The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy

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I. Introduction

Nearly ten years have passed since Congress purported to settle what was clearly the most controversial intersection of bankruptcy and labor law since the enactment of the Bankruptcy Code (the "Code"). In NLRB v. Bildisco & Bildisco, the Supreme Court held that a business that filed a Chapter 11 bankruptcy unilaterally could reject or modify its collective bargaining agreement without committing an unfair labor practice. Congress' response to organized labor's outcry over this decision was swift. In the same year that the Supreme Court handed down the Bildisco decision, Congress added section 1113 to the Bankruptcy Code.²

2. See Pub. L. No. 98-353, § 541(a), 98 Stat. 390, 390-91 (1984) (codified at 11 U.S.C. § 1113 (1988)). Indeed, on the very same day that the Supreme Court handed down its Bildisco decision, Congressman Rodino introduced a bill, the stated purpose of which was to "clarify congressional intent with respect to the limited circumstances under which collective bargaining agreements may be rejected." 130 CONG. REC. 2989 (1984).

Section 1113 of the Code reads as follows:

§ 1113. Rejection of collective bargaining agreements

(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 necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and

(B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.

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

(207, 156, 210, 156)
Initially, section 1113 was viewed as a victory for organized labor. Before long, however, commentators began questioning whether the new Code provision was indeed nothing more than a

(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 such 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 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 period 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 the 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.

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


3. See, e.g., Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074, 1087 (3d Cir. 1986) (noting that the version of § 1113 which ultimately was passed responded to workers’ concerns over the Bildisco decision).
dressed-up version of the most central holdings in the very case that it was thought to overrule. 4 After nearly a decade and dozens of cases, the debate concerning section 1113 is far from settled. Neither the courts nor scholars can agree about what Congress intended to accomplish with section 1113. Similarly, courts still have not arrived at a consensus concerning how they ought to interpret that section's nebulous standards for allowing a Chapter 11 company's rejection of a collective bargaining agreement. 5

As section 1113 approaches its tenth anniversary, a fresh source of controversy concerning that Code provision has emerged in the case law. Bankruptcy courts and federal appellate courts have not been able to agree on the answers to two fundamental questions under section 1113: first, whether a court-approved rejection of a collective bargaining agreement creates a cognizable claim in bankruptcy for the union workers whose rights were protected by the agreement; 6 and second, whether a Chapter 11 company that neither rejects its collective bargaining agreement nor complies with it creates a superpriority claim in bankruptcy for any worker rights that are provided for under the agreement. 7

In addition to these two new sources of controversy under section 1113, courts continue to struggle with the fundamental issue of when the rejection of a collective bargaining agreement is "necessary" to permit a Chapter 11 debtor's reorganization. 8 This Article is the first to examine the new uncertainties that have emerged in recent case law concerning section 1113. The Article is also the only attempt thus far to consider the "necessary to reorganization" standard of section 1113 within a broader economic perspective.

Part II of the Article briefly discusses the events that led to the enactment of section 1113. Part III explores the case law interpret-
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The various requirements that must be met by a Chapter 11 debtor who seeks to reject its collective bargaining agreement. Part IV then considers some procedural and subsidiary issues that have arisen under section 1113. Part V examines in detail the major unsettled questions under section 1113 and suggests for each a framework within which courts might solve these remaining puzzles. The Article concludes by questioning whether one can justify the need for section 1113 in a world in which union workers possess, in any event, the leverage created by their right to strike.

II. THE WORLD BEFORE SECTION 1113

It is perhaps easy to forget that prior to 1984, the Bankruptcy Code arguably was already equipped to handle the issue of whether a Chapter 11 debtor could reject a collective bargaining agreement in bankruptcy. Even though section 1113 did not yet exist, the Code did include section 365, a provision that handles the issue of executory contracts in bankruptcy. The generally accepted definition of an executory contract is a contract in which nontrivial performance remains on both sides. An unexpired collective bargaining agreement certainly meets that definition.

The fighting issue prior to section 1113's enactment, however, was not so much whether a collective bargaining agreement was indeed an executory contract. The question, rather, was how much the normal standard for allowing a debtor to reject an executory


10. The Bankruptcy Code itself does not define just what constitutes an executory contract. Professor Vern Countryman, in his famous article, defined an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 439, 460 (1973). Michael Andrew has proposed a slightly different definition of an executory contract. Andrew defines an executory contract as consisting of two necessary components: "(a) debtor and non-debtor each have unperformed obligations, and (b) the debtor, if it ceased further performance, would have no right to the other party's continued performance." Michael T. Andrew, Executory Contracts in Bankruptcy: Understanding "Rejection", 59 U. Colo. L. Rev. 845, 893 (1988).
contract ought to vary in a case involving the special executory contract that was embodied in a collective bargaining agreement.\(^{11}\)

**A. The Pre-Bildisco Case Law**

Prior to the enactment of section 1113, the National Labor Relations Act (NLRA)\(^{12}\) provided, as it still does today, that existing labor agreements can be modified or terminated only through a process involving notice and bargaining. Specifically, section 8(d) of the NLRA prohibits employers from unilaterally terminating or modifying a collective bargaining agreement.\(^{13}\) If an employer attempts to effect a unilateral termination or modification, the National Labor Relations Board (NLRB) may begin proceedings to enforce the provisions of the NLRA.\(^{14}\)

Thus, prior to the enactment of section 1113, bankruptcy courts faced an interesting dilemma when a Chapter 11 debtor attempted to reject a collective bargaining agreement unilaterally. On the one hand, nothing about a bankruptcy filing would appear to negate section 8(d)'s prohibition against unilateral rejections of labor agreements. On the other hand, if the filing of a Chapter 11 case creates a new legal entity, then the Chapter 11 debtor may qualify as a "successor employer" to whom the prohibition against modification does not apply.

In sorting through these considerations, federal circuit courts prior to *Bildisco* generally fell into two camps. One view was that even if the Chapter 11 debtor qualified as a successor employer, the debtor could reject a collective bargaining agreement only when it could show that such a rejection was necessary to avoid a

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11. See *Local Unions v. Brada Miller Freight Sys., Inc. (In re Brada Miller Freight Sys., Inc.),* 702 F.2d 890, 901 (11th Cir. 1983); *Local Joint Executive Bd. v. Hotel Circle, Inc.,* 613 F.2d 210, 212-14 (9th Cir. 1980).


13. *Id.* § 158(d); *see also* *Champion Parts Rebuilders, Inc. v. NLRB, 717 F.2d 845, 852 (3d Cir. 1983).*

14. 29 U.S.C. § 158(d); *see also* *Taylor v. NLRB, 786 F.2d 1516, 1520 (11th Cir. 1986)* (noting the NLRB's exclusive jurisdiction to decide unfair labor practices). There is, however, one qualification to the NLRA's prohibition against unilateral terminations or modifications of collective bargaining agreements. A successor employer is not bound by a labor agreement entered into by previous management and thus may unilaterally terminate or modify such an agreement without violating § 8(d). *NLRB v. Burns Int'l Sec. Serv., Inc.,* 406 U.S. 272, 287-88 (1972).
liquidation. As might be expected, this view was embraced by labor unions and disavowed by management.

The standard articulated by the opposing group of cases was more sympathetic to the possibility of rejection by the debtor. Those decisions held that a Chapter 11 debtor could reject a collective bargaining agreement in bankruptcy, not only if it was necessary to avoid liquidation, but also when a court balanced the equities on both sides and found rejection appropriate under the circumstances.

Interestingly, no circuit court adopted the view that the debtor's rejection of a collective bargaining agreement should be subject to the same business judgment standard applicable to the usual executory contract under section 365. Even the courts whose decisions were more sympathetic to management did not believe that a collective bargaining agreement should be subject to rejection as readily as any other executory contract.

B. The Bildisco Decision

The controversy came to a head in 1984 when the Supreme Court agreed to hear a typical labor contract rejection case. In NLRB v. Bildisco & Bildisco, the bankruptcy court allowed a building supplies distributor that had filed Chapter 11 to reject its collective bargaining agreement that was in place at the time of its bankruptcy filing.

The Supreme Court's Bildisco decision had four key components. First, the Court made it clear that collective bargaining
agreements were indeed executory contracts that were subject initially to analysis under Bankruptcy Code section 365. In support of this conclusion the Court noted that section 1167 of the Code expressly exempted from the coverage of section 365 any collective bargaining agreements that were subject to the Railway Labor Act. Thus, the Court reasoned, Congress must have intended labor agreements that were not subject to the Railway Labor Act to be covered under section 365, because Congress clearly knew how to exclude labor contracts from section 365 when it wished to.

Having concluded that section 365 covered the rejection of collective bargaining agreements, the Court then defined the standard by which a Chapter 11 debtor could reject such an agreement. The Court concluded that such a rejection should be allowed when the debtor could show that the collective bargaining agreement burdened the estate and that the balance of the equities favored rejection of the contract. In adopting this standard, the Court said that it believed Congress intended the rejection of labor agreements to be governed by a standard higher than the usual business judgment test under section 365, but not as stringent as the "necessary to avoid liquidation" test that was being used by some of the lower courts.

The Court's third and most controversial holding was that a Chapter 11 debtor, even in the absence of court approval, could reject unilaterally a collective bargaining agreement without violating the NLRA. At least one commentator has complained that this holding was inconsistent with the Court's first holding that collective bargaining agreements were within the purview of section 365.

19. Id. at 522.
20. Id.
21. Id.
22. Id. at 526-27.
23. Id.
24. Id. at 532. Whereas the Supreme Court unanimously held that § 365 did govern a labor contract and that the proper standard for rejection was the balancing of the equities test, the Court's decision that unilateral rejection was not an unfair labor practice carried only a 5-4 majority. The majority's rationale for its decision on this score was that from the filing of the debtor's bankruptcy until formal acceptance of the labor agreement, such an agreement was not an enforceable contract within the meaning of NLRA § 8(d). Id. 25. Rait, supra note 4, at 361.
That criticism is misplaced. A unilateral rejection of a labor agreement by a Chapter 11 debtor may violate section 365, which requires court approval for rejection of executory contracts. But that is not the same thing as saying that such a unilateral rejection violates nonbankruptcy labor law. The NLRA question to which the Court spoke was in effect whether a Chapter 11 debtor was a successor employer that would not be bound by the prohibitions of NLRA section 8(d). If one concludes, as the Court did, that a Chapter 11 debtor is like a successor employer, then it is certainly possible that a unilateral rejection might contravene the Bankruptcy Code without violating the NLRA.

