONSISTENT APPROACHES

Given the ambiguity of various terms within § 1113 and the lack of authoritative legislative history, it comes as no surprise that various courts have developed differing interpretations of the section's meaning. This part of the paper will briefly detail the major court decisions interpreting § 1113. In doing so, it will illustrate the problems inherent in attempting to interpret the statute and will lay the framework for the policy discussion in the next section.

One of the earlier decisions to construe § 1113 was *In re American Provision Company.*[71] The bankruptcy court denied a debtor's motion to reject an executory contract because the debtor had only met once with the union to discuss the proposal, the projected savings from rejection of the collective bargaining agreement only amounted to two percent of the company's total monthly expenses, and the agreement was due to expire in eight months. While noting that § 1113 was "not a masterpiece of draftsmanship," the judge distilled nine elements from that provision under which the debtor bears the burden of persuasion by a preponderance of the evidence:

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

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[70] Cosetti, *supra* note 48, at 193.

[71] 44 B.R. 907 (Bankr. D. Minn. 1984).

the reorganization of the debtor.

4. The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.

5. The debtor must provide to the union such relevant information as is necessary to evaluate the proposal.

6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union.

7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.

8. The union must have refused to accept the proposal without good cause.

9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.[72]

These nine elements have been employed by the majority of courts as the basis for determining whether a debtor has met the requirements under § 1113 for rejecting a collective bargaining agreement.[73]

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[72] *Id.* at 909 (footnotes omitted).

[73] *See, e.g.*, In re Sun Glo Co., Inc., 144 B.R. 58 (Bankr. E.D. Ky. 1992) (applying nine-point *American Provision* test to deny rejection of collective bargaining agreement); In re Valley Steel Products Co., Inc., 142 B.R. 337 (Bankr. E.D. Mo. 1992) (applying same to allow rejection of collective bargaining agreement); Matter of GCI, Inc., 131 B.R. 685 (Bankr. N.D. Ind. 1991) (applying same to deny rejection); In re Express Freight Lines, Inc, 119 B.R. 1006 (Bankr. E.D. Wis. 1990) (applying same to deny rejection); In re Big Sky Transp. Co., 104 B.R. 333 (Bankr. D. Mont. 1989) (applying same to allow rejection); Matter of Sol-Sieff Produce Co., 82 B.R. 787 (Bankr. W.D. Pa. 1988) (applying same to allow rejection); In re Texas Sheet Metals, Inc., 90 B.R. 260 (Bankr. S.D. Tex. 1988) (applying same to allow rejection); Matter of Walway Co., 69 B.R. 967 (Bankr. E.D. Mich. 1987) (applying same to allow rejection). *See also* HAGGARD & PULLIAM, *supra* note 2, at 89.

Another early decision, *In re Allied Delivery Systems*,[74] construed the term "necessary" in "necessary modifications" to be less stringent than "essential" to avoid liquidation. The bankruptcy court in this case authorized the debtor to reject a collective bargaining agreement although the debtor and the union had met only twice to discuss the proposal before the court held its hearing on the motion to reject, the debtor proposed a greater reduction of wages and benefits for union employees than for non-union employees and the contract was due to expire within six weeks.

The court first reasoned that Congress had adopted a more rigorous standard for interim, as opposed to permanent, relief. Because the word "essential" was in the interim relief section of the statute, the word "necessary" must have a less stringent meaning.[75] The court also held that:

> [I]n the context of this statute 'necessary' must be read as a term of lesser degree than 'essential.' To find otherwise, would be to render the subsequent requirement of good faith negotiations, which the statute requires must take place after the making of the original proposal and prior to the date of the hearing, meaningless, since the debtor would thereby be subject to a finding that any substantial lessening of the demands made in the original proposal proves that the original proposal's modifications were not 'necessary.'[76]

The court noted that the company was in dire financial straits. The company's direct labor costs attributable to the debtor's union employees were 87 percent of the its gross revenues. Therefore, the debtor's proposal was necessary.[77] The court held that the balancing of the equities favored rejection because the debtor was in dire

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[74] 49 B.R. 700 (Bankr. N.D. Ohio 1985).

[75] *Id.* at 702.

[76] *Id.*

[77] *Id.*

financial distress, and reduction of labor costs was the only way the debtor could reorganize.[78] The court also determined that "fair and equitable" does not mean that all employees' wages have to be reduced by the same percentage. Of significance to the court was the fact that the wages of the non-union employees were less than the wages and benefits of the union employees and that the non-union employees did not have a pension plan.[79] The court stated: "[f]air and equitable does not of necessity mean identical or equal treatment."[80] The *Allied Delivery System* court interpreted § 1113 as allowing a debtor flexibility to reorganize its business.

