

Collective Bargaining Agreements and the Bankruptcy Code: Are Damage Claims for Rejection of Collective Bargaining Agreements Available Under Section 1113?

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The authors explain that, based on recent decisions, no damage claim arises from court-approved rejection of a collective bargaining agreement pursuant to Section 1113.

Collective bargaining agreements play a critical role in the operation of many American companies. By establishing the terms of employment for unionized employees, collective bargaining agreements provide predictable labor costs over the term of the applicable agreement. Unfortunately, many companies have collective bargaining agreements in place that lock in above-market wages and benefits. These agreements have hampered the competitiveness of such companies and in some cases, contributed to their financial distress. Section 1113 of the Bankruptcy Code was enacted to address the treatment of collective bargaining agreements when a company in such dis-

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truss declares bankruptcy. Specifically, Section 1113 provides a heightened standard for allowing the rejection of collective bargaining agreements by the debtor-company. Under that statute, a bankruptcy court can approve the rejection of a collective bargaining agreement only if the company can prove that such rejection is necessary for reorganization.

Until recently, the question that has largely been left unanswered is whether such rejection of a collective bargaining agreement by a company in bankruptcy will result in a claim for damages caused to the union employees, as was the case prior to the promulgation of Section 1113. Several courts have suggested that a rejection damage claim must arise. Previously, the only court to address this issue directly, the Bankruptcy Court for the Middle District of Tennessee in the *Blue Diamond* case, held that no such damage claim would arise from court-approved rejection of a collective bargaining agreement under Section 1113.

More recently and conclusively, the Second Circuit Court of Appeals and the Bankruptcy Court for the Southern District of New York have commented and decided, respectively, on this issue in the Northwest Airlines bankruptcy case. Together, the decisions in the Northwest Airlines case make clear that no breach occurs and therefore, no damage claim arises, from court-approved rejection of a collective bargaining agreement pursuant to Section 1113. The impact of these decisions on unions and the future of unionized labor likely will be considerable.

OVERVIEW OF SECTION 1113

Section 1113(c) of the Bankruptcy Code establishes procedures a debtor must comply with in order to reject a collective bargaining agreement or “CBA.”¹ Courts have articulated nine factors, extrapolated from the requirements of Section 1113(c), which must be met to effectuate a Section 1113 rejection.² The nine requirements for court approval of the rejection of CBAs traditionally used by bankruptcy courts are:

- the debtor must have made a proposal to the union;
- the proposal must be based on the most complete and reliable information available at the time of the proposal;
- the modification must be necessary to permit reorganization;
- the modification must provide that all affected parties are treated fairly and equitably;
- the debtor must provide the union with such relevant information as is necessary to evaluate the proposal;
- the debtor must have met with the collective bargaining representative at reasonable times subsequent to making the proposal;
- the debtor must have negotiated with the union in good faith concerning the proposal;
- the union must have refused to accept the proposal without good cause; and
- the balance of the equities must clearly favor rejection of the agreement.³

Essentially, a bankruptcy court, in its discretion, will approve the rejection of a CBA upon a finding that the debtor's proposed modifications of the CBA are "necessary"⁴ to the reorganization of the debtor, the union refused to accept the modifications without good cause and the balance of the equities clearly favors rejection.

THE EFFECT OF COURT-APPROVED REJECTION OF CBAs UNDER SECTION 1113

While Section 1113(a) provides that a debtor "may assume or reject a collective bargaining agreement only in accordance with the provisions of this section," courts have struggled with the application of Section 1113(a) when addressing issues not explicitly referred to in the language of Section 1113. For instance, while Section 1113(a) contem-

plates assumption of collective bargaining agreements, it does not provide whether the union may assert a cure claim as a result of the assumption similar to the claims asserted when other types of contracts are assumed.⁵ Section 1113 also does not address the priority which would be afforded to employees in the event an employer unilaterally rejects a collective bargaining agreement — that is, a rejection without prior court approval.⁶

Similarly, despite the fact that Section 1113 imposes clear substantive and procedural requirements that a debtor must satisfy in order to reject a prepetition CBA, Section 1113 is silent as to whether a claim for damages arises from a court approved rejection of a CBA. As discussed below, prior to the decision in the Northwest Airlines case, courts faced with this issue have been guided by different factors such as the legislative history or the explicit language of the statute in rendering their decisions. This occasionally led to inconsistent interpretations of Section 1113 and the right to assert a claim after CBA rejection.

Decisions Disallowing Damage Claims Arising from Court-Approved Rejection of CBAs

Statutory Construction Argument

Courts that have held that no claim for damages arises from rejection of a CBA under Section 1113 generally support this conclusion through statutory construction of the statute.⁷ Before the enactment of Bankruptcy Code Section 1113, CBAs were considered executory contracts which could be assumed or rejected within the framework of Section 365 of the Bankruptcy Code.⁸ Pursuant to Section 365, once an executory contract is rejected, it is treated as having been breached as of the date immediately preceding the filing of the debtor's bankruptcy petition.⁹ In turn, Section 502(g) provides the entity injured by the rejection of an executory contract, either pursuant to Section 365 or a plan of reorganization, with the right to assert a prepetition claim for any resulting damages from the breach.¹⁰

Section 502(g) serves as a necessary statutory connection between the rejection of contracts under Section 365 and the allowance of claims

under Section 502. Section 502 of the Bankruptcy Code governs the allowance of claims in bankruptcy cases and it provides that a claim is allowed only to the extent that it can be determined as of the debtor's petition date, unless the claim falls into one of the named exceptions in Section 502(b).¹¹ Each of the exceptions listed in Section 502(b) provides that certain postpetition claims will be treated as if such claims had arisen before the date of the filing of the petition, thereby enabling these claims to qualify for allowance under Section 502(b).¹² If a postpetition claim does not fall within one of exceptions to the allowance rules of Section 502(b), such claim that otherwise arises after commencement of the debtor's case could not have been determined as of the petition date and therefore, cannot be allowed.

