In re Northwest Airlines:

After Contract Rejection Under Section 1113

- No Right to Strike
- No Claim for Rejection Damages

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***In re Northwest Airlines Corp.*, 483 F.3d 160 (2d Cir. 2007): After Contract Rejection Under Section 1113**

In the vast majority of Section 1113 proceedings, the debtor and its labor groups reach a consensual restructuring of terms and conditions of employment. Achieving settlement is one of the core purposes of the Section 1113 process--and the process usually works, although frequently only after long and difficult negotiations. Some Section 1113 cases do reach the point of decision by a court, and there is, of course, a substantial body of case law that has developed in the 25 years since Section 1113 was enacted. Nonetheless, because Section 1113 is so effective in causing settlements (including settlements after initial Section 1113 decisions), a surprisingly large number of legal issues concerning important elements of the Section 1113 process and the parties' respective rights after rejection of a labor agreement have remained largely undeveloped in the case law. Two of these important issues were addressed in the Northwest Airlines Chapter 11 case.

In Northwest Airlines, the debtor reached a consensual resolution of the Section 1113 process with all of its unions except the union representing the flight attendants. Indeed, although the negotiators for the flight attendants' union reached two separate agreements with the company, they could not obtain ratification of either of these agreements by the rank and file flight attendants. When the first agreement failed ratification, the flight attendants threw out not just their bargaining team, but the entire union, and certified another union to represent them. Then, after a second agreement was reached by the bargaining team for the new union, the rank and file refused to ratify that agreement as well. Unable to obtain ratification of the agreements reached between the flight attendant's negotiating teams and the Company, Northwest was left with little choice but to reject the agreement under Section 1113 and impose the terms and conditions that had been approved by the bankruptcy court.[1] As a result, two important legal issues were litigated and decided in the Northwest Airlines case, for which there was little prior judicial guidance. These issues were (1) whether an airline debtor who has rejected a collective bargaining agreement and imposed new terms and conditions of employment, may enjoin a labor group from striking in response to the rejection, at least under certain circumstances; and (2) whether a union has a claim for "rejection damages" after the collective bargaining agreement has been rejected.

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[1] *In re Northwest Airlines Corp.,* 483 F.3d 160, 177 (2d Cir. 2007) ("Although this is a complicated case, one feature is simple enough to describe: Northwest's flight attendants have proven intransigent in the face of Northwest's manifest need to reorganize.")

I. Injunction Against Labor Strike

After Northwest rejected the flight attendant contract, and imposed new terms and conditions of employment, the flight attendants threatened to invoke "CHAOS." CHAOS is a strategy trademarked by the AFA which stands for "Create Havoc Around Our System" and is essentially a series of intermittent strikes and other tactical work cessations designed to disrupt the airline operations in ways that cannot be planned for or managed well by the airline. Of course, CHAOS actions can also be disruptive to the traveling public. Northwest asked the bankruptcy court to enjoin the CHAOS on the ground that it was prohibited under the RLA. The bankruptcy court denied the injunction, ruling that it did not have the authority to enter it. On appeal, the district court reversed the bankruptcy court decision and entered the injunction to prevent CHAOS.[2]

This set the stage for a hotly contested battle that went to the United States Court of Appeals for the Second Circuit, which was joined by the United States as well as a number of intervenors and amici from labor and business groups.[3] The Second Circuit panel held that at least under the particular facts and circumstances of the Northwest case, notwithstanding the anti-injunction provisions of the Norris LaGuardia Act, an injunction could issue to prevent a strike in response to a contract rejection under Section 1113. Although all three members of the panel reached the same conclusion, the majority and concurring decisions took two very different paths to that conclusion and each observed that they could not reach the conclusion on the path taken by the other. Neither opinion followed closely the reasoning of the district court.

The majority opinion reasoned that the rejection "abrogated" but did not breach the labor agreement.[4] The abrogation terminated the "status quo" under the Railway Labor Act ("RLA"), thereby freeing Northwest from a duty to maintain the status quo under that act, permitting it to change terms and conditions of employment.[5] The AFA's proposed strike

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[2] *In re Northwest Airlines Corp.*, 349 B.R. 338, 384-5 (S.D.N.Y. 2006).

[3] In addition to the briefing from Northwest and the Association of Flight Attendants, the Court received and reviewed briefing submitted by the United States Department of Justice; amicus curiae International Brotherhood of Teamsters; amicus curiae American Federation of Labor and Congress of Industrial Organizations; amicus curiae Aircraft Mechanics Fraternal Association; Amicus Curiae Official Committee of Unsecured Creditors of Northwest Airlines Corporation; intervenor Air Line Pilots Association.

[4] *In re Northwest Airlines Corp.*, 483 F.3d at 169.

