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INTRODUCTION

On September 24, 1983, Continental Airlines, the nation’s eighth largest air passenger carrier, filed with the U.S. Bankruptcy Court for the Southern District of Texas a petition for relief under Chapter 11 of the Bankruptcy Reform Act of 1978 [Code]. Continental then unilaterally changed work rules and slashed salaries in violation of collective bargaining agreements in effect with the several unions representing Continental employees. Three days later the airline resumed operations on roughly one-third of its former system, using employees willing to cross picket lines set up by two unions opposed to the company’s actions. These employees found themselves working under fundamentally different conditions. Pilots formerly earning an average of $77,000 a year now earned a flat $43,000, while flight attendants went from a pre-Chapter 11 filing average of $29,000 to a new base of $14,000.

The Continental case, while furnishing a dramatic example of the use of bankruptcy laws to escape obligations under collective bargaining agreements, was by no means an extraordinary occurrence. Petitions filed by businesses for relief under Chapter 11 totaled 18,306 for the year ending on June 30, 1983, compared to 12,385 and 7,230 for 1982 and 1981, respectively. In many instances, these petitions were filed by companies hit hard either by the effects of the recent recession or by governmental deregulatory efforts, especially in the trucking, airline, steel, and heavy manufacturing industries. Frequently, such companies were contractually required to pay high wages and benefits to unionized employees under collective bargaining agreements. Businesses in Chapter 11 often cited these costs as an impediment to successful reorganization, while union members argued that such claims constituted little more than legalized unionbusting.

The controversy intensified after the Supreme Court decision in NLRB v. Bildisco and Bildisco. The decision outraged union leaders and led to the

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MONTHLY LAB. REV. 73 (November 1983).
Id.
Id.
passage of 11 U.S.C. § 1113. This comment will explore the issues arising from efforts by businesses to reject or modify collective bargaining agreements under section 1113. The comment will review the history of such efforts, and will then discuss the Bildisco decision. The comment will then examine section 1113 and offer suggestions as to its interpretation.

BACKGROUND

Under Chapter 11 of the Code, a financially distressed corporation is given an opportunity to reorganize. Such a reorganization contemplates a restructuring of the entity’s finances in order to preserve the continued existence of the business as well as to preserve its employees’ jobs. Section 365(a) furthers this goal by allowing a debtor-in-possession, subject to the court’s approval, to assume or reject any executory contract. This power to reject any executory contract is well established in bankruptcy law and is based on the principle that a trustee in bankruptcy might renounce title to and abandon burdensome property.

Although the Bankruptcy Code contains no definition of the term executory contract, it has long been interpreted to include collective bargaining agreements. In NLRB v. Bildisco and Bildisco, the Supreme Court agreed with this interpretation. The Court noted that section 365(a) contains limitations on the debtor-in-possession’s power to reject executory contracts, yet none of these limitations apply to collective bargaining agreements. In addition, section 1167 of the Bankruptcy Code expressly exempts executory contracts subject to the Railway Labor Act from the reach of the debtor-in-possession’s rejection power. Thus, the Court concluded that Congress intended

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b Section 365(a) provides: “Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.” Bankruptcy Reform Act of 1978, §365(a) (Supp. IV 1980).
c For the purposes of this comment the term debtor-in-possession will include both a trustee and a debtor-in-possession since under the Code, with a few variations, a debtor-in-possession has essentially the same rights as a trustee. See 11 U.S.C. §1107.
d The power to reject executory contracts was first codified in the Chandler Bankruptcy Act of 1938, but had previously been well established by judicial decision. 4a Collier On Bankruptcy §70.43(1) (15th ed. 1984).
e 2 Collier On Bankruptcy §365.01(1) (15th ed. 1984).
f Professor Countryman has defined an executory contract as follows: “[a] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other.” Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973). This definition was followed in New England Carpet Co. v. Connecticut Gen. Life Ins. Co., 18 Bankr. 514, 516 (Bankr. D. Vt. 1982); In re Sun Ray Bakery, Inc., 5 Bankr. 670, 672 (Bankr. D. Mass. 1980).
g 2 Collier On Bankruptcy supra note 14, at § 365.03.
h 104 S. Ct. at 1194.
i Id. at 1194-95, 1995 n. 8. Section 1167(a) provides “Notwithstanding section 365 of this title, 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 Railway Labor Act (45 U.S.C. §§151 et seq.) except in accordance with section 6 of such act (45 U.S.C. §156).” 11 U.S.C. §103(g) limits this section to cases con-
that under section 365(a) executory contracts include collective bargaining agreements.