Among these exceptions is Section 502(g)(1), which provides that a claim arising from the rejection of an executory contract under Section 365, shall be allowed or disallowed the same as if such claim had arisen before the date of the filing of the petition. Thus, Section 502(g) enables a claim arising from rejection of an executory contract to be determined and allowed as a prepetition claim.

As noted previously, Section 1113 was promulgated in 1984 to provide a special standard for the rejection of CBAs.¹³ However, Section 1113 fails to establish the statutory connection between CBA rejection under Section 1113 and allowance of damage claims from such rejection. Section 1113(a) expressly states that a debtor-in-possession or trustee "may assume or reject a collective bargaining agreement *only* in accordance with the provisions of [Section 1113]" (emphasis added).¹⁴ As a result, some have argued that Section 1113 completely removes CBAs from the framework for contract rejection contained in Section 365.¹⁵ Unlike Section 365, however, Section 1113 does not provide that rejection of a CBA constitutes breach of the CBA as of the petition date. Also, Section 502 does not provide that claims arising from rejection of a CBA pursuant to Section 1113 shall be determined as if such claims had arisen before the petition date. Thus, from a strict statutory construction perspective, the Bankruptcy Code does not appear to provide or recognize a remedy for breach of contract or the damages resulting from the rejection of a CBA under Section 1113.¹⁶

The bankruptcy court in *In re Blue Diamond Coal Company* (“*Blue Diamond*”), 147 B.R. 720, 732 (Bankr. E.D. Tenn. 1992), based its decision on this statutory construction when it held that no damage claim arises from court-approved rejection of CBAs under Section 1113. The *Blue Diamond* court also concluded that an entity injured by the rejection of a collective bargaining agreement under Section 1113 is not entitled to file a proof of claim.¹⁷ Pursuant to Section 501 of the Bankruptcy Code, only a creditor or any indenture trustee may file a proof of claim in a bankruptcy case.¹⁸ The term “creditor” is defined in Section 101(10) of the Bankruptcy Code to include either “an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor” or “an entity that has a claim against the estate of a kind specified in Section 348(d), 502(f), 502(g), 502(h) or 502(j).”¹⁹

The court in *Blue Diamond* reasoned that an entity alleging a damage claim for rejection of a collective bargaining agreement under Section 1113 neither had a claim against the debtor as of the petition date nor a claim falling into one of specified exceptions in Section 101(10). Accordingly, such an entity is not a “creditor” and cannot file a proof of claim for the rejection damage claim under Section 501.²⁰ Without the statutory ability to file a proof of claim, an entity seeking rejection damages cannot have such a claim allowed.²¹

Legislative History Argument

Disallowing a CBA rejection damage claim also is supported by the legislative history of Section 1113. Congress enacted Section 1113 in response to the Supreme Court’s decision in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L. Ed. 2d. 482 (1984). In *Bildisco*, the Supreme Court affirmed the position of several circuit courts that because of the special nature of CBAs, a somewhat stricter standard should govern the decision of the bankruptcy court to allow rejection of a CBA.²² The *Bildisco* Court specified that this standard should be higher than the traditional business judgment test used for contract rejection pursuant to Section 365, but it should not be as stringent as the “necessary to avoid liquidation” test that had been proposed by some lower courts.²³ Accordingly, the Supreme Court held that a

bankruptcy court should permit rejection of a CBA under Section 365 “if the debtor can show that the collective-bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejection the labor contract.”²⁴ Additionally, the Supreme Court in *Bildisco* held that a Chapter 11 debtor could unilaterally reject a CBA prior to the bankruptcy court’s approval of formal rejection without violating the National Labor Relations Act (the “NLRA”).²⁵ This second holding produced serious concern, particularly among labor unions.²⁶

In reaction to the *Bildisco* decision and specifically to provide protection for the interests of union employees, Congress decided to amend the Bankruptcy Code to make the standard for allowing rejection of a CBA more strenuous and to forbid debtors from unilaterally terminating or altering any provisions of a collective bargaining agreement prior to compliance with this new standard.²⁷ Within one month of the Supreme Court’s decision in *Bildisco*, the United States House of Representatives passed H.R. 5174 to address rejection of collective bargaining agreements.²⁸ This proposal would have created a separate section for the rejection of collective bargaining agreements and amended Section 365 to read:

Except as provided in sections 765, 766 and 1113 of this title and in subsections (b), (c) and (d) of this section, the trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.²⁹

Additionally, H.R. 5174 would have amended Section 503(b)(1)(A) of the Bankruptcy Code to provide that the actual, necessary costs and expenses of preserving the estate shall be allowed including “wages, salaries or commissions for services rendered after the commencement of the case, except that such wages or salaries covered by a collective bargaining agreement to which Section 1113 of this title applies shall only be measured at the rate prescribed for such services in such agreement.”³⁰

The proposed cross-references in Sections 365 and 503 to the newly-proposed Section 1113 may have supported the argument that

those provisions were to continue to apply to CBAs to the extent that they were not inconsistent with the provisions of Section 1113. But, neither of these references were included in the final bill that was enacted by Congress in 1984.³¹