[5] *Id.*

would have violated the RLA duty to "exert every reasonable effort" to make an agreement before striking, and thus could be enjoined under the RLA, notwithstanding the Norris LaGuardia Act.[6] The court distinguished a rejection under Section 1113 from a rejection under Section 365, due to the special requirements and determinations necessary for an 1113 rejection (changes to agreement must be "necessary" "fair and equitable" and rejected by the union "without good cause"), and concluded that while a Section 365 rejection is a contract "breach", an 1113 rejection is not a breach.[7] The majority concluded that it was necessary to reach the question of whether there was a breach (or not) resulting from the contract rejection in order to answer the question as to whether the rejection freed the union to strike.[8]

In contrast, the concurring opinion focused on the fact that although Northwest altered the status quo after the contract rejection, it did not do so "unilaterally" but rather after a long fair statutory process, and with court approval.[9] The Court noted the multilateral aspects of the Section 1113 process, and the public interest in avoiding airline strikes, as embodied in the provisions of the RLA. The concurring judge observed that throughout the Section 1113 process the flight attendants had been under a duty not to strike, which was imposed by the RLA, and that nothing in the Section 1113 process or the implementation of the court's authorization pursuant to the process relieved the flight attendants of this duty not to strike. The authority relied upon by the unions in support of the claim that a right to strike had been triggered by the contract rejection was based on carriers "unilaterally" changing terms and conditions of employment and thus was held inapposite to the Section 1113 context.

It is important to note that this decision was made in the context of labor agreements controlled by the RLA. Although the majority and the concurrence disagree on the rationale, they are in complete agreement that a union may be enjoined from striking after contract rejection when the contract is governed by the RLA. This view has been

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[6] *Id.*

[7] *Id.* at 170.

[8] *Id.* at note 3.

[9] *Id.* at 178 (Jacobs, Chief Judge, concurring).

adopted or followed by other lower courts facing the issue[10], with the exception of the bankruptcy court in the Northwest case itself, which had denied the injunction request. Most labor agreements, however, are governed by the NLRA, as opposed to the RLA. The majority opinion observes that the Second Circuit has previously "hinted" that a union is free to strike after a contract rejection under Section 1113, when the contract is governed by the NLRA.[11] Thus, while the door may not be completely shut on obtaining a strike injunction in an NLRA context, it would certainly present a more difficult case for a debtor. (The prevailing view is probably that the door is completely shut on obtaining a strike injunction after rejection in an NLRA context, due to the effect of the Norris LaGuardia Act, but this author believes that there could be some subset of cases in which a strike injunction might conceivably be obtained, even after a rejection of a labor agreement covered by the NLRA.)

II. <u>Claim for Rejection Damages</u>

Unlike the strike injunction issue, the rejection damage claim issue was decided by the bankruptcy court, but was not appealed. In a decision based on the language and rationale of the Second Circuit decision that the contract had not been breached, Judge Gropper held that the rejection under Section 1113 did not create a rejection damage claim.[12] In reaching this conclusion Judge Gropper specifically quoted the statement in the majority opinion of the Second Circuit panel that "[i]f a carrier that rejected a CBA simultaneously breached that agreement and violated the RLA, the union would be correspondingly free to seek damages or strike, *results inconsistent with Congress' intent in passing section 1113.*"[13] Judge Gropper further noted the majority opinion's reliance on *In Re Blue Diamond Coal Co.*, a decision that held that rejection of a labor agreement under Section 1113 did not give rise to a claim for rejection damages.

Since rejection damage claims are a common bargaining chip in the Section 1113 process, this ruling is likely to provide an additional incentive for the labor union to reach a consensual agreement, rather than face the risk of losing the Section 1113 hearing and

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[10] *In re Delta Air Lines, Inc.*, 359 B.R. 491 (Bankr. S.D.N.Y. 2007); *In re Mesaba Aviation, Inc.*, 350 B.R. 112 (Bankr. D. Minn. 2006); *Global Aero Logistics v. Air Line Pilots Ass'n*, Int'l., 2008 U.S. Dist. LEXIS 46621 at *9 (E.D.N.Y. June 17, 2008).

[11] *In re Northwest Airlines Corp.,* 483 F.3d at 173.

[12] *In re Northwest Airlines Corp.*, 366 B.R. 270 (Bankr. S.D.N.Y. 2007).

[13] *Id.* at 276

receiving no rejection damage claim. The ruling also raises the possibility that a debtor can affirmatively use a stipulated rejection damage claim as part of the package of value offered in the Section 1113 proposal.

III. Other Issues

A reader of the factual background portions of the published opinions in Northwest Airlines might observe that a number of other procedural issues related to the Section 1113 rejection process potentially could have been challenged on appeal, but were not. In fact, neither side appealed the rejection order itself, and certain of the procedures in the Northwest Section 1113 process that could possibly be subject to challenge were agreed or at least not objected to during the hearing and negotiation process. In future cases, therefore, we may see more clarity around a number of other common issues in the Section 1113 process, that were not decided in this case. These issues may include (i) whether the parties' positions should be measured as of the start of the hearing, or whether moves made during the hearing are relevant to the case (both sides made moves during the hearing and these moves were taken into account by Judge Gropper by agreement of the parties), (ii) whether the court can condition a rejection order on imposition of terms that were not offered by the debtor, (iii) whether the court can condition a rejection order on a debtor imposing specific terms and conditions (Judge Gropper did condition the rejection order on certain terms and conditions, and Northwest elected not to challenge the conditions, although Norwest had asked for the freedom to impose certain terms not authorized by Judge Gropper) , (iv) whether debtors or unions can impose cross-conditions such that an offer or an agreement is only effective if certain concession levels are achieved from other unions, (v) whether a debtor can make a final Section 1113 proposal that leaves further room to offer additional concessions to "buy" a settlement or must a debtor go "all in" as a condition of meeting the "necessary" standard, (vi) whether creditors can intervene in and participate in the Section 1113 process, and if so, to what extent may they participate (vii) whether there are limits, if any, to the common practice of the same bankruptcy judge serving as the mediator and the decision-maker in the Section 1113 process, (viii) whether there are circumstances in which a union can have "good cause" to reject a Section 1113 proposal even though the proposal is "necessary" and "fair and equitable", and (ix) where multiple labor unions are involved, whether the Section 1113 process must be handled in a single or common set of hearings?

