RECONCILING LABOR AND BANKRUPTCY LAW: THE APPLICATION OF 11 U.S.C. § 1113

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INTRODUCTION

Congress, in 11 U.S.C. § 1113,[1] created procedures and standards for a debtor company to modify or reject an existing collective bargaining agreement after the company has filed a Chapter 11 bankruptcy proceeding.[2] The purpose of § 1113 was to reconcile the policy of the Bankruptcy Code, which allows rehabilitation of a Chapter 11 debtor company,[3] with the policies of labor law, which include protection of employees' rights to organize and to bargain collectively.[4]

An employer's rejection of an existing collective bargaining agreement can adversely affect the rights of employees and can adversely impact the company's creditors and the local community generally. Because of this, considerable controversy exists over what standards must be met before a debtor company may properly modify or reject the agreement. Section 1113, unfortunately, does not supply all the answers. This article will explore the underlying tension between the Bankruptcy Code, which establishes its own provisions for rejection of the collective bargaining agreement,[5] and the National Labor Relations Act (NLRA),[6] which prescribes specific procedural requirements for rejection of the agreement.[7]

Part I of this article examines existing policy conflicts between these two federal laws. Part II discusses the historical development of the existing standards for rejecting collective bargaining agreements. It begins by examining the differing standards applied by courts prior to the Supreme Court's attempt to articulate a comprehensive standard in *NLRB v. Bildisco & Bildisco*.[8] It then analyzes both the Court's *Bildisco* decision and § 1113, which is Congress' legislative reaction to *Bildisco*.

Part III presents the two competing judicial interpretations of the requirements imposed by § 1113 for rejecting or modifying collective bargaining agreements. The Third Circuit strictly interprets the provisions of

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1. Section 1113 was signed into law on July 10, 1984 as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 541(a), 98 Stat. 333, 390 (codified as amended at 11 U.S.C. § 1113 (1994)).

2. *See* 11 U.S.C. § 1113 (1994).

3. Chapter 11 reorganization protects a debtor from its creditors by placing the debtor under supervision of the court, and fosters the restructuring of debt and reorganization of the business. *See* H.R. REP. No. 95-595, at 220, 404 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179, 6360.

4. *See* National Labor Relations Act § 1, 29 U.S.C. § 151 (1994).

5. *See* 11 U.S.C. § 1113(c).

6. *See* 29 U.S.C. §§ 151-169 (1994).

7. *See* National Labor Relations Act § 8(d).

8. 465 U.S. 513 (1984).

§ 1113, permitting rejection or modification only upon a showing that, absent rejection or modification, the debtor will be faced with certain liquidation.[9] The Second Circuit interprets § 1113 to give the debtor more flexibility in proposing modifications to or rejecting the agreement.[10] Part V evaluates these competing approaches. Part IV examines in detail the differing interpretations of § 1113 among bankruptcy courts within the Sixth Circuit, to illustrate the confusion in the lower courts on the issue and the need for concrete guidance from the Supreme Court. Part V recommends a comprehensive standard for rejection or modification which will better accommodate the competing interests of labor and bankruptcy law.

I. STATUTORY POLICIES

The NLRA governs relations between employers and labor unions.[11] The Act provides:

> [I]t is declared hereby to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining . . . for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection.[12]

It is an unfair labor practice under section 8(a)(5) of the NLRA for an employer "to refuse to bargain collectively with the representatives of his employees."[13] Section 8(d) imposes an obligation to bargain collectively upon both the employer and the representative of the employees with respect to "wages, hours, and other terms and conditions of employment."[14] The parties are under no obligation to agree, but must bargain to "impasse" before modifying or rejecting the collective bargaining agreement.[15] More to the point, section 8(d) sets out a detailed, four-step process which an employer must follow before it may terminate or modify a collective bargaining agreement.[16]

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9. *See* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074 (3d Cir. 1986).

10. *See* Truck Drivers Local 807, Int'l Bhd. of Teamsters v. Carey Transp., Inc., 816 F.2d 82 (2d Cir. 1987).

11. *See* National Labor Relations Act §§ 1-19, 29 U.S.C. §§ 151-169 (1994).