Additionally, before H.R. 5174 was taken up for consideration by the Senate, the National Bankruptcy Conference (the “NBC”) sent a draft bill and a letter explaining the bill to Senator Strom Thurmond of South Carolina.³² The NBC draft bill addressed rejection of collective bargaining agreements as an amendment to Section 365, rather than as a separate provision of the Bankruptcy Code. In the letter to Senator Thurmond, which eventually was reprinted into the Congressional Record for purposes of discussion, the NBC suggested the following:

The Committee Report or floor statement accompanying the amendment should mention that the omission of any contrary provision in the amendment means that section 365(g) applies if the court approves rejection. Therefore, if the contract has not been assumed under section 365 or under a plan confirmed in a chapter 9, 11 or 13 case, rejection of the contract constitutes a breach of such contract immediately before the filing date and thus, damages arising by reason of such rejection are prepetition claims.³³

On March 21, 1984, Senator Thurmond went on to propose an amendment that adopted the form of the NBC draft bill. However, not only did the United States Senate fail to mention the continued application of Section 365(g) in either the Committee Report or the floor statements, but the final enacted bill did not address the rejection of collective bargaining agreements in Bankruptcy Code Section 365 at all. This instead was accomplished in a wholly separate, new provision of the Bankruptcy Code: Section 1113.³⁴

In light of H.R. 5174, the published letter written by the NBC and the lobbying efforts of organized labor, Congress likely was aware of the issues surrounding the effect of court-approved rejection of collective bargaining agreements and the need for explicit references to Section 365 in order to provide for a damage claim. The legislative history sup-

ports the conclusion that Congress intentionally refrained from providing a damage claim for the court-approved rejection of collective bargaining agreements and instead, intended CBA rejection to be governed exclusively by Section 1113.³⁵

With these arguments in mind, the bankruptcy court in *Blue Diamond* stated that “[g]iven the barriers to rejection included in § 1113, it is arguable that Congress intended that no claim for damages for rejection of a collective bargaining agreement would be allowed.”³⁶ Indeed, if a court were to permit the rejection of a CBA under the stringent standards of Section 1113, it would seem antithetical to then allow a damage claim that essentially would undermine the effect of court-approved rejection under Section 1113, and perhaps assure the failure of a debtor’s reorganization as an ongoing enterprise.³⁷

Decisions Implicitly Recognizing Damage Claims Arising From Court-Approved Rejection of CBAs

Most cases that can be cited as support for the allowance of damage claims arising from court-approved rejection of CBAs pursuant to Section 1113 have addressed the rejection damages issue only indirectly, as part of their analysis of the balance-of-the-equities test mandated under Section 1113.³⁸ As discussed, pursuant to Section 1113, a bankruptcy court will approve the rejection of a CBA upon a finding that: (i) the debtor’s proposed modifications of the CBA are “necessary” to permit the reorganization of the debtor; (ii) the union refused to accept the modifications without good cause; and (iii) the balance of the equities clearly favors rejection.³⁹ The latter requirement can trace its roots to a similar balance-of-the-equities test adopted by the Court of Appeals for the Second Circuit in *Shopmen’s Local Union No. 455 v. Kevin Steel Products, Inc.*, 519 F.2d 698, 707 (2d Cir. 1975). In that case, the Second Circuit held that a bankruptcy court should approve a rejection of a CBA “only after thorough scrutiny, and a careful balancing of the equities on both sides.”⁴⁰

Among the first courts to elaborate on the factors to be considered in the balance-of-equities test was the Court of Appeals for the Eleventh Circuit in a pre-Section 1113 decision, *In re Brada Miller Freight*

*System, Inc.*⁴¹ The court in *Brada Miller* held that a number of factors can be properly considered when addressing a motion to reject a CBA, including:

- the possibility of liquidation, both with and without the rejection, and the
- impact of liquidation on each of the parties involved,
- *the potential claims that will result from the rejection of the CBA, both in terms of the adequacy of relief for the employees and other claimants, and the impact of these claims on the debtor,*
- the cost-spreading abilities of the parties; and
- the good (or bad) faith of the unions and the debtor in seeking to resolve their mutual dilemma (emphasis added).⁴²

What is noteworthy about the *Brada Miller* decision is that it implicitly recognized the employees' rights to damage claims for rejection of a CBA. Of course, most decisions rendered before the enactment of Section 1113 came to the same conclusion as a result of applying Bankruptcy Code Section 365's contract rejection scheme to CBAs. Many courts, including the Supreme Court in *Bildisco*, subsequently considered potential rejection damage claims as a factor in the balance-of-the-equities test as a result of its inclusion in *Brada Miller*. Accordingly, there are several post-Section 1113 cases that can be viewed as implicitly recognizing the allowance of damage claims for the rejection of CBAs pursuant to Section 1113 simply because these courts recite and apply this list of factors, including "the possibility and likely effect of any employee claims for breach of contract if rejection is approved," when analyzing Section 1113.⁴³

Decisions Explicitly Recognizing Damage Claims Arising From Breaches of CBAs

Several courts have allowed damage claims arising from breaches of CBAs, and such decisions potentially could be cited in support of allow-

ing damage claims for court-approved rejection as well.⁴⁴ These cases typically involve a debtor that has not moved to reject the CBA pursuant to Section 1113, but rather breached its obligations under the CBA. In these cases, the courts allow the recovery of damages from the “rejection” through application of Bankruptcy Code Section 365, however these courts tend to disagree as to the priority accorded to such claims.⁴⁵ Most importantly, these courts generally conclude that Section 1113 was not intended to remove CBAs entirely from the purview of Section 365.⁴⁶ These courts instead conclude that Section 365 continues to apply to CBAs to the extent that such application would not be inconsistent with Section 1113.⁴⁷ Therefore, an expansive reading of these cases can lead to the conclusion that despite the enactment of Section 1113, the effect of court-approved rejection of CBAs is governed by Section 365, which allows damage claims arising from the rejection of executory contracts.