There are a few cases that address some of the above issues, but there is far from a sufficiently developed body of case law around these issues to preclude a debtor or union

from arguing for any reasonable position that best meets the objectives in a particular case. Some observers have argued that providing more clarity and rigidity to the rules of the Section 1113 process would be worthwhile. In view of the overall extent to which the Section 1113 process has been successful, notwithstanding these open issues and ambiguities, and perhaps sometimes because of them, a powerful argument can be made that Section 1113 is not broken, and does not need further clarifying or tinkering at this time.

A.B.I. WINTER LEADERSHIP CONFERENCE 2009

LABOR UNIONS IN TODAY'S BANKRUPTCIES
RECENT DECISIONS ON DUTY TO BARGAIN

***In re Chrysler LLC*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009)**

- Facts: Chrysler proposed to sell substantially all of its assets under § 363. Chrysler asked the court to approve the sale. The court found that a sale to Fiat, the interested buyer, was the only viable option for the company and approved the sale.
- Issue: New Chrysler negotiated with the UAW as to the collective bargaining agreements and the two parties came to terms on modifications. The parties also modified the funding arrangements for VEBA, which was the trust that funded benefits for employees and retirees. New Chrysler and the UAW agreed to fund the VEBA with equity and a note. The court held that the modifications were negotiated in good faith.
- Conclusion: The court affirmed the § 363 sale of Chrysler's assets and approved the modifications to the collective bargaining agreements.

***In re GMC*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009)**

- Facts: A combination of three unions, named the Splinter Unions, objected to the § 363 sale of GM assets. Old GM was willing to comply with § 1114, but as a practical matter, Old GM was not far from liquidation and would soon stop paying on the retiree benefits. In the end, the Splinter Union retirees would be left with unsecured claims. New GM declined to assume liability for the retiree benefits.
- Issue: The issue was whether § 1114 of the Code applied to a § 363 sale like the one being proposed by GMC and whether a purchaser of assets must assume liabilities, such as these, that it does not wish to assume.
- Conclusion: The buyer of the assets was not required to assume the liabilities to retirees. The court noted that § 363 is silent as to whether a debtor must comply with § 1114 to effect a § 363 sale. The objection of the Splinter Unions to the sale was overruled.

***In re G & C Foundry Company, Ltd*., 2006 Bankr. LEXIS 4582 (N.D. Ohio 2006).**

- Facts: The debtor motioned for an order under § 1113 authorizing rejection of its collective bargaining agreement with the Union. The debtor offered the testimony of a witness who stated that the proposal of the debtor in negotiations between the parties was the minimum reduction in labor costs necessary to successfully reorganize or effect a sale under § 363.
- Conclusion: The court stated that the debtor must prove the necessity of the entire proposal. In this case, the court stated that the debtor's final proposal in negotiations included modifications for which there was no apparent benefit with respect to increasing the likelihood of reorganization. The court held that although there was a real need to modify the collective bargaining agreement, especially the debtor's health care plan, the debtor did not meet its burden of showing that its proposal was necessary to permit

reorganization. The Union had good cause to reject the proposal and the court encouraged the parties to continue to negotiate.

In re UAL Corporation, United Retired Pilots Benefit Protection Association v. United Airlines, Inc., **443 F. 3d 565 (7th Cir. 2006).**

- Facts: Active pilots for United Airlines negotiated a modification of the existing collective bargaining agreement. The bankruptcy court approved that modification under § 363(b)(1). The retired pilots of United Airlines appealed because under the modifications they were to lose their pensions and receive no replacement benefits. (On the other hand, active pilots were given replacement benefits for the elimination of their pensions.)
- Issue: The issue was whether the bankruptcy court could approve the agreement under § 363(b)(1) without giving any consideration to retiree pilot benefits.
- Conclusion: The court's decision to approve the modification was affirmed. There was no other feasible alternative.

Pre-BAPCPA Cases:

In re Horizon Natural Resources Co., **316 B.R. 268 (E.D. Kentucky 2004).**

- Facts: The debtor filed motions to set aside its current collective bargaining agreement under § 1113 and modify retiree benefits under § 1114. The debtor intended to sell its assets in a §363 sale free of encumbrances such as liability on the collective bargaining agreement or liability to retirees.
- Conclusion: The court held that rejection of the collective bargaining agreement and modification of the retiree benefits was necessary to reorganization because the debtor was unable to otherwise sell its assets.

