New Jersey Law Journal

VOL. CLXXI – NO. 6 – INDEX 448 FEBRUARY 3, 2003 ESTABLISHED 1878

Bankruptcy Law

Union Labor Under Pressure When Companies File for Protection

Even when a debtor rejects or modifies a collective bargaining agreement, labor laws have continuing vitality in the bankruptcy context

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The recent bankruptcy filings by US Airways and UAL Corporation serve to underscore the extent to which labor issues drive not only the decision to file for bankruptcy, but also which issues will require attention during the first crucial days of the case. Although these two cases are the most recent prominent examples of where labor issues have emerged before the Bankruptcy Court, any debtor that employs union labor may find itself grappling with difficult collective bargaining agreement-related bankruptcy issues.

Labor laws specify the precise procedure that employers must follow if they wish to terminate or modify an existing CBA. Since 11 U.S.C. §1113 does not mandate that debtors adhere to these exacting requirements, the rejection of CBAs under the code results in a fundamental conflict between bankruptcy policy and labor law policy. Yet, because debtors that have rejected a CBA must adhere to the labor laws' processes to negotiate a new labor contract, labor laws have continuing vitality in the bankruptcy context.

Successfully rehabilitating a distressed company is the stated policy underpinning Chapter 11 of the Bankruptcy Code. To this end, the code permits debtors, in the sound exercise of their business judgment, to assume or reject executory contracts. 11 U.S.C. §365(a). The code has also been amended to provide for the rejection of union CBAs. 11 U.S.C. §1113.

In stark contrast to the code's policy concerning rejection of contracts and, in particular, rejection or modification of CBAs, a primary goal of the nation's labor laws is to "eliminate the causes of … substantial obstruction to the free flow of commerce" and to ensure that workers can act collectively to avoid falling victim to the whim of their employer. 29 U.S.C. §151.

In this area, it is helpful to look at the rejection of CBAs under the Bankruptcy Code in contrast to the requirements for rejecting or terminating CBAs under two of the nations' primary labor laws, the National Labor Relations Act and the Railway Labor Act.

A greater awareness of these issues is necessary for bankruptcy and labor attorneys alike, as the decision to file for bankruptcy protection is increasingly being informed by debtors' juxtaposing their need to reduce labor costs with the ability to reject CBAs in bankruptcy without following the strict requirements of the labor laws. The starkest illustration of this conflict can perhaps be seen in two of the past year's largest bankruptcy filings: US Airways, Inc. and UAL Corporation (owner of, among other entities, United Airlines).

Targeting Labor Costs

As set forth in the companies' bankruptcy pleadings, the decisions by US Airways and UAL Corporation were largely presaged by the companies' need to substantially reduce labor costs. While labor considerations were relevant to the decision to file bankruptcy by companies in labor-intensive industries other than the airline industry (such as the steel, transportation and food processing industries), these issues loom so large in the US Airways and UAL Corporation bankruptcies that they have become the driving issue.

In the US Airways case, the company's initial restructuring plan called for aggregate cost reductions and other savings of approximately $1.2 billion per year for a period of six and one-half years. To meet this goal, US Airways sought to reduce its labor costs by securing concessions from its five labor

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unions totaling approximately $950 million per year for each of the six and one-half years. Thus, the company sought labor concessions totaling more than $6 billion. This represented approximately 80 percent of the total economic concessions that US Airways alleged it needed to survive. Given these facts, it is easy to understand labor's concerns that US Airways was placing the primary financial burdens of its restructuring on its employees.

Although it is still too early to tell the extent of the concessions that will be demanded from labor unions by UAL Corporation, present information suggests that labor will be asked to accept double-digit pay cuts and the elimination of scheduled pay raises and other important benefits and working conditions (such as the prohibition on contracting-out work, which under the applicable CBA would be performed by union employees), amounting to hundreds of millions of dollars per year.

In addition to fast becoming the driving issue behind large bankruptcy filings, the relationship between unions and their debtor-employers are becoming more complex. In the case of UAL Corporation, for example, the unions own approximately one-half of the company's common stock through an employee stock ownership plan and have three seats on the company's board of directors.

Labor Laws

The National Labor Relations Act, 29 U.S.C. §§151-169, establishes workers' rights of organization, collective bargaining and collective action. The NLRA also prescribes workers' and employers' duties to bargain in good faith concerning wages, hours and other employment conditions. Employers cannot unilaterally impose changes regarding wages, hours and conditions unless they first engage in good-faith negotiations with the labor representative and such negotiations result in an impasse. See *NLRB v. Katz*, 369 U.S. 736 (1962).