This interpretation, however, places federal bankruptcy law squarely at odds with federal labor law. One of the basic policies of labor law is to encourage the creation and enforcement of collective bargaining procedures. Accordingly, the National Labor Relations Act [NLRA] and the Railway Labor Act [RLA] specify the procedures that an employer must observe when modifying or rejecting a collective bargaining agreement. These procedures and the policies underlying them are evaded when an employer is permitted to reject a collective bargaining agreement under the Bankruptcy Code.

Ordinarily, executory contracts subject to section 365(a) can be rejected by the debtor-in-possession on the basis of a simple business judgment standard. Under this test, the court will permit rejection of an executory contract when rejection is advantageous to the debtor. This test, however, has only been applied to collective bargaining agreements in two reported cases. Instead, courts have applied a stricter standard, recognizing the favored status of collective bargaining agreements and the employee rights and federal labor policies affected by such decisions.
Appellate courts developed several versions of this stricter standard before the Supreme Court reached this issue in *Bildisco*. The stricter standard was first articulated in *Shopman's Local Union No. 455 v. Kevin Steel Products, Inc.* After rejecting the business judgment test, the court held that rejection of a collective bargaining agreement should be permitted "only after thorough scrutiny, and a careful balancing of the equities on both sides. . . ."

The next important appellate case was *Brotherhood of Railway, Airline & Steamship Clerks v. REA Express*, decided by the Second Circuit Court of Appeals only a few weeks after its decision in *Kevin Steel*. Here, the court established a standard governing rejection different from that set out in *Kevin Steel*. Under this approach, rejection would be permitted only "after a careful weighing of all the factors and equities involved" establishes that unless the agreement is rejected the debtor will be forced into liquidation. While not purporting to develop a new standard, the *REA* court clearly placed a greater burden on the debtor-in-possession seeking rejection of a collective bargaining agreement. Only by establishing that the business would collapse should the petition for rejection be denied would a debtor be permitted to reject the agreement.

**BILDISCO**

The next important appellate decision was *In re Bildisco*, the first appellate case following the passage of the Bankruptcy Reform Act. Bildisco and Bildisco, a New Jersey general partnership in the business of distributing building supplies, had filed for reorganization under Chapter 11 and had been authorized to operate as a debtor-in-possession. Bildisco's petition to reject a collective bargaining agreement with a union representing forty to forty-five percent of its employees was granted by the bankruptcy court. The union meanwhile filed unfair labor practice charges with the National Labor Rela-
tions Board. The Board found that Bildisco had violated section §§ 8(a)(5) and 8(a)(1) of the NLRA by unilaterally changing the terms of the collective bargaining agreement and by refusing to negotiate with the union. The Board then ordered Bildisco to observe the terms of the agreement.

On appeal to the Third Circuit, the NLRB’s petition to enforce its order and the union’s appeal were consolidated. After holding that collective bargaining agreements were subject to rejection under section 365(a) of the Code, the court adopted the standard employed by the Second Circuit in *Kevin Steel*. The Bildisco court held that this required the debtor-in-possession to show not only that the collective bargaining agreement is “burdensome to the estate,” but also that the equities balance in favor of rejection.

The Third Circuit also refused to enforce the order of the NLRB, which rested on the finding of an unfair labor practice. The court characterized the debtor-in-possession as a new entity which was not bound by its prior collective bargaining agreement. Because it was no longer a party to this agreement, Bildisco as debtor-in-possession had the ability to reject the agreement without following the procedures set out in section 8(d) of the NLRA. The “new entity” theory therefore removed the basis for the unfair labor practice charges brought by the NLRB.

The Supreme Court granted certiorari. The Court sought to resolve the conflict between the test adopted by the Third Circuit in *Bildisco* and the stricter standard established by the Second Circuit in *REA Express*. The Court also reached the issue of whether an employer who fails to abide by the terms of a collective bargaining agreement before the court permits rejection of the agreement commits an unfair labor practice.

As to the applicable standard, the Court refused to adopt the strict *REA Express* test. According to the Court, this standard is “fundamentally at odds with the policies of flexibility and equity” underlying Chapter 11 and will “present difficulties to the debtor-in-possession that will interfere with the reorganization process.” Instead the Court, citing *In re Brada-Miller Freight*

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*Id.*

*Section 8(a) of the National Labor Relations Act, 29 U.S.C. § 158, provides in part: (a) Unfair labor practices by employer: It shall be an unfair labor practice for an employer: (1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 157 of this title; ... (5) to refuse to bargain collectively with the representatives of his employees. . . .