In re Maxwell Newspapers, Inc., **981 F.2d 85 (2nd Cir. 1992).**

- Facts: The debtor had an existing collective bargaining agreement that guaranteed over 100 employees lifetime employment. The debtor had a buyer in a § 363 sale but that buyer conditioned the sale on concessions from the Union as to the lifetime employment provision. The debtor asked the court to modify the agreement to eliminate any requirement that the buyer employ members of the Union. The debtor presented evidence of its attempt to find a purchaser who would honor the agreement and its lack of success in that regard.
- Conclusion: The bankruptcy court agreed to reject the collective bargaining agreement pursuant to §1113 and proceed with the sale of assets under § 363. The District Court reversed. The Second Circuit affirmed the bankruptcy court decision holding that the modification to the collective bargaining agreement was necessary for an effective reorganization.

LABOR UNIONS AND BANKRUPTCY

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I. THE UNION AS A CREDITOR AND MEMBER OF THE CREDITORS' COMMITTEE.

A. **Labor Union Status as a Creditor.** Labor unions hold claims arising from debts owed under collective bargaining agreements ("CBAs") and thus are creditors who can file claims. *In re Crouthamel Potato Chip Co.*, 43 B.R. 934, 935-36 (Bankr. E.D. Pa. 1984), *aff'd in part on other grounds*, *remanded in part on other grounds*, 52 B.R. 960 (E.D. Pa. 1985), *rev'd on other grounds*, 786 F.2d 141 (3d Cir. 1986).

B. **Union Eligibility for Appointment to Committees.** Unions are eligible for appointment to creditors' committees based on such claims, and appointment may be mandated to insure adequate representation of different kinds of creditors. 11 U.S.C. § 1102(a), b(1); *In re Altair Airlines*, 727 F.2d 88, 90 (3d Cir. 984). In *Altair* the Third Circuit persuasively dismissed policy concerns raised by the debtor:

> *Undoubtedly [the union's] members may be interested in a plan of reorganization which preserves both their jobs and their collective bargaining agreement*, while other creditors may be interested in liquidation, or a reorganization involving a merger with a non-union airline. Such conflicts of interest are not unusual in reorganizations. . . . Section 1103(c)(2) contemplates that the Creditors' Committee may "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business, *and the desirability of the continuance of such business . . . .*" (emphasis supplied). *There is no reason why the voice of the collective bargaining representative should be the one claimant voice excluded from the performance of that statutory role.* The Bankruptcy Code has been said to be "in tension with our national labor policy, as expressed in the National Labor Relations Act." *In re Bildisco*, 682 F.2d 72, 77-8 (3d Cir.1982), *cert. granted*, --- U.S. ---, 103 S.Ct. 784, 74 L.Ed.2d 992 (1983). *But that tension does not suggest that collective bargaining representatives should have no role in the reorganization process. Quite the contrary; resolution of the tension suggests that those representatives should be heard in appropriate cases.*

In re Altair, 727 F. 2d at 90-91 (emphasis added).

C. **Experience of Unions as Members of Creditors Committees.**

1. Unions have been appointed to scores of committees across the country since Altair was decided, including in such prominent cases as GM, Chrylser, Pilgrim's Pride, Kaiser Aluminum, Asarco, LTV I and II, Bethlehem Steel, Delta, Northwest, United, US Airways, Philadelphia Newspapers, Star Tribune, Journal Register. In some cases the

appointment of committees — with 3 members — has only been possible because of union participation. *See, e.g.*, Philadelphia Newspapers, Journal Register.

2. While some debtors view unions with suspicion, union participation has largely been accepted. Most potential committee professionals recognize this reality and include union committee members in their lobbying for support for retention, impacting the ultimate dynamic between committee professionals and unions.

3. Facing a bankruptcy process that can be very difficult and contentious, unions, as foreseen in *Altai*r, make their views known within the committee on such key issues as executive compensation, exclusivity, 1113 efforts, plans, and sales of assets.

4. Union leaders have insight into business reality that brings great benefit to other members.

II. UNION AND EMPLOYEE CLAIMS

A. **Bar Date/Proofs of Claim**. Some bar date orders in large cases exclude claims by employees and unions whose payment has been authorized by a first day wage order, thereby eliminating administrative inconvenience for all.

B. **Wage, Vacation, Notice Pay, Severance Claims.** Employees are entitled to a $10,950 priority for wages and salaries, including vacation, severance, and sick leave pay, earned in the 180 days prior to filing. 11 U.S.C.§ 507(a)(4).

C. **Post-petition Accruals.** Post-petition accruals that precede a rejection are generally entitled to administrative claim status even if they might not otherwise meet the standard applicable to other claims. *In re World Sales, Inc.*, 183 B.R. 872, 875-79 (9th Cir. BAP 1995); *In re Colo. Springs Symphony Orchestra Ass'n*, 308 B.R. 508 (Bankr. D. Colo. 2004), *aff'd, Peters v. Pikes Peak Musicians Ass'n*, 462 F.3d 1265, 1271-72 (10th Cir. 2006) (a claim made under a CBA qualifies for administrative status where musicians render post-petition service by being available for performances and rehearsals).

D. **WARN Act Claims**. Unions can pursue claims under the WARN Act, 29 U.S.C. §§ 2101 *et seq.*; *United Food & Commercial Workers Union Local 751 v. Brown Group, Inc.*, 517 U.S. 544 (1996).