The Third Circuit was the first appellate court to interpret § 1113 in *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America.*[81] In reversing the district court's affirmance of the bankruptcy court's decision to allow the debtor to reject its collective bargaining agreement, the court focused on two issues. The court inquired into: (a) the necessity of the proposed modifications -- the "how necessary" inquiry; and (b) the objective of the modifications -- the "necessary to what" inquiry.[82] Under the first inquiry, the court held that a bankruptcy court should permit only essential, minimum modifications to the collective bargaining agreement and construed the term "necessary" to mean "essential."[83] Under the second inquiry, the court determined that the objective of the modifications should be the short-term goal of preventing liquidation of the debtor, rather than the overall long-

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[78] *Id.* at 704.

[79] *Id.* at 702-03.

[80] *Id.* at 703.

[81] 791 F.2d 1074 (3d Cir. 1986).

[82] *Id.* at 1088.

[83] *Id.*

term goal of Chapter 11 of restoring financial health to the debtor.[84]

Wheeling-Pittsburgh was the seventh largest steelmaker in the United States when it filed for bankruptcy in 1985. Relations with its union were poor. It had modernized its facilities in the 1970s and became heavily indebted in the process. As a result of a recession and increased foreign competition, the company lost money in 1982 through 1984. Because of its debt, the company was forced to seek concessions from its unions, creditors and shareholders. The union had given concessions to the company on three different occasions, reducing its wages from the industry average of $25 per hour to a low of $18.60, with gradual restoration to $21.40 per hour by the end of 1984. When the company asked for a fourth round of concessions, the union refused until Wheeling-Pittsburgh had extracted concessions from its lenders. The lenders had not made any concessions up to that point. The company negotiated with the lenders and the union, but could not convince either party to compromise on the issue of pledging its current assets to the banks. The lenders wanted those assets pledged in return for concessions, while the Steelworkers feared that if those assets were pledged and the economy went bad, there would be no life-preserver and the company would go under. While the company was willing to give into the lenders' demands, the union lost confidence in the management's good faith and refused to budge. Consequently, Wheeling-Pittsburgh filed for relief under Chapter 11 on April 16, 1985. On May 9, 1985, the company made a proposal to the union to modify the collective bargaining agreement by agreeing to a five-year contract term, a maximum labor cost of $15.20 per hour, elimination of profit-sharing, reduction of medical and insurance benefits, and cut-backs on a variety of other fringe benefits. After negotiations broke down over the issue of requested financial information, Wheeling-Pittsburgh applied to the bankruptcy court to reject the collective bargaining agreement. The bankruptcy court granted the application and Wheeling-Pittsburgh began to institute unilateral changes.

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[84] *Id.* at 1088-89. *See also*, Beck, Hanson, Hayes & Judiscak, *supra* note 12, at 88.

Immediately thereafter, on July 21, 1985, the union struck. It took an eighty-seven day strike for the parties to reach a tentative agreement, which occurred while the case was still pending before the Third Circuit.[85]

Rather than determine that the case was moot, the Third Circuit rendered a decision.[86] The court determined that "necessary" meant "essential" by relying on the legislative history of the statute and determining that the Packwood proposal was the one that Congress ultimately adopted.[87] While acknowledging that "essential" appeared in the interim relief section of § 1113, the court did not place any significance on that fact. The court labelled the argument -- that "necessary" had a different meaning than "essential" because the words appeared in two different subsections -- "hyper-technical."[88]

Again relying on legislative history, the court interpreted the phrase "necessary to permit reorganization of the debtor"[89] as being concerned only with the short-term goal of preventing the debtor's liquidation.[90] The court based its answer on Congress' intent and stated that Congress had meant to emphasize the immediate future, rather than the long-term future of the debtor. Based upon this interpretation of the statute, the Third Circuit determined that the Wheeling-Pittsburgh proposal had not met the standard for rejection. The court specifically noted that the absence of a "snap-back" provision, whereby the union could share in the company's profits if business rebounded, made the proposal unfair

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[85] *Id.* at 1076-80.

[86] Cosetti, *supra* note 48, at 208.

[87] 791 F.2d at 1088. *See also* Cosetti, *supra* note 48, at 210-11 (discussing the Third Circuit's misplaced reliance on legislative history).

[88] 791 F.2d at 1089.

[89] 11 U.S.C. § 1113(b)(1)(A) (1988).

[90] 791 F.2d at 1090.

and inequitable.[91] In effect, the Third Circuit applied a strict standard to determine if a debtor could reject a collective bargaining agreement. Furthermore, the standard was based on the court's view of legislative history.