During the term of a CBA, neither the union nor the employer may unilaterally impose changes to the terms of the CBA without first complying with the strict requirements of §158(d) of the NLRA. Section 158 requires the party desiring to terminate or modify the CBA to provide notice of the proposed modification to the other party, to offer to meet with the other party to negotiate the modification, and to notify certain federal and state authorities of any dispute concerning the proposed modification. It also mandates a 60-day "cooling off" period after a stalemate is reached before either party may engage in self-help, such as strikes and lockouts.

The Railway Labor Act, 45 U.S.C. §§151-164, predates the NLRA and was America's first sweeping effort to regulate labor relations. The RLA was enacted to avoid interruption to commerce and thus forbid limits on employees' rights to form and join unions while providing for the prompt and orderly settlement of labor disputes. 45 U.S.C. §151(a)(1). Initially applicable only to railroad labor, the RLA was amended to encompass airlines.

The RLA prescribes the procedure for the modification or termination of CBAs subject to the RLA (e.g., railroad and airline CBAs). Much like the NLRA, the RLA mandates that the party seeking to modifiy or terminate the CBA must provide notice and must negotiate in good faith. It also mandates a 10-day "cooling-off" period prior to either party engaging in self-help measures.

Business Judgment

Prior to the enactment of §1113 in 1984, debtors seeking to reject CBAs did so pursuant to Bankruptcy Code §365(a) or, prior to the code's enactment in 1978, the Bankruptcy Act. Section 365(a) governs the assumption, assignment and rejection of executory contracts and unexpired leases by debtors. An executory contract is a contract where obligations are due from both parties. It is well settled that CBAs are executory contracts within the meaning of §365(a). See, e.g., *Shopman's Local Union No. 445 v. Kevin Steel Products Inc.* (*In re Kevin Steel Products, Inc.*), 519 F.2d 698 (2d Cir. 1975)(decided under the precursor to §365 — §713 of the Bankruptcy Act).

Section 365, however, does not specify the standard that courts will apply when determining a debtor's motion to assume or reject an executory contract. The vast majority of courts will approve of a debtor's application to reject an executory contract if rejection is a sound exercise of the debtor's business judgment. See, e.g., *Sharon Steel v. National Fuel Gas Distrib. Corp.*, 872 F.2d 36 (3rd Cir. 1989) and *In re G Survivor Corp.*, 171 B.R. 755 (Bankr. S.D.N.Y. 1994).

Absent a showing of bad faith, or an abuse of business discretion, a court will not second guess a debtor's business judgment. See *Lubrizol Enter. v. Richmond Metal Finishers (In re Richmond Metal Finishers, Inc.)*, 756 F.2d 1043 (4th Cir. 1985)

When the contracts to be rejected were CBAs, bankruptcy courts generally required debtors to make a greater showing than business judgment. Nevertheless, the bankruptcy courts did not agree on the appropriate standard. The Second Circuit adopted two different tests that were widely followed by courts in other jurisdictions.

The first test required the court to balance the equities between the debtor's need to reject the CBA and the effect rejection would have on the employees' rights regarding seniority, pension and welfare (for example, employee rights that are difficult to state in monetary terms for purposes of asserting a claim against the debtor's estate).

Under the second test, a Bankruptcy Court would look to considerations that speak to the burdens of the CBA on the debtor to determine whether denying the rejection motion would "thwart [the debtor's] efforts to save a failing company in bankruptcy from collapse." *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*, 523 F.2d 164 (2d. Cir. 1975).

To be sure, a few bankruptcy courts applied the garden variety §365(a) business judgment test that courts use when deciding motions concerning nonlabor executory contracts.

Bildisco

The Supreme Court's decision in *National Labor Relations Board v. Bildisco & Bildisco*, 465 U.S. 513 (1984), resolved the circuit split concerning the appropriate standard that bankruptcy courts must apply when deciding motions to reject CBAs.

After recognizing that CBAs were executory contracts under §365, the Court held that the *Kevin Steel* test, which required that bankruptcy courts weigh the equities, was the appropriate standard. The Court also recognized that CBAs differ from other executory contracts because of the unique position they occupy within the framework of competing labor and bankruptcy policies.

To balance the standard for rejecting CBAs under §365 on the one hand, and recognizing the uniqueness of CBAs on the other, the Court afforded CBAs more protection than other executory contracts. In this regard, the Court set forth several factors that a Bankruptcy Court would have to weigh before authorizing a debtor to reject a CBA: (i) the balance of equities among the debtor and its employees and creditors; (ii) the likelihood that the debtor's business will fail if it were not permitted to reject the CBA; (iii) whether denying the request to reject a CBA would reduce creditors' recovery; and (iv) the impact on the employees if the CBA is rejected.