1. **Potential Defenses**. Employers often seek to escape liability under the faltering company and unforeseen business circumstances defenses. These defenses are to be narrowly construed and the employer bears the burden of persuasion. 29 U.S.C.§ 2102(b)(1), (b)(2)(a); 20 C.F.R. § 639.9; *Carpenters Dist. Council v. Dillard Dep't Stores, Inc.*, 15 F.3d 1275, 1281-82 (5th Cir. 1994). Substantial authority holds that such defenses are only available if the employer provides a WARN notice at the

earliest possible time citing the defense and giving a factual explanation. 29 U.S.C.§ 2102(b)(3); 20 C.F.R.§ 639.9; *In re Jamesway Corp.*, 235 B.R. 329, 337-43 (Bankr. S.D.N.Y. 1999) (enforcing requirement in bankruptcy context).

2. **The Liquidating Fiduciary Defense**. A debtor may have a defense if acting as a "liquidating fiduciary." *In re United Healthcare Sys., Inc.*, 200 F.3d 170 (3d Cir. 1999); *Law v. Am. Capital Strategies, Ltd.*, Civ. No. 3:05-0836, 2007 WL 221671, at *15-17 (M.D. Tenn. Jan. 26, 2007) (distinguishing *United Healthcare* where company making deliveries on morning of shutdown and layoffs); *Cain v. Inacom Corp.*, No. Adv. 00-1724, 2001 WL 1819997 (Bankr. D. Del. Sept. 26, 2001) (denying motion to dismiss WARN Act claim based on liquidating fiduciary defense where material question of fact).

3. **Remedy**. The remedy is back pay and benefits. 29 U.S.C. § 2104(a)(1)(A), (B). Attorney's fees are available, 29 U.S.C. § 2104 (a)(6), and one bankruptcy court awarded such fees administrative priority. *In re Jamesway Corp.*, 242 B.R. 130 (Bankr. S.D.N.Y. 1999).

4. **Bankruptcy Priority**. The recent amendment of Section 503(b)(1)(A)(ii) provides administrative expense status for back pay awarded pursuant to judicial or NLRB proceeding attributed to a period of time after the commencement of the bankruptcy, without regard to the time of the occurrence of the unlawful conduct, or whether services were rendered, if court determines payment "will not substantially increase the probability of layoff or termination of current employees, or of non-payment of domestic support obligations." Recent cases interpreting this section have found additional requirements leading to denial of priority status. *In re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008) (employees must actually be employed after the bankruptcy filing to be eligible for administrative priority), *aff'd*, 403 B.R. 659 (D. Ariz. 2009); *In re Powermate Holding Corp.*, 394 B.R. 765 (Bankr. D. Del. 2008) (employees terminated on morning prior to bankruptcy filing not entitled to administrative expense status);*see also In re Beverage Enter., Inc.*, 225 B.R. 111, 113-17 (Bankr. E.D. Pa. 1998); *In re Hanlin Group, Inc.*, 176 B.R. 329, 332-35 (Bankr. D.N.J. 1995); *In re Riker Indus., Inc.*, 151 B.R. 823, 825-27 (Bankr. N.D. Ohio 1993); *In re Cargo, Inc.*,138 B.R. 923, 925-28 (Bankr. N.D. Iowa 1992).

E. **Employee Claims and a Sale of Assets**. Can a buyer's retention of employees/ assumption of a CBA be considered in bids? *See In re After Six, Inc.*, 154 B.R. 876 (Bankr. E.D. Pa. 1993). Where one potential purchaser's hiring and assumption of employee and retiree obligations will reduce or eliminate major claims against the debtor, *e.g.*, severance, vacation, insurance, those savings should be considered in evaluating the value of alternative bids.

III. RETENTION AND SEVERANCE PROGRAMS

A. The court in *US Airways II* noted that "Key Employee Retention Plans" have "something of a shady reputation."[1] In the *Delphi Corporation* bankruptcy, the court significantly reduced a cash emergence grant for management proposed as part of the company's reorganization plan.[2]

1. Congress attempted to limit executive payments through enactment of Section 503(c). Section 503(c)(1) limits retention payments unless necessary because the individual in question has a job offer elsewhere, his services are essential, and the payment meets certain limitations on amount; Section 503(c)(2) limits severance payments to insiders, unless part of a generally applicable program and within certain limitations on amount; Section 503(c)(3) limits other payments outside of ordinary course of business where "not justified by the fact and circumstances of the case." US Trustees and unions are often the sole parties opposing such programs, and the amendment has been somewhat ineffectual.

2. Programs are now characterized as "incentive" programs or non-compete agreements that avoid the strictures of Section 503(c). *See, e.g., In re Global Home Products, LLC,* 369 B.R. 778, 787 (Bankr. D. Del. 2007);[3] *see also In re Dana Corp.*, 351 B.R. 96 (Bankr. S.D.N.Y. 2006, ("*Dana I*"); *In re Dana Corp.*, 358 B.R. 567 (Bankr. S.D.N.Y. 2006) ("*Dana II*"). Among the issues raised in union objections: the proper level of court scrutiny; executives often formulate and/or approve such programs and/or exercise influence over both the consultants and the boards of directors, *see* Lucian Arye Bebchuk, *et al.*, *Managerial Power and Rent Extraction in The Design of Executive Compensation* (Nat'l Bureau of Econ. Research, Working Paper No. 9068, 2002); the absence of any required

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[1] The Court commented:

> All too often they have been used to lavishly reward—at the expense of the creditor body—the very executives whose bad decisions or lack of foresight were responsible for the debtor's financial plight. But even where external circumstances rather than the executives are to blame, there is something inherently unseemly in the effort to insulate the executives from the financial risks all other stakeholders face in the bankruptcy process.