In contrast to the *Wheeling-Pittsburgh* court, the Second Circuit in *Truck Drivers Local 807 v. Carey Transportation, Inc.*[92] construed § 1113 in a more flexible and less stringent manner. The *Carey* court held that "necessary" modifications need not be restricted to those that are absolutely "essential" or minimal, and that "reorganization" refers to the long-term financial viability of the debtor, rather than the short-term goal of preventing the debtor's liquidation.[93]

Carey Transportation, Inc. was a bus company that operated a shuttle between New York airports and New York City. The company had incurred large annual losses from 1982 to 1985. To stem its losses, it successfully obtained concessions from Local 807, the union representing its mechanics and its creditors. While obtaining some concessions from the union, it was not able to negotiate adequate concessions. Carey filed for Chapter 11 and made a proposal to Local 807 to modify its collective bargaining agreement. The union refused to accept any more changes and declined to enter into further negotiations. Carey filed a petition to reject its contract with Local 807 under § 1113. The bankruptcy court granted the petition and the district court affirmed its decision.[94]

The Second Circuit disagreed with the Third Circuit's holding in *Wheeling-Pittsburgh* that "necessary" meant "essential" or the "bare minimum." The court examined the legislative history and determined that Congress had refused to adopt the Packwood proposal of "minimum modifications" and, instead, had substituted

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[91] *Id.*

[92] 816 F.2d 82 (2d Cir. 1987).

[93] *Id.* at 90. *See also* Beck, Hanson, Hayes & Judiscak, *supra* note 12, at 91.

[94] *Id.* at 85-87.

the term "necessary."[95] The court also adopted the reasoning of the *Allied Delivery* court and held that the essential modifications standard adopted by the Third Circuit in *Wheeling-Pittsburgh* would place the debtor in an untenable position because if the debtor only proposed the absolute minimum changes, it would not be able to bargain in good faith.[96] Therefore, the court determined that Congress must have intended that the debtor be able to propose changes greater than the bare minimum, as long as those changes were made in good faith.[97] The court also held that the term "essential" in the interim relief subsection is not synonymous with the term "necessary" in the permanent relief section, arguing that two different terms in two different subsections must have different meanings.[98]

In deciding that "reorganization" in § 1113 referred to the long-term financial viability of the debtor, the court argued that a debtor, concerned only with obtaining short-term relief, would look to § 1113(e), the interim relief subsection.[99] The court also looked to § 1129(a)(11) to justify its position. The court stated that § 1129 is concerned with confirming a reorganization plan that will not result in liquidation or further financial reorganization. Therefore, the concept of long-term viability of the debtor is inherent within the reorganization process.[100]

The court also held that the union had rejected the debtor's proposal without good cause.[101] The basis for this holding was that the union had not participated in any meaningful post-petition

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[95] *Id.* at 89.

[96] *Id.* at 89-90.

[97] *Id.* at 89.

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.* at 91.

negotiations and had given no reason for rejecting the debtor's proposal other than its view that the proposed modifications were excessive. The court stated that the union must come forward with a reason, supported by evidence, for its refusal to accept the debtor's proposal or else it will be deemed to have refused the proposal without good cause as per § 1113(2)(c). The court argued that the good cause requirement was intended by Congress to ensure that good faith negotiations would take place prior to court involvement.[102] Because "the union had engaged in prehearing stonewalling . . ., it [could] not claim that it had good cause for refusing the proposal."[103]

The Second Circuit noted that § 1113 codified the balancing of the equities test of *Bildisco*.[104] The court delineated six factors as necessary to properly balance the equities involved in determining whether a collective bargaining agreement should be rejected. These six factors included:

> (1)[T]he likelihood and consequences of liquidation if rejection is not permitted; (2) the likely reduction in the value of the creditors' claims if the bargaining agreement remains in force; (3) the likelihood and consequences of a strike if the bargaining agreement is voided; (4) the possibility and likely effect of any employee claims for breach of the contract if rejection is approved; (5) the cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry; and, (6) the good or bad faith of the parties in dealing with the debtor's financial dilemma.[105]

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[102] *Id.* at 92.

[103] *Id.*

[104] *Id.*

[105] *Id.* at 93.

The Second Court summarized its analysis with the following statement:

> In sum, we conclude that the necessity requirement [of § 1113] 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.[106]

Rather than simply correct the deficiencies of the Supreme Court's decision in *Bildisco* and create a clearly-understood standard for the rejection of collective bargaining agreements by a debtor in Chapter 11, Congress, in enacting § 1113, created a statute fraught with ambiguity. Courts, like those in the Third and Second Circuit, have been unable to construe the statute in a uniform manner. Indeed, another split in the circuits has developed. One mode of analysis views § 1113 as being very strict by only allowing "essential" modifications which prevent the short-term economic ruin and liquidation of the debtor. The counter mode of analysis sees § 1113 as flexible, permitting proposals of any necessary modifications that are made in good faith and that restore the long-term financial viability of the debtor.[107]

V. A POLICY ANALYSIS OF SECTION 1113: RECONCILING THE BANKRUPTCY PROCESS WITH ECONOMIC REALITY THROUGH UNDERSTANDING THE POWER OF DEBTOR COMPANY AND UNION

Section 1113 must be reconciled in a manner that synchronizes the policies behind the NLRA and the current Bankruptcy Code

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[106] *Id.* at 90.