12. National Labor Relations Act § 1.

13. National Labor Relations Act § 8(a)(5).

14. National Labor Relations Act § 8(d).

15. An "impasse" is "a state of facts in which the parties, despite the best of faith, are simply deadlocked." NLRB v. Tex-Tan, Inc., 318 F.2d 472, 482 (5th Cir. 1963); *see generally* David G. Epstein, *Impasse in Collective Bargaining*, 44 TEX. L. REV. 769, 776-82 (1966) (discussing the factors of whether an impasse exists).

16. Section 8(d) provides, in part:

Absent meeting these requirements, it is unlawful for an employer to unilaterally reject or modify the collective bargaining agreement while it remains in force. Section 8(d), when coupled with section 8(a)(5), provides that an employer's failure to follow this process constitutes an unfair labor practice.[17]

In contrast to the provisions of the NLRA, Chapter 11 of the Bankruptcy Code permits a debtor to unilaterally reject the terms of an executory contract upon application to and approval of the bankruptcy court.[18] Under the Code, a debtor may neither assume nor reject an executory contract in part, but must assume or reject the entire contract.[19] By rejecting an unfavorable contract, the debtor company rids itself of its full contractual obligation to the union employees, i.e. the company is permitted to repudiate the contract in toto and simply convert it into a judgment for damages. The judgment then becomes an unsecured claim and must compete with all other unsecured claims against the debtor company.[20]

Allowing a debtor to reject the executory contract achieves the underlying policy of reorganization of the Bankruptcy Code, which is to permit the successful rehabilitation of debtors and to recognize that "assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap."[21] At the same time, however, such a rejection imposes a significant loss on the union and the employees the union represents.

> [T]he duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract, unless the party desiring such termination or modification –
>
> (1) serves a written notice upon the other party to the contract of the proposed termination or modification sixty days prior to the expiration date thereof, . . .
>
> (2) offers to meet and confer with the other party for the purpose of negotiating a new contract or a contract containing the proposed modifications;
>
> (3) notifies the Federal Mediation and Conciliation Service within thirty days after such notice of the existence of the dispute, . . .
>
> (4) continues in full force and effect, without resorting to strike or lockout, all the terms and conditions of the existing contract for a period of sixty days after such notice is given or until the expiration date of such contract, whichever occurs later.

National Labor Relations Act § 8(d).

17. *See* National Labor Relations Act § 8(a)(5).

18. *See* 11 U.S.C. § 365(a) (2000). Section 365(a) sets out the basic power of the trustee to assume or reject executory contracts: "[T]he trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). In a Chapter 11 proceeding, the debtor-in-possession has the right to exercise this power under § 1107(a). *See* 11 U.S.C. § 1107(a).

19. *See* 1 COLLIER BANKRUPTCY MANUAL ¶ 365.03[1] (3d ed., rev. 2000) [hereinafter BANKRUPTCY MANUAL]; *see also* City of Covington v. Covington Landing Ltd. P'ship, 71 F.3d 1221 (6th Cir. 1995).

20. *See* 11 U.S.C. § 502(g) (2000).

21. H.R. REP. No. 95-595, at 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179.

First, as noted above, the damages resulting from the permitted breach are treated as an *unsecured* claim.[22] So if the wage established by the collective bargaining agreement is fifteen dollars per hour and the post-rejection wage is ten dollars, the employees are likely to receive only pennies on the dollar toward the five dollar difference. Second, the union and employees are left without an effective remedy for the loss of provisions of the collective bargaining agreement that are not reducible to quantifiable money damages, such as seniority provisions and the employer's promise to arbitrate grievances. The Bankruptcy Code requirement that agreements be either accepted or rejected in toto ensures that these provisions are tossed out with the wage provisions.

In *NLRB v. Bildisco & Bildisco*,[23] the Supreme Court held that a collective bargaining agreement is an executory contract subject to rejection under 11 U.S.C. § 365(a).[24] Thus, the ability of the debtor company to unilaterally reject a collective bargaining agreement in order to give effect to the policy of the Bankruptcy Code favoring reorganization of the debtor company directly conflicts with the underlying purpose of the NLRA, which protects the rights of employees and encourages collective bargaining.