*682 F.2d at 76.

*Id. at 78.

*Id. at 81.

*Id. at 82-83.

*Id. at 83.

*104 S. Ct. 1188, 1191-92.

*Id. at 1196.
System, Inc., adopted the test employed by the Second Circuit below. Thus, rejection of a collective bargaining agreement under section 365(a) should only be permitted "if the debtor can show that the agreement burdens the estate, and ... after careful scrutiny, the equities balance in favor of" rejection.

The Court supplied the bankruptcy courts with several guidelines to help implement this standard. A balancing of the equities must not occur unless the court is "persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution." In addition, rejection should not be permitted without a finding in the record that such action would serve the policy of Chapter 11 to permit the successful rehabilitation of the debtor. Thus, when balancing the equities the bankruptcy court's overriding focus must concern the policy goals behind Chapter 11.

The Court split on the second issue, holding that a debtor-in-possession does not commit an unfair labor practice by failing to comply with the labor laws before the court permits rejection of the collective bargaining agreement. The Court, however, did not rely on the "new entity" theory employed by the Third Circuit below. This theory had been widely criticized for its analytical inconsistencies.

Instead, the Court characterized the debtor-in-possession as the same entity now empowered by the Bankruptcy Code to deal with its contracts in a different manner. The Code's primary purpose is to provide the debtor-in-possession with some flexibility and breathing space in moving toward a successful reorganization. Saddling the debtor-in-possession with unfair labor practice charges for failing to abide by the agreement pending judicial action on the petition would, in effect, enforce the contract terms of the agreement. This, the Court felt, runs counter to the idea of flexibility provided by Chapter 11 and thus unfair labor practice charges will not lie in this situation.

4702 F.2d 890 (11th Cir. 1983).
104 S. Ct. at 1196.
4 Id.
9 Id. at 1197.
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 creditor's claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees. Id.
9 Id. at 1199.
5 See, e.g., Bordewieck & Countryman, The Rejection of Collective Bargaining Agreements by Chapter 11 Debtors, 57 AM. BANKR. L.J. 293, 301 (1983) "The 'new entity' theory simply cannot withstand close scrutiny; one need only observe that a 'new entity', not a party to the contracts of its prepetition predecessor, would scarcely need bankruptcy court approval to reject one of these contracts." Id. at 301. See also In re Brada Miller Freight System, Inc., 702 F.2d 890, 895 (11th Cir. 1983).
5104 S. Ct. at 1198-99.
Four justices dissented on this second holding. Justice Brennan argued that an accommodation between the bankruptcy and labor laws must focus on the policies behind both statutes and not solely on the bankruptcy laws. Refusing to recognize unilateral termination as an unfair labor practice would not serve section 8(d)'s policy of regulating terminations so as to facilitate agreement and to discourage economic warfare.\(^3\) In addition, Chapter 11’s policy to promote successful reorganization is still served if the court permits rejection of the agreement.

**The Reaction to Bildisco**

Organized labor reacted immediately to the *Bildisco* decision. Lane Kirkland, president of the AFL-CIO, expressed his disappointment in the decision and vowed to pursue a legislative remedy.\(^4\) Within two months the AFL-CIO had sent more than 20,000 letters and postcards to Capitol Hill expressing concern about the case.\(^5\) Other unions, including the Teamsters and the Air Line Pilots Association, began lobbying for some type of congressional response.\(^6\)

The reasons for the unions’ concern were apparent. In light of the *Bildisco* decision and the actions taken by Continental Airlines,\(^7\) unions feared that Chapter 11 now provided management with a method of escaping labor contracts while ignoring the safeguards built into the labor laws. Alternatively, the unions feared that Chapter 11 would at least provide management with a “big stick” with which to win concessions from the unions. This was particularly alarming to the unions because there is nothing in the Bankruptcy Code to prevent an otherwise solvent company from filing under Chapter 11.\(^8\) The Bankruptcy Reform Act of 1978 deleted the insolvency requirement found in the 1898 Act in favor of speed and simplicity in reorganizing the debtor.\(^9\)

**Section 1113**

Congress responded within three months. As part of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Congress added a new section 1113 to Chapter 11.\(^60\) Section 1113 sets out the procedure under which a debtor-in-possession in Chapter 11 may reject or modify a collective bargaining

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\(^{3}\)Id. at 1208. (Brennan, J., dissenting.)
\(^{5}\)Wall St. J., May 15, 1984, at 1, col. 5.
\(^{7}\)See text accompanying notes 1-4.
\(^{9}\)Id.

agreement.61 The section substantially adopts the standard for rejection developed by the Supreme Court in Bildisco while overruling the Court’s holding concerning unilateral rejection and unfair labor practice charges.