For example, in *In re Moline Corp.*, the Bankruptcy Court for the Northern District of Illinois noted that in light of the absence of any provision in Section 1113 governing the effect of rejection, Section 365 should “fill in the gap.”⁴⁸ The court stated that any failure on the part of Congress to include a provision similar to Section 365(g) in Section 1113, is simply a “legislative gaffe,” such that Congress forgot to make conforming amendments to Section 365 when it enacted Section 1113.⁴⁹

However, the bankruptcy court in *Blue Diamond* countered this argument by saying: “Regardless of the speculation on Congress’ intention for omitting a provision governing the effect of rejection of a collective bargaining agreement under § 1113, this court cannot ignore the plain language of the Bankruptcy Code.”⁵⁰ The court in *Blue Diamond* quoted the Supreme Court in *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991), as stating that “[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning.”⁵¹ The court in *Blue Diamond* thus refused to “read something into a statutory scheme that Congress may or may not have mistakenly left out,” because it “would be tantamount to rewriting the provisions of the Bankruptcy Code, a

task properly left to Congress.”⁵²

Even if Congress’ failure to include a specific provision addressing the effect of CBA rejection under Section 1113 (similar to § 365(g)) was just a mistake, it is important to note that Congress repeatedly has refrained from correcting the error in any of the subsequent amendments to the Bankruptcy Code. Since *Moline* was decided, Congress has made numerous amendments to the Bankruptcy Code, including major amendments in 1994 and 2005. In each instance, Congress took no action to amend either Sections 1113 or 502 in order to provide explicitly for a claim for damages resulting from the rejection of a CBA pursuant to Section 1113.

Moreover, subsequent to the enactment of Section 1113, Congress has acknowledged the allowance of claims arising under similar statutes. Section 1114 of the Bankruptcy Code, enacted in 1988, provides procedures and standards for modifying the payment of retiree benefits in a Chapter 11 case.⁵³ Section 1114(i) states that no benefits paid between the filing of a bankruptcy petition and the approval of a plan “shall be deducted or offset from the amounts allowed as claims for any benefits which remain unpaid...whether such claims for unpaid benefits are based upon or arise from a right to future unpaid benefits or from any benefits not paid as a result of modifications allowed pursuant to this section.”⁵⁴ Also, Section 1114(j) provides that “[n]o claim for retiree benefits shall be limited by section 502(b)(7) of this title.”⁵⁵ Implicit in these sections is the assumption that retirees whose benefits have been modified or rejected will have allowed damage claims against the debtor.

Similarly, Section 502(g) of the Bankruptcy Code was amended in 2005 to include subsection (g)(2), which provides that any claim for damages arising from the postpetition rejection, liquidation, termination or acceleration of various securities contracts pursuant to Section 562 will be treated as a prepetition claim.⁵⁶ These Bankruptcy Code provisions illustrate that Congress will take action to provide for the allowance of claims arising from specific statutes when it determines that such claims are appropriate. Congress likewise could have revised Section 1113 to come within the ambit of Section 502(g) if it had wanted to do so.⁵⁷

Recent Decisions in the Second Circuit Clarify Section 1113

Most recently, the issue of the availability of rejection damages under Section 1113 was presented to the Bankruptcy Court for the Southern District of New York in the Northwest Airlines Chapter 11 cases. There, Northwest Airlines Corporation and its affiliated debtors (collectively, “Northwest”) had conducted significant negotiations with its unionized flight attendants represented by the Association of Flight Attendants (the “AFA”) in order to achieve labor cost reductions necessary for its reorganization. After the AFA voted down several offers made by Northwest, the debtors sought court approval to reject the collective bargaining agreement between Northwest and the AFA and instead impose the terms of its last proposal. In a decision dated June 29, 2006, the bankruptcy court held that Northwest had satisfied the requirements of Section 1113, and on July 5, 2006, it granted Northwest’s motion to reject the AFA CBA.⁵⁸

One month later, the AFA filed a claim for damages arising from the rejection of the AFA CBA in the amount of approximately \$1.1 billion, which consisted of the full value of the “concessions” mandated by operation of the bankruptcy court’s order approving rejection of the AFA CBA. Northwest subsequently filed a motion with the bankruptcy court to expunge the rejection damage claim filed by the AFA.⁵⁹

After the issue had been briefed, but before the bankruptcy court could deliver its decision, the Court of Appeals for the Second Circuit spoke on the issue in a decision involving a related, but separate matter. In addition to filing a rejection damage claim in the Northwest Chapter 11 case, the AFA had threatened to strike in order to force Northwest to agree to terms and conditions that were more favorable to the flight attendants. Northwest then moved to enjoin the strike, however the bankruptcy court denied the injunction and held that the rejection of the AFA CBA freed the employees to strike under the Railway Labor Act (“RLA”).⁶⁰ On appeal, the District Court for the Southern District of New York reversed the bankruptcy court’s decision and issued a preliminary injunction precluding the AFA from engaging in any form of work stoppage.⁶¹ The AFA appealed the issuance of that injunction, and the Second Circuit affirmed the district court. The

Second Circuit held that the RLA forbids an immediate strike when a bankruptcy court approves a debtor-carrier's rejection of a collective bargaining agreement subject to the RLA, and permits the debtor to impose new terms upon the union.⁶²