The Court's fourth and final important statement in *Bildisco* was that prior to allowing rejection of a collective bargaining agreement, a bankruptcy court should be persuaded that the debtor had made voluntary efforts to negotiate a reasonable modification of its labor agreement with the union. This holding, like the Court's "balance of the equities" standard, managed to make its way into section 1113, the very provision that the labor community hailed as reversing the *Bildisco* outcome.

III. THE SUBSTANTIVE STANDARDS FOR REJECTION UNDER SECTION 1113

Virtually every court that is faced with the issue of whether a Chapter 11 debtor may reject its collective bargaining agreement utilizes a nine-part test that was first set down by the bankruptcy court in *In re American Provision Co.* That test, which is based on the statutory standards found in section 1113(b) and (c), requires that: (1) the debtor make a proposal to modify the agree-

27. Id.
28. Id. at 526.
29. See 11 U.S.C. § 1113(b)(2) (1988) (requiring that during the period between the debtor's modification proposal to the union and the hearing on rejection the debtor "shall meet, at reasonable times, with the authorized representative [of the union] to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement").
ment; (2) the proposal is based on the most complete and reliable information; (3) the proposed modifications are necessary to permit reorganization; (4) the modifications assure that all creditors, the debtor, and affected parties are treated fairly and equitably; (5) the debtor provides to the union such relevant information as is necessary to evaluate the proposal; (6) the debtor meets at reasonable times with the union between the time of the proposal and the time of the hearing on the proposal; (7) the debtor negotiates with the union in good faith at these meetings; (8) the union refuses to accept the debtor's proposal without good cause; and (9) the balance of equities clearly favors rejection of the agreement.\textsuperscript{31}

What follows is a brief discussion of how the case law has fleshed out each of these elements. A discussion of the third element, which requires that the debtor's proposed modifications be necessary to permit the reorganization of the debtor, is reserved for Part V.

A. Debtor Must Make a Proposal to Modify

Three points are worth emphasizing about this initial requirement of the American Provision test. First, the debtor's proposal to modify must relate to the collective bargaining agreement that is currently in force rather than to a successor agreement that will arise when the current one ends.\textsuperscript{32} Thus, any negotiations in bankruptcy that relate to the terms of a labor contract that is not yet in existence will not be affected by the requirements of section 1113.\textsuperscript{33}

Second, a timing issue affects the debtor's required proposal to modify its labor agreement. The debtor's proposal has to be made after the debtor has filed for Chapter 11 but before the point when the debtor goes to court seeking rejection of the agreement.\textsuperscript{34} This

\textsuperscript{31.} American Provision, 44 B.R. at 909.

\textsuperscript{32.} See In re Valley Kitchens, Inc., 52 B.R. 493, 497 (Bankr. S.D. Ohio 1985) (refusing to allow the debtor's rejection of a labor contract in part because the proposals made to the union were in connection with negotiations of a new collective bargaining agreement, not to modify the existing agreement).

\textsuperscript{33.} See In re Sullivan Motor Delivery, Inc., 56 B.R. 28, 29 (Bankr. E.D. Wis. 1985) (holding that when the debtor's collective bargaining agreement expires prior to bankruptcy, § 1113 will have no application).

\textsuperscript{34.} 11 U.S.C. § 1113(b)(1) (1988) (requiring the debtor's proposal to be made "[s]ubsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement").
means that any proposals that the debtor made prior to its filing for bankruptcy cannot count as the proposal that is required to be made under section 1113.

Finally, one bankruptcy court held that the required proposal to modify does not necessarily need to be made by the debtor itself where the only hope for reorganization is the sale of the company to a new owner. In *In re Maxwell Newspapers, Inc.*, the court determined that the required proposal to modify under section 1113 could be made by the party who was negotiating to purchase the debtor’s business. The bankruptcy court held that this was sufficient to meet the section 1113 requirement when, as here, the debtor’s sole attempt at survival involved the sale of the business to this potential purchaser.

B. Proposal Must Be Based on Recent Information

Courts have tended to merge this second requirement of the *American Provision* test with the fifth, which requires that the debtor provide to the union any information that is necessary to evaluate the debtor’s modification proposal. Although unions do not frequently invoke these two information requirements as a barrier to the debtor’s rejection, the requirements have nevertheless proven outcome determinative in a few cases.

In more than one case, bankruptcy courts have found it insufficient for the debtor to simply attach its bankruptcy schedules to its modification proposal as a means of providing the required information. First, these bankruptcy schedules can be well out of date by the time of the modification proposal. Another problem with these schedules is that they are prepared by the debtor itself.

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36. *Id.* at 929.

37. *Id.*


40. See *George Cindrich*, 130 B.R. at 24 (noting that the only information given by the debtors were bankruptcy schedules which were 14 months old at the time of the proposal and that the union had no reason to assume that such old information was still valid and relevant to the currently proposed modifications to the collective bargaining agreement).
Courts are much more comfortable with projections and information that are provided by independent consultants.\textsuperscript{41}

One case held that the debtor had not met its duty to provide adequate information where the debtor failed to mention to the union that its modification proposal ultimately would involve the layoff of about one-third of the union work force.\textsuperscript{42} On the other hand, the debtor is not required to provide a cost estimate for any modification counterproposals made by the union.\textsuperscript{43} Finally, if the debtor fears that the information it is required to supply involves trade secrets or other confidential material, the bankruptcy court can provide a protective order to help ensure that the information is not disseminated beyond the union's representatives.\textsuperscript{44}

C. Proposal Must Treat All Parties Fairly and Equitably

This fairly important requirement has tended to raise two major issues in the case law. The first is whether this requirement mandates that the debtor's proposal provide for a pro rata sharing of burdens.\textsuperscript{45} Specifically, unions have argued that this requirement means that any cuts proposed to union salaries must be matched in kind by reductions in the compensation of owners and nonunion workers as well as by reductions in the returns to unsecured creditors.\textsuperscript{46}

\textsuperscript{41} See K \& B Mounting, 50 B.R. at 467 (suggesting that instead of providing merely its bankruptcy schedules, debtor would be well advised to give projections or recommendations from a management consultant, preferably an independent consultant).

\textsuperscript{42} In re Fiber Glass Indus., 49 B.R. 202, 207 (Bankr. N.D.N.Y. 1985).

\textsuperscript{43} See In re Salt Creek Freighways, 47 B.R. 835, 839 (Bankr. D. Wyo. 1985).


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.

\textit{Id.}, see also K \& B Mounting, 50 B.R. at 467 (reminding the debtor that the court can enter a protective order if the debtor wishes to prevent disclosure of information by the union to the debtor's competitors).


Courts generally have not been sympathetic to the strict interpretation of parity that has been espoused by unions. Rather, they have been quick to point out that sometimes only the union wages, and not the salaries of the debtor's workers generally, are above market at the time of bankruptcy. Furthermore, cases have highlighted the risk that the debtor will lose many of its talented nonunion employees if it is forced to impose nonunion pay reductions that mirror those cuts proposed for the union. Finally, courts have noted in some cases that managers who were not forced to take a pay cut nevertheless assumed additional responsibilities as a way of shouldering their fair share of the burden of reorganization.

The second major issue that has arisen under the "fair and equitable" requirement is whether a debtor's proposal must include a "snap-back" provision. Essentially, a snap-back provision is a clause in a collective bargaining agreement that says if the debtor's earnings reach a certain level in the future, any cuts that were made to union wages can "snap back" to their previous level.

Unions have contended that the absence of a snap-back provision in the debtor's proposal for modification automatically precludes the proposal from being "fair and equitable." While courts will consider the absence of a snap-back clause as one factor in assessing the "fair and equitable" requirement, almost all courts have held that the absence of a snap-back clause is not necessarily fatal to the debtor's proposal for modifications.

47. See Carey, 816 F.2d at 90-91; Blue Diamond, 131 B.R. at 645; Walway, 69 B.R. at 974; cf. In re Indiana Grocery Co., 138 B.R. 40, 48 (Bankr. S.D. Ind. 1990) (noting that part of meeting the "fair and equitable" requirement is showing that the creditors are bearing a fair share of the burden of ensuring a successful reorganization, because they are parties who stand to benefit from a reorganization). But see In re William P Brogna & Co., 64 B.R. 390, 392 (Bankr. E.D. Pa. 1986) (holding that the debtor's proposal was not fair and equitable to all parties where the proposal would repay all unsecured creditors in full over three years but would at the same time cut union workers' wages by 41%).

48. See, e.g., Carey, 816 F.2d at 90-91.

49. See, e.g., Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074, 1091-93 (3d Cir. 1986).

50. See, e.g., Carey, 816 F.2d at 90-91.

51. See Walway, 69 B.R. at 974.

52. See Colorado Iron Workers Pension Fund. v. Sierra Steel Corp. (In re Sierra Steel Corp.), 88 B.R. 314, 317 (D. Colo. 1987) (stating that the inclusion of a snap-back provision is merely one factor in the determination of whether the debtor's proposal is fair and equi-
One can easily see why the courts have been reluctant to adopt the plea of unions for mandatory snap-back provisions. Nothing is magic about a snap-back provision. It is simply one vehicle by which union workers receive a more attractive compensation package. But so, too, are higher wages from the start. Whether a snap-back provision ends up being more attractive to a worker than a slightly higher wage that is not contingent on future events will simply be a function of a worker's risk aversion.