In re US Airways, Inc., 329 B.R. 793, 797 (Bankr. E.D. Va. 2005).

[2] Gretchen Morgenson, *Royal Pay at Delphi, Reined in by a Judge*, N.Y. Times, Jan. 27, 2008.

[3] This was presaged by a leading practitioner's candid admissions that "[w]e no longer call them KERPS because we want to do everything possible not to have to fit them into the new evidentiary requirements," and "[a]ny form of compensation is a retention plan, I don't care how you define it." *Top Chapter 11 Attorneys Plot Ways for Executives to Reap Fat Bonuses,* Daily Bankruptcy Rev., June 12, 2006 at 1, 5.

executive accomplishment in order to gain an award; the absence of relation of awards to creditor recoveries; the timing of programs; sacrifices by bargaining unit employees and the impact on morale of other employees.

B. The adoption of such a program may be relevant in a Section 1113/1114 litigation, particularly on fair and equitable treatment. 11 U.S.C. § 1113(b)(1)(A); *cf. In re Jefley, Inc.*, 219 B.R. 88, 93-94 (Bankr. E.D. Pa. 1998).

IV. CURRENT LEGAL ISSUES UNDER SECTION 1113

A. How Relevant is the Union Counterproposal?

1. In a *Delta/Comair* case the court opines that only the debtor proposal is relevant to the "necessary" analysis:

> the focus in a Section 1113 motion is on the *debtor's* Section 1113 proposal, not the union's counterproposal. Although the negotiating conduct of the union may have some relevance under certain of the statutory tests, Section 1113 does not require or indeed authorize the court to compare and contrast the debtor's and the union's proposals and decide the motion on the basis of the court's view as to which proposal is most appropriate, or equitable, or reasonable. The statute must be applied as it is written, and it is the debtor's proposal which must meet the statutory criteria. If it does, the motion must be granted regardless of the union's proposal.

In re Delta Airlines, *Inc.*, 359 B.R. 468, 476 (Bankr. S.D.N.Y. 2006).

2. By contrast, in analyzing the necessary, balance of equities, and good cause requirements, the Second Circuit in *Royal Composing Room* emphasized that the "balance of the equities nearly always will tip in favor of the party that seeks to reach a compromise," and if "the union seeks to negotiate compromises that meet its needs while preserving the debtor's required savings, it would be unlikely that its rejection of the proposal could be found to be lacking good cause." *In re Royal Composing Room*, *Inc*., 848 F.2d 345, 349 (2d Cir. 1988).

B. How Negotiable or Non-Negotiable Must an Initial Debtor Proposal Be?

1. The *Delta* court held that Delta subsidiary Comair's nonnegotiable demand for $8.9 million in annual concessions from flight attendants demonstrated bad faith. The demand was based on: (a) a business model, and (b) agreements with other unions requiring certain levels of concessions from all unions. The court emphasized that pursuant to

Section 1113 a debtor's initial proposals should be negotiable, and found support in Second Circuit decisions concluding that "necessary" was not the equivalent of "bare minimum" because, *inter alia*, a debtor was required to negotiate in good faith after making an initial proposal:

> This [*Carey Transportation*] analysis clearly suggests that implicit if not explicit in the mandate in subsection (b)(2) to "confer in good faith," or to "negotiate in good faith over the proposed modifications" as the Second Circuit put it, is the willingness to moderate the debtor's initial proposal referred to in subsection (b)(1)(A) and to reach a compromise.

In re Delta Air Lines, 342 B.R. 685, 695 (Bankr. S.D.N.Y. 2006). While conceding that "there may be circumstances where some aspect of the debtor's Section 1113 proposal must indeed be non-negotiable if reorganization is to be possible," such a non-negotiable demand must, at minimum, be "central to the negotiations" and make a "material impact." *Id.* at 695-97. Comair later reduced its proposed cut to $7.9 million, and the Court granted a renewed motion to reject. *In re Delta Air Lines*, 351 B.R. 67 (Bankr. S.D.N.Y. 2006).

2. The *Mesaba* court held that Mesaba met Section 1113's necessary and good faith bargaining standards notwithstanding not moving at all from its initial proposals for a cut of labor costs of 19.4%, a 6 year duration, and a "structure that did not envision reversal or amelioration of the cuts for any change in the Debtor's circumstances during the six years." *In re Mesaba Aviation, Inc*., 341 B.R. 693, 726-27, 742-43 (Bankr. D. Minn.), *aff'd in part, rev'd in part, Ass'n of Flight Attendants-CWA v. Mesaba Aviation, Inc*., 350 B.R. 435 (D. Minn. 2006). The court noted that if Mesaba had

> started off at some polar position in its proposal, completely beyond the bounds of a reasonable and temperate resolution, it would have been far, far more vulnerable to an accusation of bad faith gamesmanship *in the context*, under § 1113(b)(2). Under bankruptcy law, there was neither the time nor the warrant to go through an extended exercise of posturing, blustering, grinding, and incremental falling back-whatever expectations of that the unions may have brought into the process, couched by the dynamics under mainstream labor law.