[107] In 1990, the Tenth Circuit sided with the Second Circuit's flexible interpretation; namely, that "necessary" does not require absolutely minimal modifications and that the goal of Chapter 11 is to allow the debtor to complete a successful reorganization, one that is economically viable in the long-term. *In re* Mile Hi Metal Systems, Inc., 899 F.2d 887 (10th Cir. 1990).

with the economic reality of the bargaining power between the debtor company and the union. On its face, § 1113 is an ambiguous, poorly-drafted statute which is susceptible to numerous interpretations. Yet, § 1113 was enacted by Congress as a reaction to the Supreme Court's decision in *Bildisco*.[108] It was viewed at passage as a pro-labor statute which would better accommodate the differing interests of the bankruptcy act and the labor laws by making rejection of collective bargaining agreements more difficult.[109]

Given the statute and the inherent tension involved in situations where a debtor attempts to reject a collective bargaining agreement, complex, costly and time-consuming litigation may ensue.[110] Yet, as one commentator has written, "[c]ourts clearly do not settle labor disputes by judicial process. Labor negotiations occur at the bargaining table."[111] Bankruptcy courts need to realize that, even though they may reject a collective bargaining agreement, the relationship between labor and the debtor company continues. Therefore, rather than exacerbate a tense situation, bankruptcy courts need to use their equitable powers to encourage the parties to engage in good faith negotiations in order to achieve a mutually

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[108] *See supra* notes 46-52 and accompanying text.

[109] *In re* Mile High Metal Systems, Inc., 899 F.2d at 895-97 (discussion of legislative history) (Seymour C.J., concurring); *In re* Royal Composing Room, 848 F.2d 345, 352-354 (1988) (discussion of legislative history) (Feinberg C.J., dissenting).

[110] Cosetti, *supra* note 48, at 183.

[111] *Id.* at 208. *See also In re* Wheeling Pittsburgh Steel Corporation, 50 B.R. 969 (Bankr. W.D. Pa. 1985) where the court stated the following:

> The parties recognize that this is a collective bargaining dispute and that this court, as a place for resolving a collective bargaining dispute, is not the proper forum.
>
> The real decisions must be made at the bargaining table.

Id. at 984.

acceptable resolution of the dispute at issue.[112]

While it appears that the policies of labor law and bankruptcy law are at odds with each other, their underlying policies and goals are similar:

> The labor laws, of course, stress the maintenance of industrial peace through free collective bargaining and through adherence to the terms and conditions arrived at by the parties in their negotiations for the duration of their collective-bargaining agreement.
>
> Chapter 11 properly understood has a parallel aim, the development of an agreed on plan of reorganization that will make a financially distressed company a productive economic entity.[113]

Therefore, any interpretation of § 1113 should encourage good faith negotiations and promote consensual resolutions of labor disputes.

The Second Circuit's *Carey* decision is more apt to promote bargaining and consensual resolution of the situation than the Third Circuit's *Wheeling-Pittsburgh* decision. The Third Circuit's reliance upon only the "essential" modifications to ensure that the debtor is prevented from liquidation does not promote legitimate bargaining and does not allow the debtor to successfully reorganize its company.[114] Meaningful negotiations between debtor company and union can only occur if the "necessity" requirement is interpreted in a manner similar to that of the *Carey* court.[115]

Yet, the courts need to better accommodate the requirements of

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[112] Cosetti, *supra* note 48, at 226.

[113] 130 Cong. Rec. 6181 (daily ed. May 22, 1984) (statement of Senator Packwood). *See also* Cuevas, *supra* note 11, at 138-39 (arguing that both the Bankruptcy Code and the NLRA seek to promote negotiations and resolution of disputes through a bargaining process); Cosetti, *supra* note 48, at 224 ("[f]or all creditors, voluntary negotiations is the essence of the chapter 11 plan process.").

[114] Nichols, *supra* note 11, at 1003.

[115] *Id.* at 1005.

the NLRA in the bankruptcy context. Section 1113(b)(2) obligates a debtor to "meet, at reasonable times, with the [employees'] authorized representative [and] to confer in good faith in attempting to reach mutually satisfactory modifications of [the collective bargaining] agreement."[116] The phrases "meet, at reasonable times" and "confer in good faith" are identical to the language used in § 8(d) of the NLRA, which defines the duties of the employer and the employees' authorized representative to bargain in good faith.[117] Therefore, Congress intended that the parties' duties to bargain in good faith should be interpreted and applied in the same manner as those duties are defined in the NLRA.[118] Thus, the courts should apply the NLRA's duty to bargain in good faith standard to evaluate if the debtor or the union have negotiated in good faith. If a party has not engaged in good faith negotiations, the court should strongly consider that factor in making its determination as to whether a collective bargaining agreement should be rejected.[119]

Even though not capable of precise definition, the duty to bargain in good faith involves an "'obligation . . . to participate actively in the deliberations so as to indicate a present intention to find a basis for agreement. . . .' This implies both 'an open mind and a sincere effort . . . to reach an agreement' as well as 'a

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[116] 11 U.S.C. § 1113(b)(2) (1988).