Granted, a snap-back provision has the visceral appeal of "sharing the wealth" when the reorganizing company ends up performing better than expected. Yet, so do employee stock options. But nobody is suggesting that a debtor's proposal for modification must include employee stock options or else fail the "fair and equitable" test. If unions place a high value on snap-back provisions, they certainly can bargain for them with the debtor during the mandatory negotiation sessions of section 1113. Bargaining for such provisions, however, should not necessarily mean getting them in addition to whatever wage level is initially proposed by the debtor.

D. Debtor Must Bargain with the Union in Good Faith

Courts generally have construed as a single element the sixth and seventh requirements of the American Provision test, which require that the debtor meet regularly with the union once its modification proposal is made and that the debtor bargain in good faith during these meetings. In striving to meet this element, debtors should realize that courts are impressed by the frequency

53. Presumably, a risk-preferring worker would choose a slightly lower wage at the start with the chance that wages would increase if the company performed better than expected. Conversely, a risk-averse worker probably would choose slightly higher wages at the outset rather than gamble on still higher wages in the future if certain unpredictable events were to occur.

with which the debtor meets with its union. Indeed, one court held specifically that the "good faith" element should be measured objectively rather than subjectively. In applying an objective test to the debtor's good faith in negotiations, a court would be hard-pressed to avoid considering the total number of meetings that were held between the debtor and the union.

Although section 1113 speaks only of the debtor's duty to bargain in good faith, some courts have inferred a comparable duty on the part of the union. At least one commentator has criticized the courts' creation of this corresponding duty on the part of the union, arguing that a strict interpretation of section 1113 cannot justify putting the good faith burden on any party but the debtor. On the other hand, the requirement that the union's rejection of the debtor's proposal be "without good cause" suggests that the union, and not just the debtor, has an independent duty to negotiate fairly.

E. Union Must Reject the Debtor's Proposal Without Good Cause

Some commentators have suggested that no independent significance inures to the requirement that the union must reject the debtor's proposal without good cause. Whether or not this requirement is completely redundant of the other prerequisites for rejection of the labor contract, no one can question that the courts strictly construe the phrase "good cause" when a union rejects the debtor's proposal.

55. See, e.g., Walway, 69 B.R. at 973 (holding that the debtor's frequent meetings with the union helped to show the debtor's good faith bargaining under § 1113); see also Janell M. Kurtz et al., Rejection of Collective Bargaining Agreements in Bankruptcy: A Review, Update, and Guide for Debtors, 96 Com. L.J. 31, 40 (1991) (suggesting that a debtor would be wise to hold at least two collective bargaining sessions between submitting the proposal to the union and the hearing on rejection in order for the debtor to fulfill the requirement of meeting at reasonable times).


57. See, e.g., Sheet Metal Workers' Int'l Ass'n v. Mile Hi Metal Sys. (In re Mile Hi Metal Sys.), 899 F.2d 887, 892 (10th Cir. 1990); GCI, 131 B.R. at 692.

58. See McClan, supra note 4, at 202.

59. Id. at 203-04; see also Kurtz et al., supra note 55, at 42.

60. McClan, supra note 4, at 204.
More than one court has refused to accept as good cause for rejection the effect that the debtor's proposal would have on other union contracts that were not before the court. In In re Sierra Steel Corp., a clause in other labor agreements of the union bargaining in bankruptcy provided that the union would bargain for equal wage treatment across employers. This meant that if the debtor's modifications were accepted, then union employees of nonbankrupt companies would end up receiving the same wage cut as that contained in the debtor's proposal. Nevertheless, the court held that "good cause" must be interpreted narrowly to encompass the effect of the proposed modifications solely on the specific case before the bankruptcy court.

Even a debtor's proposal to ignore a collective bargaining agreement's lifetime job guarantees for certain union workers has been held insufficient to constitute "good cause" for the union's rejection of the proposal. Doubtless the "rejection without good cause" requirement has ended up helping the debtor rather than the union.

The Second Circuit, in fact, opined in New York Typographical Union No. 6 v. Maxwell Newspapers, Inc. (In re Maxwell Newspapers, Inc.) that the purpose of the "good cause" requirement is to force the union to be flexible in receiving the debtor's modification proposals, or else risk a court-sanctioned total rejection of the collective bargaining agreement.

Even the "good cause" requirement does not place all of the bargaining onus on the shoulders of the union. The flipside of the "good cause" requirement in the negotiating dynamic is that the debtor has to show that its proposed modifications are "necessary" for a successful reorganization.

63. Id. at 340-41.
65. 981 F.2d 85 (2d Cir. 1992).
66. Id. at 90.
F Rejection Is Favored by a Balance of the Equities

Not much case law exists interpreting the requirement that rejection must be favored by the balance of the equities, largely because this requirement is more or less subsumed into the other more specific requirements of the American Provision test. The fact that this requirement gets so little attention in the section 1113 case law is ironic, considering that the "balance of the equities" concept was borrowed from the Bildisco case itself.68

In any event, unions are not likely to find much help in this requirement. One court went so far as to say that the primary question under the balance of the equities test is what effect rejection of the labor agreement will have on the debtor's prospects for reorganization.69 Certainly some courts might find such a view contrary to the commonly accepted spirit of section 1113, which purports to focus on how proposed modifications to the labor agreement will affect all parties, including union workers. On the other hand, if the modifications proposed are not sufficient to enable a reorganization of the debtor, then the union workers probably will lose in the end anyway.

IV Procedural and Other Subsidiary Issues Under Section 1113

Much of the case law concerning section 1113 has involved issues other than the straightforward application of the provision's requirements for the rejection of a collective bargaining agreement in Chapter 11. For example, courts have faced procedural questions such as allocating the burden of proof and determining whether parties acted within the statutorily required time periods.70 Additionally, section 1113 provides special standards that allow the debtor to obtain emergency interim relief.71 Finally, the fundamental question is just what effect a court-approved rejection has on the continuing relationship between the debtor and the union whose labor agreement was rejected.72

70. See infra text accompanying notes 73-83.
71. See infra text accompanying notes 84-90.
72. See infra text accompanying notes 91-96.
A. Burden of Proof

Section 1113 does not address expressly the question of which party, the debtor or the union, has the burden of proof as to rejection of the collective bargaining agreement. Nevertheless, the debtor is clearly the moving party and thus the party that will assume the burden of proving the elements necessary for rejection. As one court observed candidly, a debtor that wishes to win rejection of the labor agreement must show both that it is without sin and that the union is at fault.\(^3\) In other words, the issue under section 1113 is not one of relative behavior; a debtor cannot win merely by showing that it acted in "better faith" than did the union.\(^4\)

The discussion does not end, however, merely by observing that the burden of proof under section 1113 will be the debtor's. Nearly all courts are in agreement that although the burden of persuasion as to all nine elements of the American Provision test rests with the debtor, the burden of production as to certain of those elements may shift to the union.\(^5\) Courts have held that once the debtor makes its prima facie case for rejection, the union will have the burden of production as to three of the nine American Provision elements: (1) whether the union was provided with relevant information; (2) whether the debtor bargained in good faith; and (3) whether the union refused to accept the debtor's proposal without good cause.\(^6\)

Thus, once the debtor brings forward sufficient evidence to sustain a prima facie case for rejection, the union must produce some evidence to show that it was not provided with relevant information, that the debtor did not bargain in good faith, and that the union's refusal to accept the debtor's proposal was not without good cause. When the union meets its burden of pro-


\(^{74}\) Id.


\(^{76}\) E.g., *Blue Diamond*, 131 B.R. at 643; *Express Freight*, 119 B.R. at 1011; *Garofalo's*, 117 B.R. at 370; *American Provision*, 44 B.R. at 909-10.
duction as to these three elements, then the burden of persuasion by a preponderance of the evidence shifts back to the debtor.77

B. Timing Issues

The time periods within which the court must rule on applications for rejection under section 1113 are relatively straightforward. As noted above, the debtor’s proposal for modification must be made to the union after the debtor’s bankruptcy but before the debtor’s application for rejection of the agreement.78 Section 1113(d) provides that when the debtor files its application to the court for rejection, the court must hold a hearing on rejection within fourteen days of the debtor filing the application.79 The court has the discretion to extend the start of such a hearing by seven additional days when the circumstances merit it, but extensions beyond seven days must be agreed to by both the debtor and the union.80

The court is then given thirty days from the date of the commencement of the rejection hearing to make a ruling on the debtor’s rejection application.81 Both the debtor and the union must agree to any extensions of this time period.82 If the court fails to rule on the debtor’s application within the statutory time period, the debtor is allowed unilaterally to terminate or modify any provisions of the collective bargaining agreement pending the court’s ruling.83

C. Interim Relief

Occasionally, the Chapter 11 debtor’s situation will be such that it literally cannot afford the time necessary to engage in all of the required steps under section 1113 in order to modify its collective bargaining agreement. To account for these more immediate crises, Congress included a special provision, section 1113(e), that pro-

77. American Provision, 44 B.R. at 910; see also Indiana Grocery, 138 B.R. at 46; Express Freight, 119 B.R. at 1011; Garofalo’s, 117 B.R. at 370.
78. See supra text accompanying note 34.
80. Id.
81. Id. § 1113(d)(2).
82. Id.
83. Id.
vides for the possibility of interim modifications to the labor agreement.84

Section 1113(e) articulates a high standard for interim modifications. Such modifications must be "essential to the continuation of the debtor's business," or necessary "to avoid irreparable damage to the estate."85 One court which allowed such interim modifications bluntly rephrased the standard to the effect that absent the requested changes, the Chapter 11 company will collapse and the employees will no longer have jobs.86

Courts have been amenable to using their discretion under section 1113(e) to craft interim modifications that may not mirror precisely those that were requested by the debtor. One court noted that Congress certainly did not want judges rewriting collective bargaining agreements on a permanent basis, but nonetheless the court felt compelled to change the agreement temporarily in response to the debtor's request for interim modifications.87 Another court that drafted its own interim modifications was quick to urge either party to return to the court for further adjustments of the interim reductions, "[r]ecognizing the inherent fallibility of the projections" upon which the judge's reductions were based.88

An important point about section 1113(e) that is sometimes lost on the two bargaining parties is that any interim modifications should not cause an interruption in negotiations about any long-term modifications proposed by the debtor. Section 1113(e) itself provides that "[t]he implementation of such interim changes shall not render the application for rejection moot."89 In other words, a court's allowance of interim changes postpones the larger question of rejection, but by no means avoids it.90

84. Id. § 1113(e).
85. Id.
90. See Salt Creek Freightways, 46 B.R. at 351 (reminding parties that the grant of interim relief under § 1113(e) in no way relieved either party of the responsibility to negotiate under § 1113(b)).
D. Consequences of Rejection

On the surface, a court’s authorization of the debtor’s rejection of a collective bargaining agreement seems to translate into a complete victory for the debtor. After all, once a court allows rejection, the debtor no longer has a collective bargaining agreement about which to worry. While that may be true, even following rejection, the union will still exist, and that union will remain the exclusive bargaining representative for its workers, notwithstanding the authorized rejection.