Under Section 1113 the court can approve an application for rejection of a collective bargaining agreement only if the following requirements are met: (1) The debtor-in-possession has proposed necessary modifications to the agreement that are fair and equitable to all parties; (2) The union rejects the proposal without good cause; and, (3) The balance of the equities clearly favors rejection of the agreement.62

Proposal to Modify the Agreement

In general, Section 1113 requires negotiations to attempt to save both the collective bargaining agreement and the business prior to court adjudication of an application to reject the agreement.63 Thus, subsection (b)(1)(A) requires the debtor-in-possession to make a proposal to the union before filing such an application.64 The proposal must provide for “those necessary modifications [in the agreement] that are necessary to permit reorganization of the debtor, and [to] assure[ ] that all creditors, the debtor, and all affected parties are treated fairly and equitably. . . .”65

According to the legislative history, the key phrase is “necessary modifications,” meaning only those modifications that must be accomplished if the reorganization is to succeed.66 By imposing this limitation, Congress sought to prevent a debtor-in-possession from using Chapter 11 to “rid itself of unwanted features of the labor agreement that have no relation to its financial condition and its reorganization.”67

In In re American Provision Co.,68 the bankruptcy court considered an application to reject two collective bargaining agreements under section 1113. The court held that the debtor-in-possession bears the burden of persuasion by

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61Section 1113 does not apply to a case covered by subchapter IV of Chapter 11 and by title I of the RLA. 11 U.S.C. §103(g) limits subchapter IV to cases concerning a railroad. Thus, section 1113 will not apply to cases concerning the reorganization of debtor railroads.
6211 U.S.C. §1113(c).
64Subsection (b)(1)(a) provides: Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee . . . 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 reorganizations of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably. . . .
65Id.
66130 CONG. REC., supra note 63, at H7496 (statement of Rep. Morrison).
67Id. at S8898 (statement of Sen. Packwood).
the preponderance of the evidence of showing that the proposed modifications are necessary to permit successful reorganization. Here, the debtor-in-possession failed to meet its burden because the proposed modifications would have produced savings amounting to only two percent of the debtor's monthly operating expenses. Thus, under subsection (b)(1)(A) the debtor-in-possession must be able to justify its proposed modifications since courts will strike down any proposals that are not necessary to permit successful reorganization.

Under subsection (b)(1)(A), the proposal must also assure that "all creditors, the debtor, and all of the affected parties are treated fairly and equitably . . ." This requirement assures that the burden of sacrifices in the reorganization process does not fall exclusively on the unionized employees but is spread among all affected parties.

Wage reduction is one such burden. The pre-section 1113 cases may offer some guidance in this area. The In re Blue Ribbon Transportation Co., Inc. court granted the debtor-in-possession's petition to reject a collective bargaining agreement but only on the condition that the company reduce its management costs. The court noted that unionized workers had agreed to significant concessions before the company filed under Chapter 11, while management expenses remained far above the industry average. The court therefore ordered the company to reduce management salaries, cut the number of company cars, eliminate gas credit cards, and reduce management welfare and pension plan payments before the agreement could be rejected. Thus, in keeping with this rationale, the union can argue that under subsection (b)(1)(A) any proposed reductions in union wages and benefits must be accompanied by corresponding reductions among management and non-union employees. The debtor-in-possession may again bear the burden of showing that the proposed modifications treat all parties fairly and equitably.

Under subsection (b)(1)(B), the debtor-in-possession must provide the union with "such relevant information as is necessary to evaluate the proposal." Under subsection (b)(1)(A), the proposal itself must be based on the "most complete and reliable information available at the time of such
proposal." Therefore, relevant information would include such current complete and reliable information.

The legislative history emphasizes the mandatory character of this provision by stating that if the debtor-in-possession does not meet or delays his obligation to provide this information the petition to reject the agreement should be denied. In In re American Provision Co., the court held that the debtor must show what information it provided to the union. The union then bears the burden of production to show that the "information provided was not the relevant information which was necessary for it to evaluate the proposal." Thus, if the union meets this burden, then the petition should be denied.