II. DEVELOPMENT OF A STANDARD FOR REJECTION OF COLLECTIVE BARGAINING AGREEMENTS

A. Standards Prior to *NLRB v. Bildisco & Bildisco*[25]

Prior to the enactment of § 1113, it generally was assumed that a collective bargaining agreement was an executory contract subject to rejection in a Chapter 11 proceeding.[26] However, there was considerable disagreement as to the correct standard for rejection. Under the prior Bankruptcy Act, and under the present Code, the standard for rejection of executory contracts generally was, and is, the "business judgment test,"[27] which favors the debtor's interests and allows rejection of the agreement merely upon a

22. *See supra* note 20 and accompanying text.
23. 465 U.S. 513 (1984).
24. *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522-23 (1984).
25. 465 U.S. 513 (1984).
26. *See supra* note 18.
27. BANKRUPTCY MANUAL, *supra* note 19, ¶ 365.03[2].

showing that it is burdensome to the debtor.[28] Under this standard, interests of labor would not be considered.[29]

The Second Circuit, however, applied a very different standard in *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*[30] First, in response to the NLRB's claim that the Bankruptcy Act must yield to section 8(a)(5) of the NLRA in order to achieve industrial peace, the court found that a debtor-in-possession is a new entity and is not bound by the existing labor contract because it is not a party to the contract.[31] Nonetheless, the court held that the new entity is subject to the NLRA and that it therefore must bargain collectively with the union representing the employees.[32] Second, the court considered the circumstances under which it would permit a debtor to reject its collective bargaining agreement.[33] The Second Circuit expressly adopted a "balancing of the equities" test that previously had been created by the Federal District Court for the Eastern District of New York in the case of *In re Overseas National Airways, Inc.*[34] Stating that "[t]he decision to allow rejection should not be based solely on whether it will improve the financial

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28. *See In re* Klaber Bros., 173 F. Supp. 83, 85 (S.D.N.Y. 1959). In *Klaber Brothers*, the referee in bankruptcy found that the Bankruptcy Act made no distinction among classes of executory contracts and that collective bargaining agreements therefore were subject to rejection when the contract "is a burden on the estate." *Klaber Bros.*, 173 F. Supp. at 85; *see also In re* Gray Truck Line Co., 34 B.R. 174 (Bankr. M.D. Fla. 1983).

29. *See* Group of Institutional Investors v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523 (1943). The court stated that the question of whether a lease should be rejected and, if not, on what terms it should be assumed, is one of business judgment. *See* BANKRUPTCY MANUAL, *supra* note 19, ¶ 365.03[2] n.9 (citing *Group of Institutional Investors*, 318 U.S. at 523).

30. 519 F.2d 698 (2d Cir. 1975). The debtor, Kevin Steel Products, Inc., was a steel fabricator that appealed from a decision of the District Court for the Southern District of New York finding that the court had no power to allow the debtor to reject its contract with the union. *See* Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698, 700 (2d Cir. 1975). The union filed unfair labor practice charges against the debtor with the NLRB after the debtor would not, inter alia, sign a new collective bargaining agreement, and subsequently filed for protection under Chapter 11 of the Bankruptcy Act. *See Shopman's Local Union No. 455*, 519 F.2d at 700-01. Affirming the decision of the administrative law judge, the NLRB found the debtor had committed an unfair labor practice by refusing to sign the contract. *See id.* at 700. The debtor did not comply with the Board's order to sign the new contract and the Board appealed to the court of appeals for enforcement of its order. *See id.* at 701. Meanwhile, the bankruptcy court permitted the debtor to reject the contract as being onerous. *See id.* at 700. On appeal, the district court held that the power of the Bankruptcy Court to relieve the debtor of burdensome executory contracts did not apply to collective bargaining agreements. *See id.* at 701. The debtor appealed to the Second Circuit, resulting in this decision. *See id.*

31. *See Shopmen's Local Union No. 455*, 519 F.2d at 704.

32. *See id.*

33. *See id.* at 707.