One court that allowed the rejection of the debtor’s collective bargaining agreement under section 1113 took pains to point out that the debtor’s rejection of the agreement by no means signalled the end of negotiations between the debtor and the union.\(^9\) Rather, the court said, the allowance of rejection by the debtor simply signalled a new phase in the negotiations.\(^9\)

In this new phase of negotiations, the union certainly has lost whatever leverage section 1113 gave it with respect to retaining its pre-existing labor agreement. The union, however, is not without weapons in its continuing negotiations with the debtor. The debtor, of course, still needs workers. And the union probably still retains its right to strike.\(^9\) The question at this point will be simply whether the two sides can reach an arrangement by which the workers will work for terms less attractive than those for which they previously had bargained under the old labor agreement.

Interestingly, one case suggests that a debtor that meets all of the requirements for rejection under section 1113 will not necessarily end up without a collective bargaining agreement. In In re

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92. Id., see also Salt Creek Freightways, 47 B.R. at 842 (observing that even following an allowed rejection of a collective bargaining agreement under § 1113, the debtor still had a continuing duty to negotiate in good faith with the union towards achieving a new labor contract).

93. The one possible limitation on this right would be Bankruptcy Code § 362, the automatic stay. 11 U.S.C. § 362 (1988). To the extent that the strike is seeking not just better conditions going forward but recovery of pre-petition wage claims, there is the argument that striking is a prohibited “act” to collect a pre-petition debt under § 362(a)(6). Cf. Crowe & Assocs., Inc. v. Bricklayers Union Local No. 2, 20 B.R. 225, 227 (E.D. Mich. 1982) (employer believed that acceding to its employees’ demands to pay pre-petition debts to the employees would violate the stay), aff’d, 713 F.2d 211 (6th Cir. 1983).
Garofalo's Finer Foods, Inc., the court concluded that where all of the requirements for rejection had been met, section 1113 could be used by the court to effect a mere modification of the collective bargaining agreement rather than a complete rejection. In essence, the court used the debtor's modification proposal that the union had rejected earlier without good cause as the new agreement. Even though this result was not sanctioned specifically in section 1113, the court justified its result by pointing to Bankruptcy Code section 105, which grants to the court certain equitable powers.

E. Section 1113 and Retiree Medical Benefits

Collective bargaining agreements commonly include a provision that guarantees continuing medical benefits for union retirees of the company. One issue facing courts is whether retirees should be considered "employees" for the purpose of section 1113's protections. In United Steelworkers v. Unimet Corp. (In re Unimet Corp.), the Sixth Circuit Court of Appeals determined that retirees were indeed employees for purposes of section 1113's requirements. Thus, the court said, the Chapter 11 debtor had to keep paying retiree medical benefits in bankruptcy until there was a court-approved modification or rejection of the collective bargaining agreement that was the source of those benefits.

In a case decided two years prior to Unimet, In re Century Brass Products, Inc., the Second Circuit similarly had held that retirees are considered employees for purposes of section 1113. A related issue in Century Brass was whether, given that the retirees

95. Id. at 370.
96. Id., see also 11 U.S.C. § 105(a) (stating that the bankruptcy court may issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title").
99. Id. at 885-86.
100. Id. at 883.
102. Id. at 275.
were employees under section 1113, the retirees could be represented adequately by the current employees. On this question, the court held that where a retiree party articulates a conflict of interest to the court and the court agrees that a conflict exists, the court must appoint a separate party to represent the interests of retirees. One could imagine that a conflict of interest in the bankruptcy context would almost always be inherent. In a zero-sum game such as bankruptcy, every dollar used to enhance the salaries of current workers is one less dollar available for retiree medical costs, and vice versa.

The holdings of both *Unimet* and *Century Brass* were essentially codified in 1988 when Congress added section 1114 to the Bankruptcy Code. Section 1114, which borrows much of its language directly from section 1113, prevents a Chapter 11 debtor from reducing payment of its retiree medical benefits until the debtor makes a showing that modification of such benefits is necessary to permit the debtor's reorganization. Section 1114 also provides that retirees will have a separate bargaining representative with whom the debtor must negotiate if the debtor wishes to modify its retiree medical benefits.

If all courts accepted the holdings of *Unimet* and *Century Brass*, then section 1114 arguably does not provide much independent benefit to union retirees whose benefits flow from a collective bargaining agreement. Nevertheless, section 1114 created at least one new issue for courts to resolve: Which Code section, section 1113 or section 1114, governs the case in which a Chapter 11 debtor wishes to modify retiree medical benefits that are included in a collective bargaining agreement? The issue is significant because although the standards for modification found in sections 1113 and 1114 show a tremendous overlap, the two standards are not completely identical.

The relationship between sections 1113 and 1114 was one of many issues the bankruptcy court faced in *In re Ionosphere Clubs, Inc.* That court concluded that in a case where retiree medical...
benefits arguably are covered both by section 1114 and by section 1113, only section 1114 should be applied to determine whether those benefits can be modified. The court reasoned that in the absence of any answer in the statutory language or in the legislative history, the court should proceed to apply the rule of statutory construction that the more specific statute supersedes the more general one. In addition, the court noted that “it would be a waste of resources and a needlessly complicated process to require compliance with both [section] 1113 and [section] 1114.”

V THE OPEN QUESTIONS OF SECTION 1113

Even after nearly ten years of case law interpreting section 1113, courts continue to struggle with certain issues that arise thereunder. For one thing, courts have yet to resolve just what it means to say that the debtor’s proposed modifications must be “necessary” to permit the reorganization of the debtor. In addition, recent case law has uncovered two significant but previously unnoticed puzzles under section 1113. First, it is not clear whether a debtor’s court-approved rejection under section 1113 gives to union workers a claim for damages in bankruptcy Second, courts cannot agree about what should happen to the rights of union workers when the Chapter 11 debtor neither rejects its collective bargaining agreement in bankruptcy nor complies with it.

A. Giving Meaning to the “Necessary” Standard

Without question the single most controversial question under section 1113 has been how to define what modifications are necessary to permit the debtor’s reorganization. Indeed, while the American Provision nine-part section 1113 test has gained wide acceptance, a number of courts adopting that test nevertheless will devote the majority of their opinion to the “necessary” issue.

108. Id. at 519.
109. Id.
110. Id. (footnote omitted).
111. See infra text accompanying notes 114-43.
112. See infra text accompanying notes 144-64.
113. See infra text accompanying notes 165-204.
114. See McClain, supra note 4, at 208-09 (contending that courts have let the “necessary” requirement swallow up all of the other requirements of § 1113).
Two important circuit court cases have helped shape the terms of the debate. On the one side is the Third Circuit and its opinion in *Wheeling-Pittsburgh Steel v. United Steelworkers*. In that case, the court said that “necessary” in section 1113 means “essential” and should be construed strictly to allow only those modifications that are directly related to the Chapter 11 company’s financial condition and its reorganization. The Third Circuit claimed that Congress intended the word “necessary” to focus on the somewhat shorter-term goal of preventing the debtor’s liquidation rather than on the far-sighted goal of ensuring a long-term reorganization.

As noted earlier, some courts consider the lack of a snap-back provision to implicate the “fair and equitable” requirement of section 1113. The court in *Wheeling-Pittsburgh* took that position in holding that the lack of a snap-back provision in the debtor’s five-year modification proposal prevented the proposal from meeting the “necessary” requirement. Apparently, the Third Circuit believed that a long-term modification of this sort could not be justified absent a provision ensuring that workers would end up reaping the benefits of a greater-than-expected future profitability.

In contrast to the Third Circuit’s holding in *Wheeling-Pittsburgh* stands the Second Circuit’s decision in *Truck Drivers Local 807 v. Carey Transportation, Inc.* In *Carey*, the court took issue with the *Wheeling-Pittsburgh* construction of “necessary” in section 1113. The Second Circuit contended that “necessary” should not mean “essential” or “bare bones,” but instead should require a proposal made in good faith by the debtor that contains necessary changes that will enable the debtor to complete the reorganization process successfully. Thus, the *Carey* standard focused on changes that would ensure the long-term health of the

115. 791 F.2d 1074 (3d Cir. 1986).
116. Id. at 1088.
117. Id. at 1089.
118. See supra text accompanying notes 51-53.
119. *Wheeling-Pittsburgh*, 791 F.2d at 1090.
120. See id.
121. 816 F.2d 82 (2d Cir. 1987).
122. Id. at 89-90.
123. Id. at 89.
debtor rather than on changes that would simply stave off a liquidation in the short term.

The Second Circuit in Carey made three powerful points supporting its interpretation of "necessary" over the approach set forth in Wheeling-Pittsburgh. These reasons have helped persuade the vast majority of courts considering the question that the Carey standard is the appropriate one to use in the section 1113 context.124

First, the court in Carey said if a debtor were forced to make a proposal that included only the absolute minimum changes that would avoid a liquidation, then the debtor would have no room for negotiation.125 This factor is significant because Congress contemplated, indeed required, that the debtor would engage in good faith negotiations with the union after it presented the union with its modification proposal, but before its application for rejection.126 If the debtor's modification proposal could not include any changes beyond those necessary to avoid a liquidation, then the debtor would have nothing to offer to give back to the union in these statutorily required negotiation sessions.