There are limits on the reach of this subsection. Under subsection (d)(3), the court may enter protective orders, consistent with the union's needs to evaluate the proposal, which may be necessary to prevent disclosures which could harm the debtor-in-possession's competitive standing. The legislative history also insists that the proposal is not to be construed to require a detailed accounting of how the difficult burden of reorganization is to be distributed amongst the competing parties.

Good Faith

After making the proposal the debtor-in-possession is obligated under subsection (b)(2) to meet at reasonable times with the union to confer in good faith concerning a modification of the agreement. This subsection does not explain what is good faith. However, the legislative history indicates that the concept should be interpreted according to the Bildisco decision. In Bildisco, the Court held that in reviewing the negotiation process, the bankruptcy court "need not determine that the parties have bargained to impasse or make any other determination outside the field of its expertise." Thus, it appears that the bankruptcy court should interpret the good faith requirement according to the needs of the situation, rather than according to established labor law con-

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11 Id. at 909.
12 Id. at 910.
13 Subsection (d)(3) provides:
   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 neces-
   sary to prevent disclosure of information provided to such representative where such disclosure could
   compromise the position of the debtor with respect to competitors in the industry in which it is en-
   gaged.
17 104 S. Ct. at 1197.
cepts. In In re American Provision Co., the debtor-in-possession held a single meeting with the union to discuss modifications of the collective bargaining agreement. The debtor ignored union requests for further discussion. The union declined to accept the proposed modifications. In rejecting the petition to repudiate the agreement, the court held that the union met its burden of producing evidence that the debtor-in-possession did not confer in good faith and that the debtor-in-possession did not meet its burden of proving that it had. This result demonstrates the emphasis which Congress placed on negotiation through the use of the good faith requirement.

Good Cause

The second requirement that must be met before rejection of the collective bargaining agreement is permitted is that the union must have rejected the debtor-in-possession’s proposal without good cause. Here the key phrase is “good cause.” The legislative history indicates that “good cause” does not impart traditional labor law concepts to a bankruptcy forum, nor does it transform the bankruptcy court into a version of the NLRB. Rather, the phrase is to be interpreted narrowly, intending to ensure that a continuing process of good faith negotiation will take place before court involvement. Thus, the requirement of “good cause” in subsection (c) puts pressure on the debtor-in-possession to negotiate in good faith in order to make it more difficult for the union to have good cause to reject the proposal.

The legislative history also states that “good cause” is intended to embody the standard set out by Professor Countryman in a recent article. In his article, Countryman argues that considerable weight should be given to a “considered union view” that rejection of the agreement is not necessary. The reasoning behind this position is apparent. A debtor-in-possession arguing that rejection of the agreement is necessary or the business will fail has little to lose if this is an incorrect position and he should prevail. In such a situation, the debtor-in-possession will have avoided the agreement when it was not necessary to do so in order to save the business. A union arguing that rejection is not necessary to save the business, however, has a great deal to lose if this is

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\(^{44}\)Bankr. at 911.

\(^{11}\)11 U.S.C. § 1113(c)(2).

\(^{130}\)CONG. REC., supra note 63, at S8887 (statement of Sen. Thurmond).

\(^{Id.\ at\ H7495\ (statement\ of\ Rep.\ Lungren).\}

\(^{Id.\ at\ H7496\ (statement\ of\ Rep.\ Morrison).\}

\(^{Id.,\ citing\ Bordewieck\ &\ Countryman, supra\ note\ 51,\ at\ 299,\ 309.\}

\(^{Bordewick\ &\ Countryman, supra\ note\ 51,\ at\ 299-300,\ 319.\}
an incorrect position and the union prevails. In that case, the collective bargaining agreement remains intact, the business fails, and the unionized employees lose their jobs.

Another commentator has offered an alternative interpretation of “good cause.” Under this interpretation, the union would have good cause to reject a debtor-in-possession’s proposal when the union submits a counterproposal that also meets the requirements of section 1113(b)(2). Such an interpretation is consistent with the purpose of section 1113 of placing the overall emphasis on the negotiation process and not on the courts.