Id. at 727 (emphasis in original). On appeal the district court reversed, in part because of the failure to consider snap-backs. *Mesaba,* 350 B.R. at 458-59. The ultimate CBA differed from the stated "necessary" requirements. Notwithstanding the court's

ruling that savings of 19.4% and 6 year contracts were "necessary" for the debtor's survival, the negotiated agreement with each union provided for savings estimated at less than 16% and were for four-year terms — and creditors received a 100% payment on their claims under the confirmed plan of reorganization.

C. **What is the Relationship Between a CBA and a Sale of Assets?**

1. The Third Circuit has emphasized that in the context of a sale of assets, a debtor and/or a buyer cannot "misuse the Code in an effort to avoid the collective bargaining process that Congress deemed essential to the balance between labor and reorganizing debtors that it struck in section 1113"; thus a debtor that "binds itself contractually to obtain a change in the legal relations created by a CBA as a condition precedent to closing a sale of substantially all of the debtor's assets" is pursuing an "attempt to effect an alteration of the CBA" that implicates the requirements of Section 1113. *Am. Flint Glass Workers Union v. Anchor Resolution Corp.*, 197 F.3d 76, 81-82 (3d Cir. 1999); s*ee also In re Allegheny Health Educ. & Research Found.,* 383 F.3d 169 (3d Cir. 2004) (applying *Anchor Resolution* to a sale of assets with partial assumption of CBA;) *In re Stein Henry Co.*, No. 91-15491S, 1992 WL 122902 (Bankr. E.D. Pa. June 1, 1992) (pursuant to Section 1113, plan of reorganization must provide for compliance with contractual successorship provision).

2. The existence of a successorship clause does not in and of itself establish a basis for Section 1113 relief where potential purchasers are willing to negotiate with a union. *In re Bruno's Supermarkets, LLC*, No. 09-00634-BGC-1, 2009 WL 1148369 (Bankr. N.D. Ala. Apr. 27, 2009) (union did not reject debtor proposal to eliminate successorship clause "without good cause" where potential purchasers were willing to negotiate with union in an attempt to reach new consensual collective bargaining agreement).

3. In a case involving lifetime employment guarantees under a CBA, the Second Circuit held that Section 1113 can be employed where a purchaser demands CBA modifications before it will purchase and continue operations, affirming a district court decision emphasizing that the procedural and substantive protections should apply in such circumstances. *In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 87 (2d Cir. 1992), *aff'g*,149 B.R. 334, 338 (S.D.N.Y. 1992).

D. **How Does an 1113/1114 Settlement Relate to Creditor Claim Recoveries?** Section 1114 envisions claims for lost future benefits or other benefits not paid as a result of Section 1114 relief. 11 U.S.C. § 1114(i). One court held that settlements of Section 1114 motions may properly provide retirees with cash, unsecured claims, and a minimum guaranteed recovery, without improperly discriminating or establishing *sub rosa* plans. *In re Tower Auto., Inc.*, 342 B.R. 158 (Bankr. S.D.N.Y. 2006), *aff'd*, 241 F.R.D. 162 (S.D.N.Y. 2006).

E. **Is there a Right to Strike upon Rejection?**

1. **Prior law.** Until the *Northwest* litigation courts consistently held that rejection of a CBA resulted in a union having the right to strike, without reference to the labor statute involved. *See, e.g., Briggs Transp. Co. v. Int'l Bhd. of Teamsters*, 739 F.2d 341 (8th Cir. 1984); *Truck Drivers Local Union No. 807 v. Bohack Corp*., 541 F.2d 312, 318 (2d Cir. 1976).

2. ***Northwest* Litigation.** In a case involving parties governed by Railway Labor Act, 45 U.S.C. §§ 151 *et seq*., which governs railroads and airlines, the Second Circuit affirmed the grant of an injunction against a threatened strike following implementation of a Section 1113 rejection order. *In re Nw. Airlines Corp.*, 483 F.3d 160 (2d Cir. 2007)**;** *see* Richard M. Seltzer & Thomas N. Ciantra, *The Return of Government by Injunction in Airline Bankruptcies*, 15 Am. Bankr. Inst. L. Rev. 499 (Winter 2007, Volume 2). The decision also has relevance to the question of rejection damages and is further discussed *infra.*

3. **Impact on NLRA Unions.** The *Northwest* Court noted that because the obligation not to strike under the National Labor Relations Act ("NLRA"), 29 U.S.C. §§ 141 *et seq*., is contractual, rather than statutory, when a contract governed by the NLRA is abrogated a union is relieved of its contractual obligation not to strike. *Northwest,* 483 F.3d at 173.