[117] 29 U.S.C. § 158(d) (1988). The employer's and the union's duty to bargain collectively are mentioned at § 8(a)(5) and § 8(b)(3), respectively, of the NLRA. 29 U.S.C. §§ 158(a)(5) and (b)(3) (1988).

[118] *See* Martha S. West, *Life after Bildisco: Section 1113 and the Duty to Bargain in Good Faith*, 47 OHIO ST. L.J. 65, 123 (1986).

[119] For example, if the debtor company has not fulfilled its duty to bargain in good faith with the union or if both parties have not negotiated in good faith, the court should deny the debtor's petition seeking rejection of the collective bargaining agreement. Similarly, if the union has not engaged in good faith negotiations but the debtor company has done so, the court should allow rejection of the collective bargaining agreement as long as the debtor has also met all of the other obligations under § 1113.

sincere effort . . . to reach a common ground.'"[120] It is discerned from the totality of conduct by each party.[121] It requires an evaluation of a number of factors; such as, "frequency and duration of meetings, exchange or lack of exchange of counteroffers, repetitious offering of clearly unacceptable proposals, and inability to reach agreement on any significant issue."[122] The duty to bargain in good faith also includes a broad duty to furnish information, especially when such proof is needed to verify the accuracy of an argument. The inability to pay a certain wage rate is a good example of when this proof is necessary.[123]

The bankruptcy courts should develop the expertise to determine whether the debtor and/or the union have fulfilled their good

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[120] *See* CHARLES J. MORRIS ET AL.,THE DEVELOPING LABOR LAW 2D ED. 571 (1983) (quoting NLRB v. Montgomery Ward & Co., 133 F.2d 676, 686 (9th Cir. 1943)) (footnotes omitted) [hereinafter LABOR LAW]. *See also* West, *supra* note 118, at 69-70. The bankruptcy court in *Matter of Walway, Co.* defined good faith bargaining as "conduct indicating an honest purpose to arrive at an agreement as the result of the bargaining process." 69 B.R. at 973.

The concept of good faith bargaining is extremely complex and highly fact-specific. Cases discussing the concept are endless. The purpose of this paper is not to interpret the good faith bargaining standard in any great detail. An excellent summary of the determination of good faith bargaining can be found in LABOR LAW, at 570-606.

[121] *Id.* at 571-72.

[122] West, *supra* note 118, at 70.

[123] The Supreme Court in NLRB v. Truitt Mfg. Co., 351 U.S. 149 (1956), stated:

> Good-faith bargaining requires that claims made by either bargainer should be honest claims. . . . If . . . an argument is important enough to present in the give and take of bargaining, it is important enough to require some sort of proof of its accuracy.

Id. at 152-53. The duty to furnish information is mentioned in § 1113(b)(1)(B) as a duty to "provide . . . relevant information . . . necessary to evaluate the proposal." 11 U.S.C. § 1113(b)(1)(B) (1988). A list of articles discussing the duty to furnish information is detailed in LABOR LAW, *supra* note 120, at 607 n.348.

faith bargaining obligations. Such a determination, while not simple, is not beyond the capacity of a bankruptcy court judge and is required by statute. It involves reaching a legal conclusion based on the facts of the case.[124] If the judge does not feel competent, a special master with labor law expertise can be appointed to make a recommendation to the judge. Alternatively, if either party does not have confidence in the bankruptcy judge, they can request that the district court rule on the rejection issue as per § 157 (d) of the Bankruptcy Code.[125]

Even if the court determines that rejection of the current collective bargaining agreement is warranted, the debtor must still abide by its NLRA obligations and "bargain in good faith under NLRA § 8(a)(5) over the terms and conditions of a possible new contract."[126] Obligations under the NLRA are not suspended by the filing of a Chapter 11 petition. Under the NLRA, the duty to bargain in good faith continues as long as a relationship between the employer and union exists. The debtor cannot just institute any unilateral changes after rejection is approved.[127] The debtor must bargain to impasse before making any unilateral changes involving

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[124] West, *supra* note 118, at 124-25.

[125] Section 157(d) states:

> The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.

29 U.S.C. § 157(d) (1988). *See* West, *supra* note 118, at 125 n.256.

[126] *Bildisco*, 465 U.S. at 534. West, *supra* note 118, at 91-92.