The second point involved section 1113(e), the provision that provides a standard for interim modifications to the debtor's collective bargaining agreement.127 The Second Circuit noted the standard for allowing interim modifications under section 1113(e): The interim changes would be allowed when they were essential to

124. See Sheet Metal Workers' Int'l Ass'n v. Mile Hi Metal Sys. (In re Mile Hi Metal Sys.), 899 F.2d 887, 892-93 (10th Cir. 1990) (noting that most courts have rejected the Wheeling-Pittsburgh standard and adopted the Carey standard of "necessary," and following the majority approach itself); Typographical Union No. 6 v. Royal Composing Room, Inc. (In re Royal Composing Room, Inc.), 848 F.2d 345, 348 (2d Cir. 1988) (following the Carey standard and rejecting the union's contention that "necessary" in § 1113 means that every element of the debtor's modification proposal must itself be independently necessary for a successful reorganization), cert. denied, 489 U.S. 1078 (1989); In re Indiana Grocery Co., 136 B.R. 182, 192 (Bankr. S.D. Ind. 1990) (adopting Carey and noting that in order for labor contract modifications to be shown necessary for a successful reorganization, it need not be shown that the debtor's problems were caused by the labor agreement as opposed to some other factor such as slumping sales).

125. Carey, 816 F.2d at 89.

126. See 11 U.S.C. § 1113(b)(2) (1988) (requiring that as a prerequisite to rejection the debtor must meet with the union "to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement").

127. See id. § 1113(e); see also supra text accompanying notes 84-90.
the continuation of the debtor's business or were necessary to avoid irreparable damage to the estate.\textsuperscript{128} The problem with the \textit{Wheeling-Pittsburgh} approach, the Second Circuit said, was that its formulation of "necessary" for the debtor's long-term proposal was essentially indistinguishable from the standard set down by Congress for mere interim modifications.\textsuperscript{129} The court in \textit{Carey} did not think that Congress intended the same standard of "necessary" for the debtor's long-term modifications in the labor agreement as Congress specifically set down for any short-term modifications.\textsuperscript{130}

The court's third reason for refusing to adopt the \textit{Wheeling-Pittsburgh} standard of "necessary" involved the Bankruptcy Code's requirements for confirmation of a plan of reorganization. Section 1129(a)(11) provides that a court should confirm a plan of reorganization only if confirmation "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor."\textsuperscript{131} If the \textit{Wheeling-Pittsburgh} standard is taken at face value, said the Second Circuit, then, most likely, the debtor could not confirm a plan of reorganization.\textsuperscript{132} A feasible plan of reorganization is one that provides a cushion for future emergencies. Where the debtor is allowed to modify its collective bargaining agreement only to the extent of avoiding a short-term liquidation, providing for such a cushion is nearly impossible.

One additional consideration implicates the "necessary" standard of section 1113, but it is a factor on which no court has yet focused attention—section 1129's "best interests of creditors" test.\textsuperscript{133} Essentially, the "best interests" test says that no unsecured creditor can be forced to accept a Chapter 11 plan unless that plan provides the creditor with at least as much value as the creditor would receive in a Chapter 7 liquidation of the same company\textsuperscript{134}

\textsuperscript{128} \textit{Carey}, 816 F.2d at 89.
\textsuperscript{129} \textit{Id}.
\textsuperscript{130} \textit{Id}.
\textsuperscript{131} 11 U.S.C. § 1129(a)(11).
\textsuperscript{132} \textit{Carey}, 816 F.2d at 89.
\textsuperscript{133} 11 U.S.C. § 1129(a)(7).
\textsuperscript{134} See \textit{id}. (requiring as a prerequisite to confirmation that each impaired claimholder either accept the proposed plan or "receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than
In order to appreciate the effect of this standard on the determination of what is necessary under section 1113, one first needs to step back for a moment and remember what a Chapter 11 reorganization is all about. One of the main functions of a Chapter 11 reorganization is to preserve the going-concern value of those companies that are worth more intact than they are piecemeal. The reason that bankruptcy can be a more effective device than state law at achieving this end is that bankruptcy helps to cure the collective action problem that exists under state law.

State debtor-creditor law is essentially the law of the swiftest. Whenever the debtor has fewer assets than it has liabilities, priorities among unsecured creditors generally are determined in the order that creditors bring collection actions. Therefore, when things are looking bleak for the debtor, each individual creditor has an incentive to institute collection proceedings to recover its claim. This incentive will exist even where the creditor group as a whole would be better off if the debtor remained intact instead of being dismantled asset by asset. Therein lies the collective action problem. Individual creditors under state law have an incentive to take actions that are destructive to the creditor group as a whole.

Absent the application of bankruptcy law, the collective action problem typically will not be resolved for at least two reasons. First, the group of creditors is often widely dispersed, resulting in prohibitively high transaction costs for any creditor who might wish to bring the group together to negotiate a collective solution to the problem of the debtor's insolvency. Second, even if the creditor group can be assembled in one place, any forbearance agreement that might be reached must be unanimous among the creditors. Otherwise, nonconsenting creditors would have no competition in their individual collection actions against the

the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date.

135. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 220 (1977) (stating that the premise of business reorganization is that a company's assets are worth more as a going concern than they are if sold for scrap); see also In re Kleinsasser, 12 B.R. 452, 455 (Bankr. D.S.D. 1981) (contending that "it was the intent of Congress that a debtor be given one meaningful opportunity to rehabilitate").


137. See id. at 3-25 (providing an overview of state law collection processes).
debtor, and the collective benefits of forbearance would be reduced or lost completely.

Bankruptcy responds to each of these problems in state law collective actions. First, bankruptcy provides a single forum in which all creditors must come together to decide the most efficient deployment of the debtor's assets. This feature of bankruptcy responds to the problem of creditor dispersion and the high transactions costs of meeting to negotiate a settlement. Second, bankruptcy's automatic stay prevents any individual advantage-taking once the bankruptcy petition has been filed. The mandatory nature of bankruptcy gives teeth to its more specific features. No creditor can opt out of the process, and the only returns available to creditors once the petition is filed are those through the bankruptcy estate.

The Chapter 11 negotiation process itself often will involve allocating the debtor's going-concern surplus. The debtor's going-concern surplus can be defined as the difference between what the debtor is worth as a going-concern and what the debtor's assets would be worth if they were liquidated on a piecemeal basis. The main negotiation regarding allocation of that surplus typically will occur between the debtor's equity holders and its general unsecured creditors. When a collective bargaining agreement is in place, effectively a third distinct party must negotiate for a share of that surplus—the debtor's union workers.

Consider this example of how the debtor's union wage rates affect the negotiation over the debtor's going-concern surplus. Imagine a debtor that is worth $10 million if liquidated piecemeal and that is worth $9 million as a going-concern if its collective bargaining agreement is not modified. Suppose that if union wage rates

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139. See id. (providing for an automatic stay which prevents any actions by pre-petition creditors against the debtor or against property of the estate); id. § 524(a)(2) (creating a post-discharge injunction which prevents any pre-petition creditor from pursuing the debtor following debtor's discharge in bankruptcy); id. § 726 (providing for distribution of the property of the estate).
140. See Keating, supra note 97, at 188-95 (describing complications in the process of negotiating for going-concern surplus).
were cut by twenty percent, the debtor's going-concern value would increase to $11 million because of the effect that this reduction in expenses would have on the debtor's projected annual cash flow.

What section 1113 and its "necessary" standard do not determine is just how much of a burden the union ought to bear in order to create a going-concern surplus that makes the Chapter 11 reorganization possible. In other words, the unanswered issue is whether section 1113 is intended to force union workers in the above hypothetical to accept a wage cut of five percent, twenty percent, or something in between. The specific words of section 1113 provide neither a baseline nor a ceiling as to the size of concessions that union workers are expected to make.

The best interests of creditors test found in section 1129(a)(7) can provide at least some guidance. Once again, that important section requires that each claimholder receive at least as much in the Chapter 11 plan as the claimant would receive if the debtor were liquidated under Chapter 7. What this means in the above example is that, at a minimum, union wages must be cut by ten percent to ensure a going-concern value of at least $10 million. If the going-concern value were less than $10 million, then unsecured creditors would end up receiving less in the Chapter 11 plan than they would if the debtor simply were liquidated. Section 1129(a)(7), then, provides a basis on which a minimum figure for required union concessions can be calculated.

On the surface, it would appear that the Wheeling-Pittsburgh test in this example would allow the debtor to make union wage cuts of no greater than ten percent. A ten percent union wage cut is the amount that would just meet the "best interests" test and thus would avert the liquidation that could come from failing to meet that test. What the Wheeling-Pittsburgh test fails to account for, however, is that any plan still has to receive the affirmative vote of claimholders. Thus, if union wages were cut by merely

143. One of the 13 prerequisites to the confirmation of a plan under § 1129(a) is that each class of "impaired" claims has accepted the plan. Id. § 1129(a)(8). Under the Bankruptcy Code, a class of claims is considered to be "impaired" when its nonbankruptcy entitlements would be altered by the plan. Id. § 1124. "Acceptance" of a plan by a class of
ten percent, claimholders would be unlikely to vote for confirmation of the Chapter 11 plan.

The problem with a wage cut of just ten percent is that unsecured creditors would receive none of the going-concern surplus that Chapter 11 is intended to preserve. Put another way, the *Wheeling-Pittsburgh* definition of "necessary" as applied literally in this hypothetical would make the unsecured creditors as well off, but no better off, in Chapter 11 than they would be in Chapter 7. The flaw, then, in the bare-bones approach to "necessary" is that while meeting the "best interests" test may be necessary for a successful reorganization, it likely will not be sufficient to bring the debtor out of Chapter 11.