34. 238 F. Supp. 359 (E.D.N.Y. 1965).

status of the debtor,"[35] the Second Circuit in *Kevin Steel* agreed with the *Overseas National* court that rejection of a collective bargaining agreement should be permitted:

> [O]nly after thorough scrutiny, and a careful balancing of the equities on both sides, for, in relieving a debtor from its obligations . . . [the court] may be depriving the employees affected of their seniority, welfare and pension rights, as well as other valuable benefits which are incapable of forming the basis of a provable claim for money damages . . . . at the same time enabling the debtor, at the expense of the employees, to consummate what may be a more favorable plan of arrangement with its other creditors.[36]

Little more than one month after its decision in *Kevin Steel*, the Second Circuit announced a third, more onerous standard for rejection in *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*[37] The court held that rejection of the contract would be permitted only after a "careful weighing of all of the factors and equities involved," *and* a determination that the contract is so "onerous and burdensome" that it would "thwart efforts to save a failing carrier in bankruptcy from collapse."[38] In so holding, the court added an additional requirement to the *Kevin Steel* balancing of the equities standard – one that permitted rejection only where it could be shown that absent rejection the company would collapse and be thrown into liquidation.[39]

B. The *Bildisco* Decision

With the decision in *REA Express*, conflict developed among the circuits as to which of these three standards should be applied, with the Third, Ninth and Eleventh Circuits rejecting the strict standard favored by the Second Circuit and applying instead the *Kevin Steel* balancing of the equities standard.[40] This split of authority brought the matter before the Supreme Court in *NLRB v. Bildisco & Bildisco.*[41]

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35. *Shopmen's Local Union No. 455*, 519 F.2d at 707.

36. *Id.* (quoting *In re* Overseas Nat'l Airways, Inc., 238 F. Supp. 359, 361-62 (E.D.N.Y. 1965).

37. 523 F.2d 164 (2d Cir. 1975).

38. Bhd. of Ry., Airline and S.S. Clerks v. REA Express, Inc., 523 F.2d 164, 169 (2d Cir. 1975).

39. *See REA Express Inc.*, 523 F.2d at 170.

40. *See* Daniel S. Ehrenberg, *Rejecting Collective Bargaining Agreements Under Section 1113 of Chapter 11 of the 1984 Bankruptcy Code: Resolving the Tension Between Labor Law and Bankruptcy Law*, 2 J.L. & POL'Y 55, 64 (1994); Judith DeMeester Nichols, *Rejection of Collective Bargaining Agreements by Chapter 11 Debtors: The Necessity Requirement Under Section 1113*, 21 GA. L. REV. 967, 981 (1987).

41. 465 U.S. 513 (1984).

The *Bildisco* decision addressed two issues. The first asked "under what conditions . . . a Bankruptcy Court [can] permit a debtor-in-possession to reject a collective-bargaining agreement."[42] The second was whether the National Labor Relations Board (NLRB) may "find a debtor-in-possession guilty of an unfair labor practice for unilaterally terminating or modifying a collective-bargaining agreement before rejection of that agreement has been approved by the Bankruptcy Court."[43]

In answering the first issue, a unanimous court rejected the NLRB's argument that Congress had adopted the stricter *REA Express* standard for rejecting collective bargaining agreements, i.e., that rejection is permitted only if essential to prevent liquidation, when it enacted § 365(a) of the Bankruptcy Code.[44] The *Bildisco* Court found that this standard is "fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code."[45] The Court agreed with the NLRB, however, that a "somewhat stricter standard" than the "traditional 'business judgment' standard" should be applied to collective bargaining agreements.[46]

The Court adopted the balancing of the equities test from *Kevin Steel*, stating that the bankruptcy court should permit rejection under § 365(a) if the debtor can show that both the "agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."[47] The Court added that the bankruptcy court only should act after it is persuaded that reasonable efforts to negotiate a voluntary agreement are not likely to result in a satisfactory solution as required by the NLRA.[48] Should the bankruptcy court then find that it needs to step into the process, it must make a reasoned finding on the record that the policy of Chapter 11, to permit successful rehabilitation of debtors, would be served by permitting rejection.[49] In making its finding, the court is to consider the interests of all the "affected parties – the debtors, creditors, and employees."[50] "The Bankruptcy Court must consider the likelihood and consequences of liquidation for the debtor absent rejection [of the collective bargaining agreement;] the reduced value of the creditors' claims that would follow" from affirming of the agreement;

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42. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 516 (1984).
43. *Bildisco*, 465 U.S. at 516.
44. *See id.* at 525.
45. *Id.*
46. *Id.* at 523-24 (quoting *Group of Institutional Investors*, 318 U.S. at 550).
47. *Id.* at 526.
48. *See id.*
49. *See Bildisco*, 465 U.S. at 527.
50. *Id.*

the hardship that affirming the agreement would impose on the creditors; and the impact felt by employees of rejecting the agreement.[51]