In its decision discussing the intersection of the RLA and the Bankruptcy Code, the Second Circuit specifically addressed the effect of contract rejection under Section 1113. The Second Circuit held that before it could evaluate what the AFA's rights and remedies were subsequent to a court-approved rejection under Section 1113, the court had to determine the effect of such rejection.⁶³ Under Section 365, the Bankruptcy Code "treats rejection as a breach so that the non-debtor party will have a viable claim against the debtor."⁶⁴ However, as the Second Circuit stated "Northwest did not reject the CBA at issue pursuant to §365. It acted with the authority of a court order entered pursuant to §1113. Contract rejection under §1113, unlike contract rejection under §365, permits more than non-performance; it allows one party, with the court's approval, to establish new terms that were not mutually agreed upon..."⁶⁵ The court added that "Congress [in § 1113] sought to ensure that carriers would not avoid their agreements with their employees immediately upon entering bankruptcy; rather it made contract avoidance possible only after the debtor procured court permission. But under § 365, if a debtor rejects an executory contract, courts assume a breach as of "the date immediately prior to the debtor's filing for bankruptcy." Rejection under § 365 thus leads to a legal fiction at odds with the text of (and impetus behind) § 1113. Consistent with Congress's purpose, we are obligated to construe the statutory scheme to distinguish the legal consequences of rejection under § 365 — including our suggestion that employees aggrieved by the rejection may strike — from the legal consequences of rejection under § 1113."⁶⁶

Accordingly, the Second Circuit held that Northwest, acting pursuant the authority conferred to it by the bankruptcy court, abrogated, without breaching, the existing collective bargaining agreement between the AFA and Northwest, a conclusion consistent with the purpose of Section 1113.⁶⁷

In light of the Second Circuit's decision, the bankruptcy court

allowed Northwest and the AFA to refile briefs on Northwest's motion to expunge the AFA's rejection damage claim. In deciding that the AFA would not be allowed a rejection damages claim, the bankruptcy court directly cited the Second Circuit decision. The bankruptcy court held that "the majority's analysis [in the Second Circuit's decision] expressly excludes the possibility of damages for the lawful rejection of a collective bargaining agreement pursuant to §1113."⁶⁸ The bankruptcy court agreed that Section 1113 was an exception to the general principle that rejection constitutes a breach thereby giving the non-debtor party a viable claim against the debtor.⁶⁹

The decisions by the Second Circuit and the bankruptcy court in the *Northwest* case provide the most recent and explicit guidance that because court-approved rejection of a collective bargaining agreement under Section 1113 abrogates rather than breaches the existing CBA, no resulting rejection damage claim should be allowed. These decisions are consistent with the rationales promulgated by earlier courts such as *Blue Diamond* and are supported by the legislative history of Section 1113.⁷⁰ Importantly, by these decisions, the Second Circuit and the bankruptcy court in *Northwest* explicitly rejected the arguments put forth by the unions that Bankruptcy Code Section 365's contract rejection scheme should continue to apply to CBA rejection under Section 1113. With the *Northwest* decision, we now have an explicit statement by a circuit court of appeal as to exactly what rights arise from rejection under Bankruptcy Code Section 1113.

CONCLUSION

The *Northwest* decisions provide a definitive statement that no claim may arise from rejection of a CBA. However, while these decisions conclusively resolve the controversy over whether there is any right to assert a claim after CBA rejection under Section 1113, Congress nevertheless may have the last word on this subject. Recently, the House of Representatives' Subcommittee on Commercial and Administrative Law (which is part of the House Judiciary Committee) conducted a hearing on what it called "chapter 11 fairness."⁷¹ At that

hearing, members of Congress as well as union leaders decried the perceived unfairness in the Chapter 11 process with respect to organized labor interests, including the interpretation and application of Section 1113 by the bankruptcy courts.⁷²

Subsequently, a bill was introduced in the House of Representatives (H.R. 3652) that was intended to provide additional protections for employees and retirees affected by Chapter 11 cases.⁷³ Titled the “Protecting Employees and Retirees in Business Bankruptcies Act of 2007,” H.R. 3652 proposes wide-ranging changes to the Bankruptcy Code to advance the interests of labor. Among other things, H.R. 3652 would revise Bankruptcy Code Section 1113 to explicitly provide that the rejection of a CBA “constitutes a breach of such contract with the same effect as rejection of an executory contract pursuant to section 365(g).”⁷⁴

It should be noted that many of the advocates of the changes proposed in H.R. 3652 represent the same parties, such as organized labor, that originally sought the enactment of Section 1113. Disappointed with the outcome of the rejection scheme created by Bankruptcy Code Section 1113, these parties now seek to rectify what they contend was an unintended result, while also attempting to gain further explicit protections of collective bargaining agreements. It remains to be seen what the business and industry response will be to the “pro-labor” proposals contained in H.R. 3652, and how Congress will weigh these disparate interests to ensure that all parties are treated equally in the bankruptcy process. However, given the diverse and fervent views regarding the rights of labor in the Chapter 11 process, we can expect to see additional proposed revisions to Section 1113 addressing, among other things, the right to assert claims after rejection of a CBA.

NOTES

¹ 11 U.S.C. § 1113(c).