When one considers the realities of the bargaining dynamic in a Chapter 11 reorganization, specifically the negotiations over allocation of a debtor's going-concern surplus, the liberal *Carey* standard of "necessary" appears to be the more logical approach. The *Carey* standard of "necessary," which allows greater cuts in union wages than merely those absolutely necessary to avoid liquidation, is more likely to lead to a confirmed plan of reorganization. The reason that the *Carey* standard will have this effect is that the *Carey* definition of "necessary" is more likely to allocate at least some of the gains of the debtor's going-concern surplus to the unsecured creditors who must vote on the debtor's plan of reorganization.

Even *Carey's* standard, however, fails to answer the more fundamental question of just how much of the debtor's going-concern surplus ought to be captured by the union workers and how much should be captured by unsecured creditors. Whereas section 1129(a)(7)'s "best interests" test demands of the union that the creditors requires an affirmative vote by at least two-thirds in amount and one-half in number of the allowed claims of such class held by creditors. *Id.* § 1126(c).

Even if a class of claims votes against a plan, the plan still can be confirmed under § 1129(b), the "cramdown" procedures of the Bankruptcy Code. *Id.* § 1129(b). For a plan to be crammed down over the dissenting votes of a class of creditors, however, § 1129(b) requires that a number of conditions be met. First, all of the other twelve requirements for the confirmation of a plan in § 1129(a) must be satisfied, including the "best interests" test of § 1129(a)(7) that was noted earlier. *Id.* Furthermore, § 1129(b)(2)(B) provides that no plan can be confirmed over the "no" vote of a dissenting class unless the plan provides for that class to be paid in full or no junior class receives anything. *Id.* § 1129(b)(2)(B). This provision is known as the "absolute priority rule."
unsecured creditors at least break even in Chapter 11, Carey sug-
ests that the union must accept modifications that make the un-
secured creditors somewhat better off than they would be in a liq-
uidation of the debtor. Precisely how much better off the
unsecured creditors must be made, and at what cost to the union
workers whose wage cuts are enabling that result, are two ques-
tions that the word “necessary” and all of its interpretations thus
far have yet to fully resolve.

B. Whether Rejectin Under Section 1113 Creates a Claim

Somewhat amazingly, Congress did not clarify in section 1113
the answer to a question that is nothing less than fundamental:
Whether a court-approved rejection of a collective bargaining
agreement in bankruptcy gives union workers a right to damages.
In the world before section 1113, the answer to this question was
clear. If a Chapter 11 debtor rejected a collective bargaining agree-
ment, the rejection was governed by section 365, the Bankruptcy
Code’s general provision on rejection of executory contracts.144

Section 365(g) provides that the rejection of an executory con-
tract in bankruptcy constitutes a breach of such contract, with
damages to be measured as if the breach had occurred immediately
before the filing.145 Section 502(g), in turn, creates an exception to
the usual rule that claims must arise pre-petition in order to be
allowable in bankruptcy. Section 502(g) provides that any claims
arising from the rejection of executory contracts shall be allowed
under section 502 just as if the claims had arisen before the date of
the filing of the bankruptcy.146

Since the enactment of section 1113, courts have not agreed on
the effect of a rejection of a collective bargaining agreement on the
claims of the workers who are covered by that agreement. Some
courts hold that because section 1113, unlike section 365, does not
specifically provide that rejection gives rise to a claim, then no
claim for rejection exists.147 Further, these courts contend that al-

146. Id. § 502(g).
(holding that when § 1113 was created it took collective bargaining agreements out of the
allowing union workers a claim based on the rejection of their labor contract would defeat the purpose of section 1113. The argument is that debtors can only reject labor agreements when doing so is necessary to permit reorganization. If section 1113 allowed the workers a claim for that rejection, however, then rejection itself would prevent a successful reorganization by increasing significantly the amount of unsecured claims against the debtor.

Other courts have held that section 1113 was not meant to displace completely the provisions of section 365 as applied to collective bargaining agreements, but merely to supplement the Code's more general rules on the assumption or rejection of executory contracts. Accordingly, these courts hold that the rules of sections 365(g) and 502(g), which applied before the enactment of section 1113, should continue to govern these rejection cases, because the rules of sections 365(g) and 502(g) are not inconsistent with the provisions of section 1113.

Even accepting the notion that the workers have a claim for rejection of a collective bargaining agreement does not resolve the issue of how to define the size of that claim. A breach of contract formula provides the answer to that question. In other words, the workers' damage claim should be the difference between what the workers were entitled to under the original collective bargaining ambit of § 365 and that § 1113 did not provide an equivalent to § 365(g); In re Armstrong Store Fixtures Corp., 139 B.R. 347, 350 (Bankr. W.D. Pa. 1992) (holding that the net effect of § 1113 was to remove labor contracts from the purview of § 365).

148. See Blue Diamond, 147 B.R. at 732.

149. Id. The court in Blue Diamond also contended that the union could not be a creditor nor hold a claim because of the limitations in § 101(10)'s definition of "creditor" (stating that a creditor must hold a pre-petition claim or otherwise qualify under § 502(g)) and the limitations in § 502(b) (stating that a court shall determine the amount of claims as of the date of the filing of the petition). Id. at 732-33. In effect, the court simply was making the point that § 365(g) would be the only route for the union to have a claim that arises as a result of a post-petition rejection of a labor contract. Once § 365(g) is eliminated as a possibility, there is really no other route for the union to qualify as a claimant.


151. See Texas Sheet Metals, 90 B.R. at 273 (appllying § 365(g) pursuant to its discussion of § 1113).
agreement and what the workers actually receive for their work following the rejection of the agreement.\textsuperscript{152}

Applying this breach of contract standard to calculate damages is not as simple as it sounds. At least one debtor raised the question of whether this measure yields any damages at all for the disappointed union workers.\textsuperscript{153} The argument of this skeptical Chapter 11 debtor was that if no rejection of the labor contract had occurred, the debtor would have liquidated anyway and thus the workers would not have received the higher wages that originally were promised.\textsuperscript{154} The bankruptcy court refused to accept that argument, instead making the rather circular argument that because the debtor did not in fact liquidate, employment was available to those employees whose collective bargaining agreement was rejected.\textsuperscript{155}

A better response to the "no damages" argument is that it is irrelevant that the debtor would have liquidated in the absence of the court-sanctioned rejection of the labor contract. The real issue in calculating damages in bankruptcy for rejected executory contracts is simply determining the difference between what the nondebtor actually receives given the rejection and what that nondebtor party was entitled to receive under the rejected contract.

The argument that the debtor would have been unable to perform the contract even in the absence of rejection is an argument that will often be available in the bankruptcy setting. That reality, however, has never caused courts to deny damage claims to nondebtor parties under section 365(g) when the debtor rejects executory contracts outside the realm of collective bargaining agreements. Nothing is distinctive about a collective bargaining agreement that makes this "no damages" argument any less weak in that context than the argument is in the typical executory contract setting.

A separate issue concerning potential damages for rejection of a labor contract is whether section 502(b)(7) of the Bankruptcy Code

\textsuperscript{152} See Indiana Grocery, 138 B.R. at 50.


\textsuperscript{154} Id. at 625.

\textsuperscript{155} Id.
should apply to such a claim. That provision of the Code limits the damages available to an employee for the debtor's termination of an employment contract. The limit on the employee's claim given in section 502(b)(7) is for one year's worth of compensation that is provided for by the rejected employment contract.

The one district court that considered this issue held that the section 502(b)(7) limit did not apply to the union's claim arising from rejection of the collective bargaining agreement. The court reasoned that the section 502(b)(7) limitation was intended to apply to employment contracts between individual employees and the debtor rather than to a collective bargaining agreement that encompassed the entire group of union workers.

On the question of whether a claim exists at all, it is rather hard to believe that Congress intended, without expressly stating so, that union workers should have no claim following a rejection. As mentioned above, some courts contend that allowing a damage claim in these cases would cause the very liquidation of the debtor that the rejection of the labor contract was supposed to avoid. But that argument ignores the fact that any damage claim against the estate will not be paid in real dollars, but instead will be paid with the proverbial "ten-cent bankruptcy dollars." Put another way, the issue of whether the union workers get a damage claim is simply one of asset distribution. Resolution of that question will determine whether the workers end up with a piece of the debtor's pie at the expense of other general unsecured creditors. By contrast, the issue of whether the debtor should liquidate or reorganize is one of asset deployment.

The answer to the deployment question will not necessarily be determined, as some courts seem to suggest, by the answer to the distribution question. Whether union workers receive a larger piece of the pie need not affect the question of whether its employer liquidates or reorganizes. Certainly the deployment question should not, as a normative matter, be driven by distributional concerns.

157. Id.
158. United States Truck, 89 B.R. at 628.
159. Id.
160. See supra text accompanying notes 147-49.
Ideally, the decision of whether the debtor’s assets should remain together or be broken up is one that ought to be made by a single owner or, in the alternative, by a group of claimants whose collective judgment mimics that of a single owner. The best way to ensure that the deployment decision of a creditor group will mirror that of a single owner is to maintain the relative priorities of the individual creditors no matter which deployment decision is chosen. Thus, individual creditor priorities should not change depending on whether the debtor is liquidated or reorganized.

As a general matter, the most effective way to avoid skewing the deployment decisions of bankruptcy claimants as a group is to answer the distribution question in bankruptcy with reference to state law. In fact, bankruptcy law tends to take state law entitlements and priorities as it finds them. This makes sense due to the fact that if bankruptcy drastically reordered nonbankruptcy entitlements, forum-shopping problems might result. Claimants who received a better relative deal inside of bankruptcy would have an incentive to see their debtor in bankruptcy even if the creditor group as a whole would be better served with a nonbankruptcy solution. This forum-shopping incentive, in turn, would adversely affect an individual claimant’s decision about the optimal use of its debtor’s assets.

In determining whether the union workers should have a claim for rejection of their collective bargaining agreement, one must ask whether the workers would have such a claim if the agreement were rejected outside of bankruptcy. In fact, the union workers outside of bankruptcy would end up having something better than just a claim for breach of contract—they would ultimately have the ability to force their employer to comply with the labor agreement

161. See Douglas G. Baird & Thomas H. Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U. Chi. L. Rev. 97, 118 (1984) (suggesting that a goal of bankruptcy is to deploy the company’s assets as a single owner would).