F. **Is there a Right to Damages Following Rejection?**

1. **Damages.** Many cases decided prior to and after the enactment of Section 1113 concluded that a union was entitled to damages for rejection of a CBA, and until recently most cases decided thereafter assumed the same result. *See, e.g.*, *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531 (1984); *Truck Drivers Local 807 v. Carey Transp. Inc.,* 816 F.2d 82, 93 (2d Cir. 1987); *In re Moline Corp.*, 144 B.R. 75, 78-79 (Bankr. N.D. Ill. 1992); *In re Tex. Sheet Metals, Inc*., 90 B.R. 260, 272-73 (Bankr. S.D. Tex. 1988).

2. One court compared the language of Sections 365 and 1113 and held that rejection damages are not available under Section 1113. *In re Blue Diamond Coal Co*., 147 B.R. 720, 727-28 (Bankr. E.D. Tenn. 1992), *aff'd*, 160 B.R. 574, 576-77 (E.D. Tenn. 1993); *compare United Food & Commercial Workers Union v. Almac's Inc.*, 90 F.3d 1, 5 n.4 (1st Cir. 1996) (noting that "[b]ecause the relevant language of section 365(g) has not changed since *Bildisco*, collective bargaining agreements would appear still to be subject to the section's general provisions").

3. In *Northwest* the Second Circuit concluded that Northwest's rejection "abrogated (without breaching)" the CBA which "thereafter ceased to exist." With respect to its conclusion that contract rejection under Section 1113 abrogates a CBA and leaves the parties as if no CBA had existed, the

Court attempted to distinguish contract rejection under Section 365 which, as the Court noted, constitutes a breach. *Northwest*, 483 F.3d at 168-75. This portion of the decision was: (1) inconsistent with *Carey*, which instructed lower courts to consider the effect of a damage claim for *breach* of contract triggered by rejection of a CBA (as well as a possible strike) in determining a Section 1113 motion, (2) every prior Second Circuit 1113 decision, none of which held that a rejected CBA is "abrogated" rather than rejected, (3) the statutory language of section 1113- and indeed title — which refers to rejection, (4) the governing requirements of 11 U.S.C. § 365(g), which states that the rejection of any executory contract constitutes a breach, not an abrogation, (5) settled law in every circuit that the rejection of any executory contract constitutes a breach, and (6) longstanding case law and statutory provisions that the rejection of an executory contract constitutes a breach. *See generally* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding 'Rejection'*, 59 U. Colo. L. Rev. 845 (1988).

4. Without referencing any statutory language or history, the majority held that rejection under Section 1113 "is an exception to this general principle" because a damages claim would be inconsistent with Section 1113. *Northwest*, 483 F.3d at 170 n.3. Shortly after the decision the bankruptcy court in the same case holds that under the Second Circuit's reasoning the union was not entitle to rejection damages. *In re Northwest Airlines Corp.*, 366 B.R. 270 (Bankr. S.D.N.Y. 2007).

G. **What is the meaning of rejection?**

1. Which proposal may be implemented?

(a) Last proposal before commencement of hearing. *Teamsters Airline Div. v. Frontier Airlines, Inc.*, No. 09 Civ. 343, 2009 WL 2168851, at *8-9 (S.D.N.Y. 2009) (District court holds that language in (i) Section 1113(b)(1) requiring the debtor to make its proposal for necessary CBA modifications "[s]ubsequent to filing a petition and prior to filing an application seeking rejection," (ii) Section 1113(c) providing that "[t]he 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) ..." and (iii) Section 1113(b)(2) referring to good faith negotiations "ending on the date of the hearing," mandate conclusion that the debtor "must make an initial, compliant proposal after the Chapter 11 petition has been filed and before it moves to reject," and that endpoint for negotiations and proposals that are subject of court's analysis is the start of the Section 1113 hearing).

(b) Last proposal before end of hearing.

(c) Last proposal prior to post-hearing cut-off.

(d) A tentative agreement reached during or after close of hearing (which subsequently fails a ratification vote). *In re Northwest Airlines, Corp.*, 346 B.R. 307, 331-32 (Bankr. S.D.N.Y. 2006).

See, generally In re Maxwell Newspapers, Inc., 981 F.2d at 91-92 (court conditions rejection on debtor maintaining offers made and confirmed at appellate oral argument); *In re Mile Hi Metal Sys., Inc.,* 899 F.2d 887, 893 (10th Cir. 1990) ("It is clear from section 1113, however, that the proposal which the bankruptcy court is to evaluate must be made 'prior to' the hearing."); *Carey Transp.,* 816 F.2d at 86, 92 (court reviews union proposal made after third day of hearing); *In re Royal Composing Room*, *Inc.*, 848 F.2d at 350 (court reviews union proposal made at time of final pretrial conference); *id.* at 358 (Feinberg, C.J. dissenting) (parties assume, and dissenting judge "tentatively" inclined to agree, that proper proposal to evaluate is one made prior to filing motion, as opposed to bankruptcy court's conclusion it could consider proposals made up to start of hearing); *Northwest*, 346 B.R. at 331-32 (("The rejected proposal is the key proposal for purposes of § 1113, and this is the proposal that presumably should be put in effect if the union has rejected it without good cause…. It was also agreed by all parties during the long course of negotiation and litigation that if progress were made in the negotiations, it could not be undone — *i.e.*, that if one issue were resolved, negotiations could not be reopened on that issue without good reason.").