On the second issue – whether a debtor-in-possession commits an unfair labor practice by unilaterally terminating or modifying a collective bargaining agreement before the bankruptcy court has approved rejection of the agreement – the Court split five to four.[52] The majority, rejecting the NLRB's argument to the contrary, held that a debtor who unilaterally rejects or changes the terms of the collective bargaining agreement does not commit an unfair labor practice in violation of sections 8(a)(5) and 8(d) of the NLRA.[53]

Recognizing that the fundamental purpose of Chapter 11 is to prevent liquidation of the debtor, and with it, an attendant loss of jobs, the Court reasoned that the "authority to reject an executory contract is vital to the basic purpose of a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization."[54] Further, the Court reasoned that accepting the NLRB's position that rejection violates Sections 8(a)(5) and 8(d) of the NLRA would undermine any benefit the debtor obtains, under the bankruptcy code, by its authority to reject the contract.[55]

C. Congress' Reaction – The Passage of § 1113

The second part of the *Bildisco* decision, allowing debtors to unilaterally reject collective bargaining agreements, raised the ire of labor. Labor viewed the decision as giving a "new collective bargaining weapon" to employers.[56] Not surprisingly, labor turned to pro-labor members of Congress to address the matter.[57]

At the time of the *Bildisco* decision, Congress was addressing new bankruptcy legislation in the wake of the Supreme Court's decision in

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51. *Id.*
52. *See id.* at 535.
53. *See id.* at 533-34.
54. *Id.* at 528.
55. *See Bildisco*,465 U.S. at 529.
56. Peter B. Brandow, *Rejection of Collective Bargaining Agreements in Bankruptcy: Finding a Balance in 11 U.S.C. § 1113*, 56 FORDHAM L. REV. 1233, 1242 (1988) (quoting *Oversight Hearing on Effect of Bankruptcy Actions on the Stability of Labor-Management Relations and the Preservation of Labor Standards: Joint Hearing Before the Subcomm. on Labor-Mgmt. Relations and Subcomm. on Labor Standards of the Comm. on Educ. and Labor*, 98th Cong. 1 (1983) (statement of Rep. William Clay, Chairman, Subcomm. on Labor-Mgmt. Relations)).
57. *See id.*

Northern Pipeline Construction Co. v. Marathon Pipe Line Co.[58] As part of the House of Representatives version of the 1984 Bankruptcy Amendments, a bill was proposed which would require a debtor to obtain court approval before rejecting a collective bargaining agreement – much like the strict standard for rejection adopted by the Second Circuit in *REA Express.*[59]

The House proposal received little enthusiasm in the Senate, however, where two competing proposals were offered. One proposal, offered by Senator Strom Thurmond, adhered to the standard articulated in the *Bildisco* decision but added a thirty-day waiting period, beginning when the motion to reject the agreement was filed, to permit the bankruptcy court to conduct a hearing on the matter.[60] The other proposal, offered by Senator Robert Packwood, required the debtor to propose only those minimum modifications necessary for reorganization and required the "bankruptcy courts to make a substantive determination that the balance of the equities clearly favored rejection."[61] After debate, a compromise bill was agreed upon, resulting in what is now § 1113.[62] This section was passed and signed into law as a part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.[63]

D. Textual Analysis of § 1113

Essentially, the elements of § 1113 are as follows: after filing its petition, and before filing its application seeking rejection of the collective bargaining agreement, the debtor-in-possession, or Trustee, "shall" make a proposal to the union of "those *necessary* modifications in the employees [sic] benefits and protections that are *necessary* to permit the reorganization of the debtor."[64] Additionally, the proposal must assure that "all creditors, the debtor, and all . . . affected parties are treated fairly and equitably,"[65] and provide the

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58. *See id.* at 1242 n.77 (citing N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982)). The Court held that Congress' grant of jurisdiction to non-Article III judges in the Bankruptcy Reform Act of 1978 to address all bankruptcy matters was a violation of Article III of the Constitution. *See N. Pipeline Constr. Co.*, 458 U.S. at 87-88. In the interim after the *Northern Pipeline* decision, Congress passed emergency legislation to allow the bankruptcy courts to function until new legislation could be passed. *See* Nichols, *supra* note 40, at 983. This emergency legislation was about to expire, so there was some urgency to pass new bankruptcy legislation. *See id.*

59. *See* Brandow, *supra* note 56, at 1242-43.