Both interpretations recognize that the union could be placed in a difficult position under subsection (c)(2). In a Chapter 11 case there may be numerous proposals that will satisfy subsection (b)(1)(A). Yet the union will inevitably prefer one alternative over the others. Thus, “good cause” should not be construed to deprive a union negotiating in good faith of the ability to bargain between the available alternatives. The court should therefore construe “good cause” liberally. This will encourage the parties to negotiate, and will prevent the union from being forced to accept the debtor-in-possession’s proposal, which may be only one of several feasible alternatives.

**Balance of the Equities**

The last requirement under the section 1113 standard for rejection is that “the balance of the equities clearly favors rejection of such agreement.” This differs slightly from the Bildisco standard since the balance must clearly favor rejection of the agreement. This was intended to assure that rejection is not warranted where the equities balance exactly equally on both sides. In addition, this requirement may also prevent a court from applying merely the business judgment test under the guise of a balancing of the equities standard.

In Bildisco, the Supreme Court held that “the Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization.” Interpreting this passage before the adoption of section 1113 another court held:

> [the court] must consider the possibility of liquidation, both with and without rejection of the contract. It must also consider the import of liquidation on each of the parties involved. The bankruptcy court must also

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*Id. at 299-300.

*Id at 341. The proposal must contain only those modifications necessary to the reorganization and that are fair and equitable to all parties. 11 U.S.C. § 1113(b)(2).

*Gibson, supra note 88, at 342.

*See text accompanying notes 63-65.

*130 CONG. REC., supra note 63, at S8891 (statement by Sen. Hatch).

*104 S. Ct. at 1197.
consider the claims of employees that will result from rejection and the impact on claims of creditors if rejection is not allowed. The court should also consider the possibility of a strike if rejection is approved. Another factor is the cost-spreading abilities of the parties.\(^{103}\)

This list of equities summarizes the discussion of the “balance of the equities” test in the leading pre-section 1113 cases.\(^{104}\) The list is not exhaustive, but one must remember that “‘balancing the equities’ is a broad, equitable test that has not yet been given rigid form by decades of judicial interpretation.”\(^{105}\) Thus, counsel should view this general list as a rough outline of the potential equities involved.

**Good Faith Revisited**

The concept of good faith plays a dual role under section 1113. In addition to arguing that the debtor-in-possession is not negotiating in good faith, the union can also argue that the Chapter 11 petition itself was not filed in good faith. Such a petition will be denied.\(^{106}\)

The proposition that a petition filed under Chapter 11 solely to repudiate the collective bargaining agreement is not one filed in good faith finds support in the pre-section 1113 cases. In *In re Tinti Construction Co.*,\(^{107}\) a unionized contractor attempting to compete with non-union outfits sought to reject a collective bargaining agreement in Chapter 11. The sole purpose of declaring bankruptcy was to reject the agreement. The court specifically found that the debtor-in-possession was “in no way whatsoever motivated by animus toward the Union,” and that this was not a “union busting” case.\(^{108}\) Nevertheless, the court denied the petition, holding that filing for the sole purpose of rejecting the agreement was not a proper use of Chapter 11.\(^{109}\) Similarly, in *In re Brada Miller Freight System, Inc.*,\(^{110}\) the appellate court ordered the bankruptcy court to “make an ‘explicit showing in the record that the debtors were not improperly motivated by a desire to rid themselves of the union’ prior to allowing the rejection of a collective bargaining agreement.”\(^{111}\)


\(^{104}\) See NLRB v. Bildisco and Bildisco, 104 S. Ct. 1188 (1984); *In re Brada Miller Freight System, Inc.*, 702 F.2d 890 (11th Cir. 1983).

\(^{105}\) Gibson, supra note 88, at 343.

\(^{106}\) In the following cases, petitions filed under Chapter 11, although unrelated to collective bargaining agreements, were dismissed as being filed in bad faith: *In re Thirtieth Place, Inc.*, 30 Bankr. 503 (Bankr. App. 9th Cir. 1983); *In re Brandon Farmer’s Market, Inc.*, 34 Bankr. 148 (Bankr. M.D. Fla. 1983); *In re Landmark Capital Co.*, 27 Bankr. 273 (Bankr. D. Ariz. 1983); *In re Avan, Inc.*, 25 Bankr. 121 (Bankr. D. Ohio 1982); and *Weathersfield Farms, Inc. v. First Inter-State Bank*, 15 Bankr. 282 (D. Ve. 1981).

\(^{107}\) 29 Bankr. 971 (Bankr. E.D. Wis. 1983).

\(^{108}\) *Id.* at 974.