² See, e.g., *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

³ *Id.*

⁴ Courts have disagreed on the interpretation of the term “necessary” in

Section 1113. Some courts require that modifications contained in the proposal be the bare minimum to avoid liquidation, while other courts focus on the long term financial health of the debtor. Compare *Wheeling-Pittsburgh Steel, Corp., v. United Steel Workers of Am.*, 791 F.2d 1074 (3rd Cir. 1986) (holding that debtor cannot reject a collective bargaining agreement because the proposed modifications were not proven to be the minimum changes that were essential to prevent liquidation), with *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82 (2d Cir. 1987) (proposed modification need not be the absolute minimum to avoid liquidation). The more liberal standard used by the Second Circuit has been adopted by the Tenth Circuit in *Sheet Metal Workers' Int'l Assoc. v. Mile Hi Metal Sys., Inc. (In re Mile Hi Metal Sys., Inc.)*, 899 F.2d 887 (10th Cir. 1990). In this case, the court observed that the majority of cases decided since *Wheeling-Pittsburgh* have declined to adopt that court's stricter approach to determining what is "necessary."

⁵ See, e.g., *Adventure Resources, Inc. v. Holland*, 137 F.3d 786, 798-99 (4th Cir. 1998); *In re Typocraft Co.*, 229 B.R. 685, 687-89 (Bankr. E.D. Mich. 1999).

⁶ See, e.g., *Adventure Resources*, 137 F.3d at 796-97 (4th Cir. 1998); *Teamsters Industrial Security Fund v. World Sales, Inc.*, 183 B.R. 872, 878 (9th Cir. BAP 1995); *In re Moline Corp.*, 144 B.R. 75, 77-79 (Bankr. N.D. Ill. 1992); *Shipwrights, Joiners and Caulkers Local 2071 of the United Brotherhood of Carpenters, AFL-CIO v. Uniflite, Inc. (In re Murray Industries, Inc.)*, 110 B.R. 585, 587-88 (Bankr. M.D. Fla. 1990); *In re St. Louis Globe-Democrat, Inc.*, 86 B.R. 606, 610 (Bankr. E.D. Mo. 1988).

⁷ See *In re Blue Diamond Coal Company (Blue Diamond)*, 147 B.R. 720, 732 (Bankr. E.D. Tenn. 1992), *aff'd*, *Southern Labor Union v. Blue Diamond Coal Co.*, 160 B.R. 574, 576-77 (E.D. Tenn. 1993); *In re Armstrong Store Fixtures Corp.*, 139 B.R. 347, 349-50 (Bankr. W.D. Penn. 1992).

⁸ See, e.g., *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L. Ed. 2d 482 (1984) (affirming that CBAs are executory contracts subject to Bankruptcy Code Section 365).

⁹ 11 U.S.C. § 365(g).

¹⁰ 11 U.S.C. § 502(g).

¹¹ 11 U.S.C. § 502.

¹² 11 U.S.C. § 502(b). The exceptions to the allowance rules of Section

502(b) are provided in Sections 502(e)(2), (f), (g), (h) and (i).

¹³ *Blue Diamond*, 147 B.R. at 730; 7 COLLIER ON BANKRUPTCY ¶ 1113.01] (Lawrence P. King ed., 15th ed. 2002).

¹⁴ *See Century Brass Products, Inc. v. International Union, United Automobile Aerospace and Agricultural Implement Workers of America (In re Century Brass Products, Inc.)*, 795 F.2d 265 (2d Cir. 1986) (stating that as a result of the enactment of Section 1113, that statute exclusively controls rejection of collective bargaining agreements in Chapter 11 proceedings).

¹⁵ *See Southern Labor Union v. Blue Diamond Coal Co.*, 160 B.R. at 576-77 (stating that “the Bankruptcy Court correctly held that 11 U.S.C. § 1113 effectively withdrew the rejected collective bargaining agreement from the rubric of 11 U.S.C. § 365 and § 501”); *see also In re Armstrong Store Fixtures Corp.*, 139 B.R. at 350 (Bankr. W.D. Pa. 1992) (holding that “[t]he net effect [of Section 1113] was to *remove* the analysis of collective bargaining agreements from the purview of § 365” (emphasis in original)).

¹⁶ *Blue Diamond*, 147 B.R. at 732.

¹⁷ 147 B.R. at 732 (stating that “[i]n the absence of provisions comparable to §§ 365(g) and 502(g), which enable an entity injured by rejection of an executory contract or unexpired lease under § 365 to assert a prepetition claim for the resulting breach, an entity asserting a claim for damages as a result of the rejection of a collective bargaining agreement under § 1113 is not a ‘creditor,’ as defined under § 101(10)(B),” because the injured entities claim is not “of a kind specified in section...502(g)”).

¹⁸ 11 U.S.C. § 501.

¹⁹ 11 U.S.C. § 101(10). The term “creditor” also includes entities that have a community claim, but this subsection of Section 101(10) is not applicable in the context of rejection damage claims.

²⁰ *Blue Diamond*, 147 B.R. at 722-23.

²¹ *Id.* at 734.

²² *Bildisco*, 465 U.S. at 524.

²³ *Id.* at 526.

²⁴ *Id.*

²⁵ *Id.* at 534.

²⁶ 7 COLLIER ON BANKRUPTCY ¶ 365.03[c] (Lawrence P. King ed., 15th ed. 2002).

²⁷ *See* 11 U.S.C. § 1113; *In re American Provision Co.*, 44 B.R. 907, 909

(Bankr. D. Minn. 1984).

²⁸ H.R. 5174, 98th Cong., 2d Sess. (1984).

²⁹ *Id.*

³⁰ *Id.*

³¹ See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

³² 130 Cong. Rec. S6195-97 (daily ed. May 22, 1984).

³³ 130 Cong. Rec. S6196 (daily ed., May 22, 1984).