162. See Butner v. United States, 440 U.S. 48, 54-56 (1979) (stating that absent federal policy to the contrary, property rights in bankruptcy are defined by state law); see also Theodore Eisenberg, Bankruptcy Law in Perspective, 28 UCLA L. Rev. 953, 953-59 (1981).

163. See Butner, 440 U.S. at 55 (asserting that an important reason for the uniform treatment of property interests inside and outside of bankruptcy is to discourage forum-shopping).
as well as to pay them any back wages due to the unilateral modification or rejection.\textsuperscript{164}

In one sense, then, in merely creating a mechanism for rejection without union consent, section 1113 is already making union workers worse off than they would be outside of bankruptcy. There seems to be no reason, in the absence of clear congressional intent, to exacerbate what is already a potential forum-shopping problem by denying the union workers any claim at all for their employer’s rejection of the collective bargaining contract.

\textbf{C. The Unrejected, Unperformed Labor Contract}

Reading the plain language of section 1113(f), one would never guess that this seemingly straightforward rule would cause the firestorm of controversy that recently has surrounded its interpretation. Section 1113(f) states: “No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this section.”\textsuperscript{165} At one level, this language could be interpreted simply as reversing that part of the Supreme Court’s \textit{Bildisco} decision that organized labor found to be the most distasteful: the Court’s holding that a debtor could unilaterally reject a collective bargaining agreement without committing an unfair labor practice.\textsuperscript{166}

Instead, section 1113(f) has become the center of a priority battle. The case in which the controversy typically arises is one in which the Chapter 11 debtor has not effected a formal rejection of its labor contract, but nor has it complied with the terms of the agreement. Workers who are owed wages and benefits under these unrejected, unperformed labor agreements contend that any rights they are owed should enjoy a superpriority status vis-à-vis the rights of other claimants.

One line of cases holds that section 1113(f) has nothing to say about the priority question and that any priority enjoyed by the claims of union workers must be found, if it all, in the Code’s gen-

\textsuperscript{164} See supra text accompanying notes 13-15.
eral priority provision, section 507. On the other side of the battle are cases that hold that section 1113(f)'s mandate against unilateral termination of the labor contract prevails over any other provision of the Code, including the Code's priority provisions. A debtor's failure to pay obligations under the unaccepted agreement, according to these courts, is tantamount to a unilateral termination or alteration of the contract by the debtor.

With the benefit of hindsight, Congress easily might have solved this problem. One approach might have been to state directly in section 1113(f) exactly what would happen if the debtor did unilaterally terminate or alter the contract. Thus, Congress might have included a sentence that said, "Any rights of parties arising from such a unilateral termination or alteration shall take priority in distribution ahead of all parties except perfected secured creditors."

Alternatively, Congress could have included within the Code's priority provision, section 507, a subsection that referred to section 1113(f) claims and where they fit in. For example, Congress simply could have added section 1113(f) claims to the category of claims under section 507(a)(1) that are entitled to first priority among unsecured claimants. Congress, of course, took neither of these approaches, leaving to the courts the question of what consequence was intended when the debtor failed to abide by the rule of section 1113(f).

In addition to numerous lower court opinions, three circuit court cases already have addressed in some way the puzzle of section 1113(f). In the first of these cases, United Steelworkers v. Unimet Corp. (In re Unimet), the debtor filed Chapter 11 at a time when the only remaining obligation under its collective bargaining


169. See Unimet, 842 F.2d at 882.

agreement was to continue paying retiree medical premiums. The bankruptcy court and the district court had determined that retirees were not employees for the purpose of section 1113(f)'s protection and that payment of the retiree premiums did not otherwise qualify as an administrative expense priority.

The Sixth Circuit in *Unimet* reversed the lower courts and noted that section 1113(f) states clearly that no other part of the Bankruptcy Code should be construed to allow the debtor unilaterally to terminate or alter any provisions of a collective bargaining agreement prior to a formal rejection procedure. Some subsequent cases have pointed to *Unimet* as supporting the proposition that section 1113(f) claims should enjoy a superpriority status. Other courts, by contrast, have maintained just as steadfastly that *Unimet* spoke not at all to the priority issue, but instead merely addressed the question of whether retirees were entitled to the protections of section 1113.

In *In re Ionosphere Clubs, Inc.* the collective bargaining agreement in question included a clause that required certain disputes between the union and its employer to be settled through arbitration. The issue faced by the Second Circuit was whether bankruptcy's automatic stay provision prohibited application of the arbitration clause even though the collective bargaining agreement that contained the clause had not been rejected yet by the Chapter 11 debtor. The court held that the arbitration clause did apply notwithstanding the automatic stay because of section 1113(f)'s mandate that no other provision of the Code should allow the debtor unilaterally to terminate or alter the labor contract in the absence of a formal rejection. The court held that a failure to abide by the arbitration clause constituted a unilateral modifica-

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171. Id. at 880.
172. Id. at 881.
173. Id. at 883.
175. See, e.g., *In re Roth American, Inc.*, 975 F.2d 949, 957 n.10 (3d Cir. 1992).
177. Id. at 986.
178. Id. at 992.
tion of the still-unrejected collective bargaining agreement in violation of section 1113(f).\textsuperscript{179}

As with \textit{Unimet}, lower courts disagree about the effect of the \textit{Ionosphere} decision on the section 1113(f) priority question.\textsuperscript{180} Courts that hold in favor of a superpriority approach to section 1113(f) point to \textit{Ionosphere} for the proposition that this subsection does indeed trump all other provisions of the Code.\textsuperscript{181} Those courts that do not believe section 1113(f) addresses priority issues at all have distinguished \textit{Ionosphere} on the basis that the conflict there was between the automatic stay and section 1113(f) rather than between the Code’s priority provisions and section 1113(f).\textsuperscript{182}

The only circuit court decision to address the priority issue is \textit{In re Roth American, Inc.}.\textsuperscript{183} That case involved an employer which initially filed Chapter 11, never formally rejected its collective bargaining agreement, and later liquidated piecemeal without having confirmed a successful plan of reorganization.\textsuperscript{184} In the aftermath of the failed reorganization, the union argued that certain vacation and severance pay claims of union workers, some of them pre-petition, were entitled to superpriority status by virtue of section 1113(f).\textsuperscript{185}

The Third Circuit in \textit{Roth} denied the union’s claim for superpriority status except to the extent that the employees earned the benefits sought during the post-petition period.\textsuperscript{186} The court first found no indication in the language or the legislative history of section 1113 that Congress intended to address the priority of employees’ claims for breaches of unrejected collective bargaining agreements.\textsuperscript{187} The court then contrasted section 1113(f) with the

\begin{itemize}
\item \textsuperscript{179} \textit{Id.} at 991.
\item \textsuperscript{181} See, \textit{e.g.}, \textit{Golden Distrib.}, 152 B.R. at 36.
\item \textsuperscript{182} See, \textit{e.g.}, \textit{In re Ionosphere Clubs, Inc.}, 154 B.R. 623, 628 (S.D.N.Y. 1993) (denying priority and contending that the Second Circuit’s \textit{Ionosphere} opinion dealt solely with the intersection of § 362 and § 1113(f)).
\item \textsuperscript{183} 975 F.2d 949 (3d Cir. 1992).
\item \textsuperscript{184} \textit{Id.} at 950-52.
\item \textsuperscript{185} \textit{Id.} at 951.
\item \textsuperscript{186} \textit{Id.} at 956.
\item \textsuperscript{187} \textit{Id.}
\end{itemize}
Code's section on retiree medical benefits, section 1114. Unlike section 1113, section 1114 specifically provides that any payment for retiree benefits required to be made under section 1114 will enjoy the status of an administrative expense priority

If one is willing to go beyond the surface debate of whether the unions are entitled to superpriority status, one can reconcile these cases sensibly, despite the courts' professed disagreement with one another. In order to appreciate this reconciliation, one first must consider two different situations. Situation 1 involves a company that is in Chapter 11 and is currently an ongoing business. The company has a collective bargaining agreement that has not yet been rejected. Imagine that this debtor is behind in payments that it owes to union workers under the collective bargaining agreement.

If the Chapter 11 debtor in Situation 1 wishes to confirm a plan of reorganization, then it first must make good on all of its past obligations under the collective bargaining agreement. Put another way, this debtor cannot treat its labor contract as rejected without formally rejecting it. In this first situation, one could argue that the effect of section 1113(f) would be to give claims under such an unrejected collective bargaining agreement a "superpriority" status. These labor contract claims would achieve this status because they would be paid in full, whereas certain other unsecured claims outside of the collective bargaining agreement would receive less than one hundred cents on the dollar.

Situation 2 involves a debtor that enters Chapter 11 at a time when it owes past obligations under a still-existing collective bargaining agreement. The debtor struggles along in Chapter 11 for a few months, never paying these pre-petition obligations under the collective bargaining agreement, and then finally is liquidated piecemeal without having bothered to reject its labor contract. The question then becomes what priority level the pre-petition claims from the never-rejected labor agreement should have in the liquidation of the debtor.

In cases that mirror Situation 2, unions have argued that section 1113(f) requires that those pre-petition claims receive a superpri-
Courts that disagree with the union in this type of case apparently believe that their decisions do not follow courts which have allowed a superpriority status to the claims in Situation 1. The truth is, a perfectly consistent interpretation of section 1113(f) would deny the priority claim in Situation 2 but would grant it in Situation 1.

That interpretation views the provision as having nothing to do with the relative priority among claimants as such. Rather, the role of section 1113(f) is twofold: first, to overrule Bildisco's holding that seemed to sanction a Chapter 11 debtor's unilateral rejection of a collective bargaining agreement;191 and second, to serve as a reminder to debtors that merely being in Chapter 11 does not give them a license to ignore contractual commitments without following the proper procedures for escaping them.192 Seen in this light, the proper remedy for a violation of section 1113(f) is an injunction. In other words, the debtor should not be able to emerge from bankruptcy as an ongoing business unless and until it has either properly rejected its collective bargaining agreement or completely fulfilled all of the obligations thereunder.