[127] Yet, some decisions have implied that a rejection of a collective bargaining agreement does allow the debtor company to immediately institute changes in the conditions of employment without engaging in further bargaining. *See, e.g.*, In re Salt Creek Freightways, 47 B.R. 835, 841-42 (Bankr. Wyo. 1985); In re Allied Delivery Systems, 49 B.R. at 704.

mandatory subjects in the collective bargaining agreement.[128] In most instances, a debtor in Chapter 11 who wants to reject its current collective bargaining agreement with the union does so because it wants to alter the "wages, hours and other terms and conditions of employment," mandatory subjects of bargaining. Therefore, the bankruptcy courts should not allow any unilateral changes in the collective bargaining agreement unless it is agreed to by both parties or unless the debtor and the union have bargained to impasse.

Bargaining to impasse should not take a lengthy period of time because the emergency context of the Chapter 11 situation should provide the debtor with an incentive to negotiate with the union on an expedited basis.[129] Yet, this requirement would also recognize the legitimate role of the union in representing the employees before the debtor company, place greater pressure on the employer to bargain in a serious manner with the union, allow the parties to work more diligently towards an agreement involving mutually satisfactory modifications, and allow the union to more actively participate in the reorganization process. It would also better accommodate the role of the NLRA within the bankruptcy process by preserving a more just bargaining relationship between the debtor and union:[130]

> If the employer has not bargained in good faith by the time of the rejection hearing, or if the parties have not yet reached impasse, the court could continue the hearing for

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[128] NLRB v. Katz, 369 U.S. 736 (1962). Mandatory bargaining subjects include those dealing with "wages, hours and other terms and conditions of employment." 29 U.S.C. § 158(d) (1988). *See* NLRB v. Wooster Division of Borg-Warner, 356 U.S. 342 (1958) (where the Supreme Court distinguished between mandatory and nonmandatory subjects of bargaining while holding that insistence on bargaining over nonmandatory subjects violates the duty to bargain in good faith).

[129] West, *supra* note 118, at 124. The author cites numerous cases in which impasse was reached in two to three meetings. *Id.* at 124 n.251.

[130] *Id.* at 103-04, 125.

> another two or three weeks, giving the parties another chance to reach agreement. If no agreement has been reached by thirty days after the initial hearing date, then, but only then, is the court required to rule on the rejection application [as per § 1113(d)(2)]. Every effort should be made to assist the parties in negotiating a modified contract. Reaching an agreement will not only avoid rejection, but will also serve the goal of successful reorganization. The debtor's financial situation will be stabilized, and the parties will not have to spend time negotiating an entirely new contract. Furthermore, a negotiated compromise will insure that no strike will occur upon rejection.[131]

Therefore, bankruptcy courts should apply § 1113 in a manner which is consistent with the provisions of the NLRA. If the debtor and union cannot reach a mutually acceptable agreement so that § 1113 must be employed, the Second Circuit's *Carey* approach is preferable. Yet, the courts must be more attentive to balancing the equities by more carefully utilizing the six factor approach delineated in the *Carey* opinion.[132]

The first factor, the likelihood and consequences of liquidation if rejection is not permitted, involves a comparison of the costs of operating the business under the current collective bargaining agreement with the costs of operating the business without the agreement or with the debtor's proposed modifications which the debtor will attempt to implement if rejection is approved.[133] Rejection of the collective bargaining agreement will, in most instances, decrease the chances of liquidation because it will lower employment costs. Yet, the question should be whether liquidation will be avoided if rejection occurs. If it is likely that liquidation will occur even after rejection, then rejection should be denied

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[131] *Id.* at 126.

[132] *See supra* notes 104-05 and accompanying text. Only one other decision, *In re* Texas Sheet Metals, Inc., 90 B.R. 260 (Bankr. S.D. Tex. 1988), explicitly utilized the *Carey* six-factor approach in balancing the equities.

[133] West, *supra* note 118, at 138.

because the goal of reorganization will not be enhanced.[134]

The second and fourth factors in the *Carey* balancing of the equities test deal with the effect of rejection on various creditors' and employee claims. Rejection of a collective bargaining agreement constitutes a breach of contract with the breach occurring at the date immediately before the Chapter 11 petition was filed.[135] Therefore, any employee claims for breach of the collective bargaining agreement will become prepetition unsecured claims. Such claims have low priority. In contrast, any claims, such as wages, for services rendered after commencement of the bankruptcy case are deemed administrative expenses and are entitled to first or highest priority.[136] The creditors and the employees are at odds with each other. Rejection of the collective bargaining agreement will most likely result in lower wages and benefits being paid to the employees. This will increase the amount of money available to the creditors compared with the amount that would have been available if rejection would not have occurred. Creditors will be more inclined to approve a reorganization plan if it favorably impacts upon their claims.[137] Although rejection of the collective bargaining agreement means a breach of contract which increases the overall amount of total claims on the estate, the low priority of a breach of contract claim means that the employees will, in reality, receive little to nothing in payment.[138] Therefore, rejection of the collective bargaining agreement will enhance the value of the creditors' claims and increase the amount, although not necessarily the value, of the employee claims. As a result, these two factors would favor rejection since it would aid reorganization.