³⁴ See generally 130 Cong. Rec. S6081-99, 6107-6131, 6177-6201, 6279-81, 6324, 6364, 6411, 6584-85, 6606, 7655, 7617-25, 7471-7500, 8887-8900.

³⁵ See *Lamie v. United States Trustee*, 540 U.S. 526, 541, 124 S. Ct. 1023, 157 L. Ed. 2d. 1024 (2004).

³⁶ 147 B.R. at 732.

³⁷ *Southern Labor Union v. Blue Diamond Coal Co.*, 160 B.R. at 577 (stating that “if rejection is truly necessary, then allowing a claim for damages, especially if the amount of that claim represents lost future wages and benefits, would necessarily assure the failure of the reorganization”). Although a hypothetical rejection damage claim would be paid in bankruptcy dollars (which may result in less than full payment), such a claim nevertheless could be onerous and potentially fatal to a bankrupt company even where unsecured claims are paid at a fraction of their filed amount.

³⁸ See, e.g., *Bildisco*, 465 U.S. 512, 530 (1984); *Truck Drivers Local 807, International Brotherhood of Teamsters v. Carey Transportation, Inc.*, 816 F.2d 82, 93 (2d Cir. 1987); *International Brotherhood of Teamsters v. IML Freight, Inc.*, 789 F.2d 1460, 1463 (10th Cir. 1986); *Brada Miller Freight System, Inc.*, 702 F.2d 890, 899-900 (11th Cir. 1983); *In re Maxwell Newspapers, Inc.*, 146 B.R. 920, 934 (Bankr. S.D.N.Y. 1992); *In re Indiana Grocery Co., Inc.*, 138 B.R. 40, 50 (Bankr. S.D. Ind. 1990); *In re Garofalo's Finer Foods, Inc.*, 117 B.R. 363, 371 (Bankr. N.D. Ill. 1990); *In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 272, 273 (Bankr. S.D. Tex. 1988).

³⁹ *In re American Provision*, 44 B.R. at 909; 11 U.S.C. § 1113.

⁴⁰ *Kevin Steel*, 519 F.2d at 707.

⁴¹ See 702 F.2d 890 (11th Cir. 1983).

⁴² 702 F.2d at 899-900.

⁴³ See, e.g., *Truck Drivers Local 807, International Brotherhood of Teamsters v. Carey Transportation, Inc.*, 816 F.2d 82, 93 (2d Cir. 1987) (in

balancing the equities to determine whether an employer was permitted to reject a CBA under Section 1113, one factor to consider was “the possibility and likely effect of any employee claims for breach of contract if rejection is approved”); *In re Maxwell Newspapers, Inc.*, 146 B.R. 920, 934 (Bankr. S.D.N.Y. 1992) (stating that “[t]he possibility of large damage claims from the rejection certainly looms as a threat to the dividend which the unsecured creditors will receive...if the Debtor is correct, the damage claim will be of a reasonable size”); *In re Indiana Grocery Co., Inc.*, 138 B.R. 40, 50 (Bankr. S.D. Ind. 1990) (stating that “[r]ejection of the CBA would entitle the [union] employees to file a claim for breach of contract, presumably for the difference between what they would have received under the CBA and what IGC will actually pay after rejection, which would be treated as a prepetition claim”); *In re Garofalo’s Finer Foods, Inc.*, 117 B.R. 363, 371 (Bankr. N.D. Ill. 1990) (stating that one factor to consider in deciding on rejection of a CBA is the amount of employee damage claims under § 502(g) for such rejection and their impact on the debtor’s ability to obtain confirmation of a plan); *In re Texas Sheet Metals, Inc.*, 90 B.R. 260, 272, 273 (Bankr. S.D. Tex. 1988) (providing that union would most likely have a claim for breach of contract relating back to date immediately before petition was filed because “rejection of any executory contract constitutes breach of that contract under 11 U.S.C. Section 365(g)”).

⁴⁴ See, e.g., *In re Family Snacks, Inc.*, 257 B.R. 884, 900 (B.A.P. 8th Cir. 2001); *Adventure Resources, Inc.*, 137 F.3d at 798 (4th Cir. 1998); *World Sales, Inc.*, 183 B.R. at 878 (9th Cir. BAP 1995); *In re Moline Corp.*, 144 B.R. at 78-79 (Bankr. N.D. Ill. 1992); *In re Murray Industries, Inc.*, 110 B.R. at 587-88 (Bankr. M.D. Fla. 1990).

⁴⁵ See St-Patrick-Baxter, Michael, *Is there a Claim For Damages From the Rejection of a Collective Bargaining Agreement under Section 1113 of the Bankruptcy Code*, 12 BANKR. DEV. J. 703, 715 (1996); see generally Keating, Daniel, *The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy*, 35 WM. & MARY L. REV. 503, 539-48 (1994).

⁴⁶ See, e.g., *Adventure Res.*, 137 F.3d at 798; *In re Moline Corp.*, 144 B.R. at 78-79; *In re Roth Am., Inc.*, 975 F.2d 949, 956-57 (3d Cir. 1992).