\(^{109}\) *Id.* at 975.

\(^{110}\) *Id.* at 901.
These cases find expression in the legislative history of section 1113. According to Representative Morrison, "it was also our understanding that a chapter 11 reorganization case that is brought for the sole purpose of repudiating or modifying a collective bargaining agreement is a case brought in 'bad faith'." Thus, a union should not limit its efforts to the scope of section 1113. Instead, the union must be prepared to attack the Chapter 11 petition itself as being filed in bad faith if it appears that the debtor-in-possession's sole motivation is to reject or modify the collective bargaining agreement.

**Timing**

Under section 1113(d)(1), the court shall hold a hearing no later than fourteen days after the filing of an application for rejection. Under subsection (d)(2), the court shall rule on the application within thirty days after commencement of the hearing. If the court does not so rule within thirty days the debtor-in-possession may unilaterally terminate or alter any provisions of the agreement pending a ruling by the court on the application. In such a situation, the debtor-in-possession would fall under Bildisco in being permitted to unilaterally terminate the agreement before formal rejection by the Bankruptcy Court.

**Interim Relief**

Subsection (3) allows the court to authorize the debtor-in-possession to make interim changes in the terms of the agreement if those changes are essential to continue the debtor's business or to avoid irreparable damage to the estate. The legislative history states that this provision essentially requires the test used in the REA Express case; that is, a rejection or modification will be permitted only when necessary to prevent the business from being liquidated.

The cases thus far have agreed with this interpretation. In *In re Wright Air lines, Inc.*, the debtor-in-possession sought interim relief under subsection (e). The court interpreted subsection (e) as providing that interim relief will

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111Id.
1111Subsection (e) provides:
   "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 trustee. The implementation of such interim changes shall not render the application for rejection moot."
111730 CONG. REC., supra note 63, at S8898 (statement of Sen. Packwood).
be granted only if the debtor establishes either "that the relief sought is essential to the continuation of its business, or, that irreparable damage to the Debtor-in-Possession will result if the relief is not granted." The court held that the debtor-in-possession had not met its burden since the proposed savings amounted to less than ten percent of its monthly losses.

Similarly, in *In re Salt Creek Freightways*, the court held that interim changes may be authorized only if the evidence establishes that, without such changes, the company will collapse and the employees will no longer have their jobs. Here the debtor-in-possession introduced evidence showing losses and asset depletion suffered by the company as well as performance schedules reflecting labor costs with and without the proposed interim changes. In addition, the president and chief executive officer testified that the company would not be able to survive for more than a week without the proposed changes. The union did not dispute this evidence. The court granted the requested relief.

These two cases make it clear that a debtor-in-possession seeking interim changes bears a heavy burden to satisfy the strict *REA Express* standard. If the relief is granted, such changes will remain in place only for the time the collective bargaining agreement continues in effect. Thus, such changes will end when the parties reach a new agreement or the court permits rejection of the existing agreement.

**Unilateral Rejection**

Subsection (f) overrules the holding in *Bildisco* that a debtor-in-possession may unilaterally terminate the agreement without committing an unfair labor practice pending court adjudication of a petition to reject the agreement. This subsection uses the language "no provision of this title shall be construed to permit" unilateral rejection. This removes the conflict on this issue be-
between the NLRA and Chapter 11, and thus a debtor-in-possession who unilaterally terminates a collective bargaining agreement commits an unfair labor practice. This provision therefore serves the policy behind section 1113 of encouraging the parties to negotiate changes in the agreement. Subsection (f) is subject, however, to subsection (d)(2) which permits the debtor-in-possession to unilaterally reject the agreement if the court fails to rule on an application to reject within thirty days after the date of the commencement of the hearing on the application.

**CONSEQUENCES OF REJECTION**

The court-approved rejection of a collective bargaining agreement may carry with it important consequences. In *Bildisco*, the Supreme Court rules that the debtor-in-possession is still an "employer" within the meaning of the NLRA and remains obligated to bargain in good faith under NLRA section 8(a)(5) over the terms and conditions of a new contract. Thus, the debtor-in-possession who prevails on an application to reject the agreement avoids the agreement only and not the union itself.