60. *See id.*

61. *Id.* at 1244-45.

62. *See id.*

63. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 541(a), 98 Stat. 333, 390 (codified as amended at 11 U.S.C.§ 1113 (1994)).

64. 11 U.S.C. § 1113(b)(1)(A) (1994) (emphasis added).

65. *Id.*

union with enough relevant information for the union to evaluate the proposal.[66] The debtor then must meet with the union at reasonable times to confer, in good faith, in an attempt to reach mutually satisfactory modifications of the agreement.[67]

According to § 1113(c), to approve rejection of the collective bargaining agreement, the court must, after notice and hearing, make three findings. First, the court must find that the debtor has fulfilled the requirements just discussed.[68] Second, the court must find that the union has refused to accept the debtor's proposal without good cause.[69] Third, the court must find that "the *balance of the equities* clearly favors rejection."[70]

The procedural aspects of § 1113 are contained in § 1113(d). The court is required to hold a hearing on the application for rejection within fourteen days after the application is filed,[71] and must issue a ruling within thirty days thereafter.[72] If no ruling is made within the thirty days, the debtor may terminate or alter any provisions of the agreement pending the ruling.[73] This section is problematic because it creates the issue of whether a debtor acting unilaterally under this section commits an unfair labor practice if the motion to reject is overruled later, or if the debtor will be liable for unpaid wages and benefits if the court does not permit rejection. The general view seems to be that the debtor should not be penalized by the NLRA or the Bankruptcy Code when acting in reliance on this section.[74]

A debtor may be granted interim relief to modify the "terms, conditions, wages, benefits, or work rules" provided in the agreement upon showing that such modification is "*essential* to the continuation of the debtor's business or . . . to avoid irreparable damage to the estate."[75] This appears to be the middle ground between the *Bildisco* opinion, which held that a debtor does not commit an unfair labor practice by unilaterally rejecting the collective bargaining agreement prior to receiving court approval, and the argument that the debtor must show that its existence would be threatened by forcing its compliance with the agreement.[76]

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66. *See* 11 U.S.C. § 1113(b)(1)(B).
67. *See* 11 U.S.C. § 1113(b)(2).
68. *See* 11 U.S.C. § 1113(c)(1).
69. *See* 11 U.S.C. § 1113(c)(2).
70. 11 U.S.C. § 1113(c)(3) (emphasis added).
71. *See* 11 U.S.C. § 1113(d)(1).
72. *See* 11 U.S.C. § 1113(d)(2).
73. *See id.*
74. *See* 7 COLLIER ON BANKRUPTCY ¶ 1113.05[4] (Lawrence P. King, ed., 15th ed., rev. 2001) [hereinafter COLLIER].
75. 11 U.S.C. § 1113(e) (emphasis added).
76. *See* COLLIER, *supra* note 74, ¶ 1113.04.

Lastly, a debtor is flatly prohibited from rejecting or modifying any provisions of the collective bargaining agreement without first complying with the provisions of § 1113.[77] In practical terms, this means that the existing collective bargaining agreement remains in effect until such time as any relief may be granted by the court. Thus, the debtor remains obligated to pay wages and benefits at the levels specified in the collective bargaining agreement, and failure to meet these obligations will be a violation of § 1113, not merely a breach of the agreement.[78]

Under § 1113, the rehabilitative goals of the Bankruptcy Code prevail over the policies of labor law. A debtor-in-possession remains bound as an "employer" under the NLRA, and must comply with its provisions, including the requirement to bargain collectively, but rejection of the collective bargaining agreement will not be an unfair labor practice if the debtor complies with the requirements of § 1113.[79]

E. The Basic Framework for § 1113 Analysis

Given its tortured beginnings and unclear language,[80] as well as the speed of its enactment and lack of legislative history,[81] it is not surprising that courts have differed on how to interpret § 1113. Section 1113 contains both procedural and substantive requirements that must be met before a debtor may reject the collective bargaining agreement.[82] While the procedural requirements of § 1113 seem plain enough, the vagueness of the language in the substantive requirements of § 1113(b), (c), and (e) creates interpretive difficulties for the courts.[83] More particularly, the rub lies in the "necessary" standard of § 1113(b)(1)(A), and it is interpretation of this standard that has created the most difficulty for courts in determining under what circumstances a debtor may reject its collective bargaining agreement.[84]

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77. *See* 11 U.S.C. § 1113(f).