⁴⁷ See, e.g., *Adventure Res.*, 137 F.3d at 798 (stating in the context of an employer’s unilateral rejection of a CBA by failing to make contributions to employee pension trusts that “in erecting § 1113’s substantive and procedural obstacles to the unilateral termination of collective bargaining agree-

ments, Congress did not indicate that it intended to otherwise restrict the general application of § 365 to those agreements”); *United Food and Com. Workers Union v. Almac's, Inc.*, 90 F.3d at 5 (1st Cir. 1996) (holding that while interim modifications to a CBA under Section 1113(e) do not constitute rejections that would implicate Section 365, “[b]ecause the relevant language of § 365(g) has not changed since *Bildisco*, collective bargaining agreements would appear still to be subject to the section’s general provisions”); *In re Family Snacks, Inc.*, 257 B.R. at 901-02 (B.A.P. 8th Cir. 2001) (stating that “§ 365 covers assumption and rejection of CBAs, except as specifically modified with regard to rejection in § 1113”); *In re Typocraft Co.*, 229 B.R. at 688 (E.D. Mich. 1999) (“the process of ‘assumption’ of CBAs continues to be governed by the general provisions of...§ 365”); *In re Moline Corp.*, 144 B.R. at 78 (Bankr. N.D. Ill. 1992) (stating in a unilateral termination situation “it would appear that § 365 must fill in the gap left by § 1113”).

⁴⁸ 144 B.R. at 78.

⁴⁹ *Id.*

⁵⁰ 147 B.R. at 732.

⁵¹ *Id.*

⁵² 147 B.R. at 732 (stating that “[i]t is beyond [the Court’s] province to rescue Congress from its drafting errors, and to provide for what we might think...is the preferred result”) (quoting *United States v. Granderson*, 511 U.S. 39, 68, 114 S. Ct. 1259 (1994) (concurring opinion)); see also *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991) (“The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning”); *Lamie*, 540 U.S. at 542 (“[i]f Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent”).

⁵³ 11 U.S.C. § 1114.

⁵⁴ 11 U.S.C. § 1114(i).

⁵⁵ 11 U.S.C. § 1114(j).

⁵⁶ See 11 U.S.C. §§ 502(g)(2), 562.

⁵⁷ Bankruptcy Code Section 1113 is effective with respect to prepetition CBAs in Chapter 11 cases commenced on or after July 10, 1984. Pub. L. No. 98-353, § 541(c) (1984). Accordingly, decisions addressing Chapter 11 bankruptcy petitions commenced prior to that date analyzed the rejection of CBAs exclusively through the framework of Section 365, rather than

Section 1113. *See, e.g., Air Line Pilots Assoc., Int'l v. Continental Airlines, Inc. (In re Continental Airlines, Inc.)*, 901 F.2d 1259 (5th Cir. 1990). Any such case cited as support for the proposition that the rejection of a CBA pursuant to Section 1113 provides the union with a rejection damages claim should be considered inapplicable to the current debate over the availability of damage claims stemming from rejections under Section 1113. *See id.*; *O'Neill v. Continental Airlines, Inc. (In re Continental Airlines, Inc.)*, 981 F.2d 1450 (5th Cir. 1993); *U.S. Truck Co., Inc. v. Teamsters Nat'l Freight Indus. Negotiating Comm. (In re U.S. Truck Co., Inc.)*, 89 B.R. 618 (E.D. Mich. 1988).

⁵⁸ *See In re Northwest Airlines Corp.*, 346 B.R. 307, 331 (Bankr. S.D.N.Y. 2006).

⁵⁹ *See In re Northwest Airlines Corp.*, Case No. 05-17930 (ALG), Docket Nos. 4557, 4559.

⁶⁰ *In re Northwest Airlines Corp.*, 346 B.R. 333, 344, 345 (Bankr. S.D.N.Y. 2006).

⁶¹ *In re Northwest Airlines Corp.*, 349 B.R. 338, 379 (S.D.N.Y. 2006).

⁶² *In re Northwest Airlines Corp.*, 483 F.3d 160, 164, 174 (2d Cir. 2007).

⁶³ *Id.* at 170 n. 3.

⁶⁴ *Id.*

⁶⁵ *Id.* at 170-71.

⁶⁶ *Id.* at 172-73.

⁶⁷ *Id.* at 169, 170 n. 3. Citing *Blue Diamond*, the Second Circuit further stated that “if a carrier that rejected a CBA simultaneously breached that agreement and violated the RLA, the union would be correspondingly free to seek damages or strike, results inconsistent with Congress’ intent in passing §1113.” *Id.* at 172.

⁶⁸ *In re Northwest Airlines Corp.*, 366 B.R. 270, 275 (Bankr. S.D.N.Y. 2007).

⁶⁹ *Id.*

⁷⁰ *See* notes 35 to 37 *infra*.

⁷¹ Chapter 11 Fairness: Hearing Before the H. Judiciary Comm., Subcommittee on Commercial and Administrative Law, 110th Cong., September 6, 2007.

⁷² *Id.* at pp. 3, 16.

⁷³ H.R. 3652, 110th Cong., 1st Sess. (2007).

⁷⁴ *Id.* Other changes proposed in H.R. 3652 include requiring the bank-

ruptcy court to presume that the debtor does not meet the requirements for Section 1113 rejection if it has implemented a senior management incentive pay, bonus or compensation plan during Chapter 11 or 180 days prior to the case. *Id.* at Section 8. H.R. 3652 also would limit the implementation of executive retention and compensation plans in bankruptcy, would increase the cap on wage claims given priority under the Bankruptcy Code, and would provide employees with allowed claims for losses arising from declines in the value of stock held in defined contribution benefit plans. *Id.* at Sections 3, 4, 7. Specifically with respect to CBA rejection under Section 1113, H.R. 3652 would require that any modification to a CBA be “no more than the minimal savings necessary to permit the debtor to exit bankruptcy, such that confirmation of such plan is not likely to be followed by a liquidation of the debtor or any successor of the debtor,” and any such CBA modification may not “overly burden the affected labor group.” *Id.* at Section 8.