With regard to the fifth *Carey* factor, the cost-spreading abilities of the various parties, the "employees are much more

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[134] *Id.* at 139.

[135] *See* 11 U.S.C. § 365(g)(1) (1988).

[136] 11 U.S.C. §§ 503(b)(1)(A); 507(a)(1) (1988).

[137] West, *supra* note 118, at 140, 143.

[138] *Id.* at 141.

vulnerable as individuals to the possible loss of income than are business creditors."[139] Yet, if rejection of the collective bargaining agreement would guarantee a successful reorganization so that some or all jobs will be saved, then rejection might be seen as beneficial because loss of some jobs and a portion of one's income may be preferable to a loss of all employees' jobs.[140] Therefore, rejection would tend to disfavor employees due to their vulnerability, unless a successful reorganization can guarantee employees their jobs and those jobs would be better than all other alternatives.

The sixth factor, focusing on the good or bad faith of the parties in dealing with the debtor's financial dilemma, is a restatement of the duty of each party to negotiate and bargain with each other in good faith.[141] Obviously, if the debtor either does not bargain in good faith with the union, or attempts to utilize the Chapter 11 process solely to avoid its obligations under the collective bargaining agreement or destroy the union, then this factor would not favor rejection. Alternatively, if the union does not engage in good faith negotiations in attempting to come to grips with the debtor's precarious financial situation, then this factor would tilt toward favoring rejection.

One area in which many courts dealing with the issue of allowing rejection of collective bargaining agreements in Chapter 11 proceedings have been remiss is not giving appropriate weight to the likelihood and consequences of a strike by a debtor's employees, factor three of the *Carey* balancing of the equities test.[142] Because the rejection of a collective bargaining agreement may lead to a strike, courts need to take that possibility and its

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[139] *Id.* at 142.

[140] *Id.*

[141] *See supra* notes 116-25 and accompanying text for a discussion of the duty to bargain in good faith.

[142] *See* Joshua L. Sheinkman, *Rejection of Collective Bargaining Agreements in Chapter 11 and the Probability of Strikes: Tipping the Balance of Equities*, 15 N.Y.U. REV. L. & SOC. CHANGE 513, 533 (1987).

consequences into account.[143] Courts need to concentrate on this factor more carefully as it may be the key element in determining whether rejection of a collective bargaining agreement will help or hinder a debtor's reorganization.

In analyzing the importance of the strike factor, courts should concentrate on two major aspects: "1) the probability of a strike occurring after rejection; and 2) the likelihood that such a strike would impair reorganization."[144] In appraising the probability of a strike after rejection, the court should consider: (1) the responses of employees of other companies in the same industry after their labor contracts have been rejected; (2) the size and labor intensiveness of the company because larger and more labor intensive companies are usually better organized and more prone to striking; and (3) whether the company is in the transportation or trucking industry or has been recently deregulated because such industries are more prone to strikes.[145]

Moreover, in evaluating the likelihood that a strike will impair reorganization, the court should assess: 1) the financial resources that the union can commit to maintain a strike; and 2) the ability of an employer to recruit and retrain qualified strike replacement workers.[146] When the union is financially committed, like in the 1983 Continental Airlines situation, a steady supply of strikebreakers can negate any deleterious effect a strike may have on reorganization.[147] Yet, if the union is strong and well-organized, like the United Steelworkers of America in the *Wheeling-Pittsburgh* situation, a rejection of a collective bargaining agreement can precipitate a harmful strike.[148] Ultimately, the court's decision

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[143] *Id.* at 532.

[144] *Id.* at 538.

[145] *Id.* at 538-39.

[146] *Id.* at 540.

[147] *Id.* at 540. *See also* Cosetti, *supra* note 48, at 183.

[148] *Id.*

comes down to an appraisal of the economic power of both sides, the union and the debtor company, while also taking into account the external environment. Unfortunately, most courts have, at best, merely evaluated the possibility of a strike in a superficial and shallow manner.

Courts need to be aware of their limited role in resolving labor disputes. They need to realize that an inappropriate rejection of a collective bargaining agreement will not resolve the situation, but, rather, may precipitate a strike. That was exactly what the bankruptcy court did in *Wheeling-Pittsburgh*.[149] The judiciary needs to realize that its involvement in a labor dispute and its use of § 1113 will not resolve the situation. Instead, it can have the opposite effect by hardening positions and wasting valuable time and resources.[150]

When a company files a Chapter 11 reorganization petition, the company and the union are in the best position to evaluate the company, including its history, the reason that it got into trouble, its chances for a successful reorganization, the amount of sacrifices required by each party to successfully reorganize the business, the fairness of the sacrifices required by each side to make the reorganization successful, and any other relevant information. The