Going back to Situation 1, the reason that the union workers should be paid is that the court's injunction is enforced as a prerequisite to allowing confirmation of the debtor's plan of reorganization. The injunction in that first situation means that the reorganizing debtor must comply, as section 1113(f) requires, with the terms of the collective bargaining agreement that it never formally rejected.

In Situation 2, the reason that the workers should not get their pre-petition claims paid in full is that the injunction of section 1113(f) has no meaning when no ongoing entity survives against which to enforce it. A Chapter 11 confirmation hearing can serve as an appropriate point for the court to force the debtor's compliance


with an unrejected collective bargaining agreement. In Situation 2, the Chapter 11 debtor never made it to that point and therefore was never forced to comply with the injunction.

Note that even in Situation 2, in which the debtor liquidates, the union workers should get an administrative priority for any obligations they are owed that relate to work performed during the Chapter 11 case. That result, however, has nothing to do with section 1113(f). Instead, the administrative priority received by the workers would be a function of their fulfilling the requirements of section 503(b). That section defines an administrative expense as any “actual, necessary costs and expenses of preserving the estate.” Expenses owed by the debtor for work performed during the post-petition period routinely qualify for this priority.

To create yet a third situation, Situation 3, suppose that a debtor enters Chapter 11 at a time when the debtor owes certain pre-petition obligations under its still-existing collective bargaining agreement. Imagine that the debtor continues its operations in Chapter 11 for several months, and during that time fails to honor certain post-petition obligations under the labor contract. The debtor then successfully rejects the collective bargaining agreement under the provisions of section 1113.

In Situation 3, the union workers’ pre-petition claims under the now-rejected collective bargaining agreement should receive no special priority. Certainly the workers’ claims for any post-petition obligations under the agreement should qualify for priority to the extent that they otherwise qualify as administrative expense claims. But union workers in this situation have argued that section 1113(f) should give a priority status to both the pre-petition and the post-petition obligations of the debtor under the collective bargaining agreement.

The argument of the union in this third type of case is that section 1113(f) causes in effect a “deemed assumption” by the Chapter 11 debtor of the collective bargaining agreement, at least up

196. See supra text accompanying notes 194-95.
until the point of the labor contract’s proper rejection.198 During that period of deemed assumption, the argument goes, all of the union workers’ pre-petition claims under the agreement assume the status of administrative expense priorities.199 That is, in fact, the result that would occur if the debtor actually assumed an executory contract. Section 365(b) is clear that a debtor wishing to assume an executory contract in default ultimately must pay in full the amount of any pre-petition defaults as a prerequisite to assumption of the contract.200

Applying the section 365(b) rule of affirmative contract assumption to these temporary “default assumptions” would, however, lead to a number of undesirable results. First, it would prevent even the most diligent debtor from shedding obligations that stem strictly from its pre-bankruptcy past. One of the most fundamental principles of bankruptcy is that a debtor should be able to create upon filing bankruptcy a clear cleavage between its past and its future dealings with third parties.201 Under the approach to section 1113(f) advocated by the union, even if the Chapter 11 debtor took just one week to effect a proper rejection of its labor contract, all pre-petition obligations owed by the debtor to the union would instantly become priority claims upon the debtor’s Chapter 11 filing.

The second flaw in the argument for giving superpriority status to pre-petition collective bargaining claims is that the union workers’ priority would then depend largely on the fortuity of whether its employer initially filed for a Chapter 11 or a Chapter 7 bankruptcy. The placement of section 1113 in only Chapter 11 of the Bankruptcy Code is at least reasonably logical. If a company is liquidating under Chapter 7 rather than reorganizing under Chapter 11, the need for a debtor to “reject” the company’s collective bargaining agreement disappears.

198. Id.
199. Id. at 955-56.
200. 11 U.S.C. § 365(b)(1)(A) (1988) (providing that one condition to a debtor’s ability to assume a pre-petition contract that is in default is that debtor “cures, or provides adequate assurance that the [debtor] will promptly cure, such default”).
201. See id. § 301 (a voluntary bankruptcy case commences immediately upon filing a petition); id. § 362(a) (the automatic stay becomes effective immediately upon filing); id. § 541(a)(1) (property of the estate defined to include all legal or equitable interests of debtor in property “as of the commencement of the case”); id. § 727(b) (bankruptcy discharge affects all debts which arose before commencement of the case).
If section 1113(f) is construed as creating a priority for pre-petition obligations under a collective bargaining agreement, then it creates a priority that exists in Chapter 11 only. The existence of such a Chapter 11-only priority could skew, at the margin, the decision of either the company or its creditors about which bankruptcy chapter would best maximize the value of the company's assets. Put another way, allowing a Chapter 11-only priority would cause the asset distribution question to drive the asset deployment question. As discussed earlier, these two decisions ought to be independent of one another.\footnote{202}

The other problem with construing section 1113(f) to create a Chapter 11-only priority is that it would have the ironic effect of giving creditors other than union workers much greater leverage in determining whether the debtor's Chapter 11 plan should be confirmed. The operation of the "best interests of creditors" test would accomplish this result. The best interests test, as mentioned before, essentially requires that every creditor receive as much in the Chapter 11 plan as the same creditor would receive if the company were liquidated under Chapter 7.\footnote{203}

If the union workers received a priority in Chapter 11 but not Chapter 7 for their pre-petition claims under the collective bargaining agreement, then creditors who were not union workers would receive relatively less in Chapter 11 than if the company were liquidated in Chapter 7. Of course, the debtor possibly could be worth so much more as a going-concern in Chapter 11 than it would be if liquidated in Chapter 7, that the creditors who were not union workers would still be better off with the company in Chapter 11 than in Chapter 7.

If, however, the company's "going-concern surplus" were less than the amount of the union workers' Chapter 11-only priority claims, the other creditors could block the proposed Chapter 11 plan by invoking the "best interests" test. The union workers could remove this leverage from the other creditors only by giving back wage concessions to the Chapter 11 company that were sufficient to make the other creditors as well off as they would be if the company were in Chapter 7. Even if this bargaining came to a suc-

\footnote{202. \textit{See supra} text accompanying notes 160-63.}
\footnote{203. \textit{See supra} text accompanying notes 133-34.}
cessful conclusion, the negotiation itself would add yet a new cost to a Chapter 11 process that is already fraught with transactions costs.204

VI. CONCLUSION

When considering the wisdom of section 1113 in the abstract, it probably makes sense to ask whether and how that provision changes the nonbankruptcy rules that govern an employer’s relationship with its union workers. As noted earlier, the NLRA provides that existing labor agreements can only be modified or terminated through a process involving notice and bargaining.205 This rule, in fact, is fairly similar to the result under the more elaborate standard set down in section 1113.

The question then becomes whether section 1113, given that it more or less approximates the rules under nonbankruptcy law, including a separate provision in the Bankruptcy Code to state that fact, ensures any independent benefit. Certainly courts would be more efficient if they simply would translate nonbankruptcy entitlements into the bankruptcy forum. On the other hand, if section 1113 was intended to create a rejection standard that is truly different from that which exists under nonbankruptcy law, a forum-shopping problem could well arise from such a reordering of nonbankruptcy entitlements.

As this Article has explored, case law since the enactment of section 1113 has been less than clear about how that Code provision changes the set of nonbankruptcy rules that govern the modification of collective bargaining agreements. Ironically, of course, one of Congress’ primary motivations for enactment of section 1113 was to clarify what the labor contract rejection standard ought to be in the wake of the Bildisco opinion. Instead of bringing clarity, however, section 1113 has simply created additional provisions resulting in significant litigation.

Even before section 1113, the Bankruptcy Code included the fundamental provisions that could provide a framework for deter-

204. The administrative costs of a typical Chapter 11 reorganization in which a creditors’ committee is appointed have been estimated at $100,000. See Douglas G. Baird, The Uneasy Case for Corporate Reorganizations, 15 J. LEGAL STUD. 127, 135 n.13 (1986).

205. See supra text accompanying notes 12-13.
mining the ability of a Chapter 11 debtor to reject a collective bargaining agreement. Indeed, the main dispute that arose with the use of section 365 to govern the rejection of labor contracts was just how great a hardship that the debtor had to show in order for a court to allow rejection under that section. Today, with the addition of section 1113, that very same tension remains, albeit in different clothes.

The fundamental dispute regarding what level of hardship the debtor needs to show for rejection of a collective bargaining agreement simply has shifted from section 365 to the definition of "necessary" in section 1113. As this Article has demonstrated, section 1113's failure to resolve the primary unsettled issue that existed prior to its enactment is not its most troubling aspect. Besides failing to solve old problems, section 1113 created new ones that did not and could not exist in the world before section 1113.

In addition to the "necessary" debate, the two main section 1113 questions that occupy the case law today had no real analogues before that provision's enactment. The issue of whether union workers should have a claim for rejection of a collective bargaining agreement in a pre-1113 setting was easy to resolve. Section 365(g) provides unambiguously that any rejection of an executory contract under that provision gives rise to a claim for damages.206 Similarly, the superpriority issue that has arisen under section 1113(f) is solely a function of the imprecise language of section 1113(f).

One other significant point questions the need for a separate section 1113. Union workers' greatest leverage in bargaining with their employer, both inside and outside of bankruptcy, remains the same in the section 1113 world as it did in the pre-Bildisco days: the ability to strike. With or without section 1113, the union workers' employer can never modify or reject its labor contract with complete impunity because of employees' ability to vote with their feet.207 Given the existence of that simple but effective bargaining tool, one is left to wonder whether the bells and whistles of section 1113 have in fact been worth that provision's tremendous costs.

207. See In re Kentucky Truck Sales, Inc., 52 B.R. 797, 806 (Bankr. W.D. Ky. 1985) (noting that even following a court-sanctioned rejection of the collective bargaining agreement, union workers retain their right to strike as "their ultimate bargaining tool").