A critical result of rejection of a collective bargaining agreement is that the employees will have claims against the debtor-in-possession based on rejection of the agreement. Under section 365(g)(1) of Chapter 11, rejection of the agreement constitutes a breach of an executory contract. The breach relates back to the date immediately preceding the filing of the Chapter 11 petition. This results in prepetition unsecured claims for the union members for damages flowing from the breach. Under section 502(g), these claims must be presented through the normal administration process by which such claims are estimated and classified. These claims include lost fringe benefits, security provisions like seniority rights, and specifically vacation, severance, sick leave pay, and pension plan obligations.

132104 S. Ct. at 1201.
133Section 365(g) provides:
Except as provided in subsection (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, or 13 of this title, immediately before the date of the filing of the petition. . . .
134Id.
13538 Bankr. at 504.
137104 S. Ct. at 1199 n. 12 (citing 11 U.S.C. § 502(c). Section 502(c) provides: “There shall be estimated for purpose of allowance under this section—... (2) any right to an equitable remedy for breach of performance if such breach gives rise to a right to payment.”
A specific consequence of rejection involves pension plan provisions. If the agreement includes such a provision, rejection of the agreement may carry with it as a matter of law withdrawal from the pension plan. This in turn may give rise to liability under the Employment Retirement Income Security Act of 1974.

The unionized employees also retain the right to strike if their collective bargaining agreement is rejected. In *Briggs Transp. v. Int'l Bhd. of Teamster, Etc.*, the debtor-in-possession was permitted to reject the collective bargaining agreement in effect with the unions. Anticipating a strike in response to new wage schedules, the company sought a preliminary injunction to prevent the strike. The company argued that the policy behind the Bankruptcy Code and the *Bildisco* decision authorized the court to enjoin the defendants without regard to the Norris-LaGuardia Act. The court held that the dispute was one arising out of a labor dispute and therefore the Norris-LaGuardia Act applied, since "the appropriate balance between the competing policies of the Bankruptcy Code and the Norris LaGuardia Act was struck by Congress when it enacted the Norris-LaGuardia Act and this court is in no position to change that result." Thus, should employees strike after rejection of a collective bargaining agreement, the debtor-in-possession is limited to traditional recourse under the labor laws.

CONCLUSION

The conflict in bankruptcy between unionized employees and their employer may be particularly acute. A company forced to take the drastic step of filing for reorganization under Chapter 11 will want to reduce all expenses, including labor costs under a collective bargaining agreement. The union will want to preserve its members' jobs at a fair level of compensation, while assuring that it is not the only target of the company's cost-cutting efforts.

The unions were rightfully distressed by the *Bildisco* decision. The employee rights and benefits guaranteed by a collective bargaining agreement surely deserve greater protection than being subject to unilateral termination pending court approval of a petition to reject. In addition, the "balancing of the equities" test, with its uncertain contours, by itself did not provide ade-
quate protection against unwarranted action by the debtor-in-possession.

It is hoped that the procedures established by section 1113 will provide an equitable and workable solution to this conflict. Congress has responded to the concerns raised about *Bildisco* by emphasizing negotiation over unilateral action and by requiring greater speed throughout the process.

Clearly there are cases where modifications or terminations of agreements in bankruptcy may be required to save businesses and jobs. *Bildisco Manufacturing* changed from an insolvent building supply distributorship with eighty to one hundred unionized employees to a door manufacturer with twelve nonunion employees. Section 1113 recognizes both the long and short-term problems faced by the debtor-in-possession. A company suffering chronic financial difficulties will be able to reject or modify the collective bargaining agreement if the equities clearly balance toward such action. A debtor facing serious short-term problems can seek interim relief, or can act unilaterally if the court does not respond to its plea. In this manner, section 1113 serves the interests of the debtor.

Yet the primary focus of section 1113 concerns the interests of the union and its members. The union is given opportunities to negotiate changes in the agreement, to reject a proposal if the union has "good cause" to do so, and to argue that the equities do not clearly balance in favor of rejection. Cases construing section 1113 seem to understand the congressional concern for the unions. These cases have placed the burden on the debtor to justify its proposals, and have applied the strict *REA Express* standard to petitions seeking interim relief.

Future cases will provide content to the uncertain terms of section 1113. These cases should focus on the interests of both parties to a collective bargaining agreement. Rejection or modification should be permitted when necessary to save the business and the employees' jobs. On the other hand, the burden must not fall exclusively on the unionized employees. The union must also have the ability to negotiate over such changes. Thus, the phrase "good cause" should be construed to allow scope for such bargaining. In such a manner, section 1113 will serve the needs of all involved in reaching a solution to an often complex and difficult situation.

**Pierce Richardson**

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