The Court stressed that a Bankruptcy Court, prior to authorizing rejection of a CBA, must be satisfied that the debtor has made reasonable efforts to negotiate concessions from the unions prior to seeking to reject the CBA. Moreover, the Bankruptcy Court must put all of its reasons for authorizing a debtor to reject a CBA on the record.

After deciding the relevant standard for rejecting CBAs, the Court turned its attention to the NLRB's contention that Bildisco committed an unfair labor practice by unilaterally rejecting the CBA prior to receiving Bankruptcy Court approval to reject it. The Court decided that under the facts of the case, Bildisco did not commit an unfair labor practice.

The Court found that the code authorizes debtors to modify contracts after the filing of a bankruptcy petition since that filing makes a debtor's executory contracts unenforceable. Since the CBA was unenforceable by operation of law upon the filing of Bildisco's petition, the relevant portion of the NLRA concerning terminating or modifying CBAs, §158, was inapplicable. Thus, the Court decided that the code (and the policies underlying it) pre-empted the NLRA.

Congressional Response to *Bildisco*

Section 1113 was enacted shortly after *Bildisco* was decided and was a direct response by Congress to narrow the effect of the Supreme Court's ruling. Congress enacted code §1113 to govern the procedures for the rejection of CBAs and to level the playing field between debtor-employers and their union employees. See *Matter of Sol-Sieff Produce Co*., 82 B.R. 787 (Bankr. W. D. Pa. 1988).

By enacting §1113, Congress intended to preclude employers from filing for bankruptcy simply to avoid their obligations under a CBA. See *In re Ionosphere Clubs, Inc*., 22 F.3d 403 (2d Cir. 1994). Section 1113 prevents debtors from using the Bankruptcy Code as a "judicial hammer" to break unions. See *New York Typographical Union No. 6 v. Maxwell Newspapers, Inc. (In re Maxwell Newspapers, Inc.)*, 981 F. 2d 85 (2d Cir. 1992).

Despite this intent, §1113 motions in cases such as the US Airways and UAL Corporation bankruptcy cases have been threateningly held over the heads of the union leadership throughout the union-company negotiations concerning proposed concessions.

In the US Airways case, the unions were presented with largely nonnegotiable proposals for concessions. While the company was willing to meet with the unions and to provide them with financial and other information, the message to the unions was clear: If the company could not achieve the labor savings it wanted via negotiation, it would seek to achieve them in court.

The uncertainty of pushing the outcome onto the court was sufficient to induce most of the company's unions to agree to concessions. In the case of the mechanics union, which had rejected the proposed concessions once, the company used the threat of litigating the matter to compel the union's leadership to re-submit the same concessions to the membership for a vote.

Section 1113 eliminates Bankruptcy Code pre-emption of the NLRA (as stated by the Court in *Bildisco*). See Joseph L. Cosetti and Stanley A. Kirshenbaum, *Rejecting Collective Bargaining Agreements Under Section 1113 of the Bankruptcy Code — Judicial Precision or Economic Reality*, 26 Duq. L.Rev. 181 (1987).

The filing of a bankruptcy petition can no longer be said to abrogate a debtor's responsibilities under a CBA. 11 U.S.C. §1113(f). The CBA remains in effect, and the negotiating process between a debtor and a union must continue after the filing of a bankruptcy petition. See *In Re Ionosphere Clubs, Inc*., 922 F.2d 984 (2d Cir. 1990).

Seeking Rejection

Courts have developed a nine-point test to apply when determining motions to reject CBAs under §1113. Bankruptcy courts consistently apply these nine factors when ruling on a motion brought pursuant to §1113. As stated in *In re Wheeling-Pittsburgh Steel Corp*., 50 B.R. 969 (Bankr. W.D. Pa. 1985), the:

(1) debtor must make a proposal to modify the CBA or obtain concessions from the union;

(2) debtor's proposal must be based on the most complete and reliable information available at the time the proposal is made;

(3) The proposal must be necessary to the debtor's reorganization;

(4) proposal must treat fairly and equitably creditors, the debtor and all other affected parties;

(5) debtor must provide the union with relevant information as is necessary to evaluate the proposal;

After making a proposal and before the hearing, the

(6) debtor must meet at reasonable times with the union and

(7) debtor must negotiate in good faith with the union in an attempt to reach mutually satisfactory modifications of the CBA.

Only after the above steps are satisfied, do the courts have the authority to approve an application for rejection of a CBA, but only if the

(8) union has refused to accept the debtor's proposal without good cause and

(9) balance of the equities clearly favors rejection of the CBA.