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[149] Sheinkman, *supra* note 142, at 518. The article also details a number of other situations where rejections or breaches of collective bargaining agreements precipitated or exacerbated strikes by employees. Other examples mentioned in the article include: Wilson Foods (1983), Continental Airlines (1983), Bohack Corp. (1976), Briggs Transportation Company (1984) and IML Freight, Inc. (1986, where rejection of a collective bargaining agreement by a bankruptcy court precipitated a strike which forced the company into liquidation). *Id.* at 528-32. The Eastern Airlines and the Greyhound bankruptcies are two more recent examples where strikes by employees have precipitated bankruptcy filings and where the company has tried unsuccessfully to use the bankruptcy process to its advantage to solve labor disputes. *See* Aaron Bernstein, *Busting Unions Can Backfire on the Bottom Line,* BUS. WK., Mar. 18, 1991, at 108; *ALPA Leaders at Eastern Call Meeting Following Court Approval for Pay Cuts*, DAILY LAB. REP., Aug. 16, 1990, at A11; Diane B. Beckham & Amy Boardman, *Learning from Lorenzo; Weil, Gotshal Steers Greyhound to Friendly Turf*, LEGAL TIMES, June 18, 1990, at 2.

[150] Cosetti, *supra* note 48, at 221.

company, by filing a Chapter 11 petition, has evaluated its situation and has decided that a reorganization is possible and is preferable to liquidation. The union has or will also engage in that evaluation. It will need to determine whether it makes sense to attempt to work with the debtor company in rehabilitating the company, whether wage and benefit concessions are in its and the company's best interests, or whether its employees, the company and the economy are better off by having the company liquidated. The company and the union are closest to the situation, probably have more inside knowledge about the events that lead up to the Chapter 11 filing, and are the parties that have to live with the consequences of their decisions. Therefore, the court should step gingerly when involving itself in any collective bargaining dispute, especially one involving a distressed company.

The ultimate answer lies in the marketplace where the union and the debtor company can use their economic power to negotiate a resolution of their dispute. Courts are a poor substitute for the marketplace and are not very good at approximating economic reality.[151] A court can either consciously or unconsciously attempt to artificially tip the balance of power to one side or the other.[152] Yet, this does not aid the situation. It will most likely prolong the inevitable, as the parties realize that reliance on their legal positions, rather than their economic positions, has not solved their dispute.[153] Therefore, courts need to be aware of their place and the need to adhere to the NLRA, as it has evolved in defining the relationship between employer and labor organization in regards to collective bargaining.

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[151] *Id.*

[152] *Id.* at 226.

[153] *Id.*

VI. CONCLUSION

As two commentators have written:

> [L]abor is a unique creditor. Labor creditors are not completely subject to a two-thirds majority vote and the cram down provisions because of their strike power. Rejection of the labor contract does not change the designated bargaining agent or unit. The union continues to exist and is free to strike. An active and strong union will require a new contract.
>
> Further, rejection of the pre-petition labor contract does not determine the actual economic provisions to be adopted in the post-petition labor contracts. Most labor contracts are limited to relatively short periods of time, such as one, two, or three years. Success of the reorganized enterprise offers new opportunities to renegotiate contracts in the future. This is not the case for other creditors.
>
> It should be obvious (but it has not been) that unless a new labor agreement is negotiated, a strong labor organization will strike when their contract is rejected. In an ongoing business, a strike is likely even if courts determine by strict standards that rejection is appropriate. Strongly represented employees are conditioned to work only when a contract is in place. The Bankruptcy code does not provide the court with unique ability to prevent such a strike.
>
> This may not be the condition when the union is disorganized. A weak or disorganized union may be forced to accede to rejection and to the debtor's proposal. Obviously, in these situations, the court should proceed carefully so as to maintain the needed equity balance. . . . A union that cannot maintain an effective strike as a last resort has lost its ultimate bargaining weapon.[154]

Proper application of § 1113 can adequately accommodate the

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[154] *Id.* at 222-23 (footnotes omitted).

goals and policies of labor law and bankruptcy law. Both of these comprehensive federal legal systems are based upon the need for negotiations and consensual agreements.

Courts need to understand the limited role that they can play in resolving labor disputes. Ultimately, the labor dispute must be resolved in the marketplace where both parties, the debtor company and the union, can use their economic and bargaining power to effectuate a settlement. Therefore, courts should not interject themselves into a labor dispute without recognizing and accounting for each side's economic power, or attempting to tilt that balance of power in favor of one side. If they do, the consequences may be disastrous. The court's unenlightened interjection may lead to a strike, the prolongation of the reorganization process or to liquidation. In any event, it will increase the deadweight bankruptcy costs to society.

Rather than attempt to use their power to reject a collective bargaining agreement under § 1113, bankruptcy courts should utilize their equitable powers to require good faith bargaining and negotiations between labor and the debtor company, so that a mutually acceptable agreement can be reached which is based on each side's economic power.