All nine of these factors must be satisfied before a CBA may be rejected pursuant to §1113. The debtor bears the burden of persuasion by a preponderance of the evidence on each and every one of the nine requirements.

However, even if the debtor satisfies the §1113 test and is authorized by the court to reject a CBA, it is not relieved from its obligations under the NLRA to bargain in good faith with the union over the terms of a new contract. See *Bildisco*, 465 U.S. at 534. While §1113 is procedurally simple to understand, the section fails to define key phrases such as "necessary" and "fairly and equitably," and so, it is fraught with ambiguity.

The 'Necessary' Requirement

A debtor's §1113 motion must seek only that relief which is "necessary" to permit reorganization. Although there is a split of authority concerning the definition of necessary, courts have firmly held that necessary is synonymous with essential. Therefore, a debtor's proposal may include only those items that are absolutely necessary for the debtor's reorganization. See *Wheeling-Pittsburgh Steel*, 791 F.2d 1074 (3d Cir. 1986).

In *In re Cook United*, 50 B.R. 561 (Bankr. N.D. Ohio 1985), the court denied rejection of the CBA because the debtor failed to establish that wage concessions were essential to a positive cash flow.

However, in *Truck Drivers Local 807 v. Carey Transp., Inc*., 816 F.2d 82 (2d Cir. 1987), the court disagreed with the Third Circuit's decision in *Wheeling-Pittsburgh Steel*, and held that "necessary" in the §1113 context required only that the debtor propose modifications to CBAs in good faith.

'Fairly and Equitably' Requirement

Section 1113 also mandates that a debtor's proposal to modify a CBA treat all creditors, the debtor and all affected parties "fairly and equitably." A debtor may not seek to place a disproportionate share of the financial burden of avoiding liquidation upon labor unions. See *In Re National Forge Co*., 279 B.R. 493 (Bankr. W.D.Pa. 2002). Rather, the burden must be spread fairly and equitably among all affected parties.

As the *Wheeling-Pittsburgh Steel* court noted, the focus of the inquiry is upon whether the proposed sacrifices will be borne exclusively and disproportionately by members of the bargaining unit or will be spread among all affected parties. Moreover, the concessions sought from various parties "must be examined from a realistic standpoint."

In the US Airways case, 80 percent of the company's total proposed cost reductions came from union concessions. Whether this was fair and equitable was never decided since the unions ultimately agreed to the concessions rather than litigating the issue before the Bankruptcy Court.

Nevertheless, it may be assumed that, if tested, the fairness and equity of these concessions would have had to have been compared to other potential cost savings (for example, greater savings available from equipment lessors). When viewed from this perspective, it may be argued that such concessions were not fair and equitable.

While there are many features that may be included in a modification proposal to satisfy the "fairly and equitably" requirement, one that deserves mentioning here is the so-called "snap back" provision. Snap back provisions provide for the restoration of wages and benefits in the event the debtor out-performs its projections over a given time period.

Most courts favor snap back provisions "because they ensure that once a company is profitable enough for successful reorganization, further profits not 'necessary' for reorganization are returned to the employees who made the concessions." *In re Indiana Grocery Co., Inc*., 136 B.R. 182 (Bankr. S.D.Ind. 1990). The court in *In re Express Freight Lines, Inc*., 119 B.R. 1006 (Bankr. E.D. Wisc. 1990), however, held that a snap back provision was not necessary but was an element of unfairness in the modification proposal in issue.

Rejection of Railway CBAs

Section 1113 specifies that CBAs governed by subchapter IV of the Bankruptcy Code (relating to railroad reorganizations) and Title I of the RLA are not subject to the procedures set forth in §1113. Airline CBAs remain subject to the RLA for all purposes.

When Congress enacted §1113 in 1984, it chose to carve out railroad CBAs from the new provision's coverage, but included in its coverage airline CBAs, which are governed by Title II of the RLA. This is significant because save for the applicability of §1113 to airline CBAs, the RLA has continuing vitality and applicability to airline CBAs in the context of a bankruptcy case. In *In re Continental Airlines Corp*., 57 B.R. 845 (Bankr. S.D.Tex. 1984), the court noted that rejection in bankruptcy of a CBA does not undercut the principle that the RLA pre-empts claims for wrongful discharge.

Whether one represents a labor union or a debtor that employs union labor, familiarity with the requirements of the nation's labor laws, in addition to knowledge of the Bankruptcy Code, is crucial to the effective representation of the client's interests when the issue is rejecting or modifying a CBA. ■