78. *See* COLLIER, *supra* note 74, ¶ 1113.03.

79. *See id.* ¶ 1113 [1]-[2].

80. Terms in the statute that appear without definition include: "necessary" and "fairly and equitably" in § 1113(b)(1)(A); "in good faith" in § 1113(b)(2); "without good cause" in § 1113(c)(2); "balance of the equities" in § 1113(c)(3); and "essential" in § 1113(e). 11 U.S.C. § 1113.

81. *See* COLLIER, *supra* note 74, ¶ 1113.LH. No committee reports accompanied either the House version (H.R. 5174) or the Senate version, nor are there any statements of cosponsors of the House Conference Report. The result has been that courts have had to look to statements made at hearings. *See id.* (citing 130 CONG. REC. H7496, S8888, S8892, S8899, S8900 (daily ed. June 29, 1984)).

82. *See* 11 U.S.C. § 1113(a); *see also* COLLIER, *supra* note 74, ¶ 1113.01.

83. *See supra* note 80.

84. *See* 11 U.S.C. § 1113. Section 1113(b)(1)(A) states:

One of the earliest decisions under § 1113, decided precisely five months after § 1113 was signed into law, is *In re American Provision Co.*,[85] where the debtor sought to reject two agreements to which it was a party. In a much-cited comment, the *American Provision* court noted that "[w]hile § 1113 is not a masterpiece of draftsmanship," it imposes nine requirements for court approval of collective bargaining agreements:

1. The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement.
2. The proposal must be based on the most complete and reliable information available at the time of the proposal.
3. The proposed modifications must be necessary to permit the reorganization of the debtor.
4. The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.
5. The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal.
6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union.
7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.
8. The Union must have refused to accept the proposal without good cause.
9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.[86]

The majority of courts that have ruled on this issue have adopted the nine *American Provision* requirements.[87] Other courts follow the three-part test created by a literal reading of § 1113(c).[88] The distinction is one without difference, since the first part of the § 1113(c) test incorporates by reference

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(b)(1) Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall –

(A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees [sic] benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably.

11 U.S.C. § 1113(b)(1)(A).

85. 44 B.R. 907 (Bankr. D. Minn. 1984).

86. *In re* Am. Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984) (citation omitted).

87. *See* Brandow, *supra* note 56, at 1246; Nichols, *supra* note 40, at 990.

88. *See In re* Royal Composing Room, Inc., 62 B.R. 403 (Bankr. S.D.N.Y. 1986), *aff'd on other grounds*, 78 B.R. 671 (S.D.N.Y. 1987).

the requirements of § 1113(a) and (b), and these requirements account for the additional six parts of the *American Provision* test. The problem, however, is that neither test answers the question that has vexed the courts since the inception of § 1113, namely: What is the meaning of the requirement that modification or rejection of the agreement be "necessary" to reorganization?[89]

III. COMPETING JUDICIAL APPROACHES TO INTERPRETING THE "NECESSARY" REQUIREMENT OF § 1113

Lower courts have taken two different approaches to determining when modification or rejection of a collective bargaining agreement is necessary to the debtor's reorganization. The approach most favorable to unions and employees is the approach of the Third Circuit, which is that modification or rejection is only necessary if the alternative is the debtor's immediate liquidation. The approach most favorable to debtors and creditors is the approach of the Second Circuit, which focuses on the debtor's long-term goal of successful reorganization.

A. The Third Circuit's "Immediate Liquidation" Approach

In *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers*,[90] the Third Circuit reversed the district and bankruptcy courts' approval of the company's rejection of the existing collective bargaining agreement with the union, finding that the bankruptcy court had improperly determined that the debtor's rejection of the agreement was necessary to the debtor's successful reorganization.[91] Acknowledging that the bankruptcy court had correctly recognized the question to be not whether the company "*can* continue to pay the $21.40 rate required by the current collective bargaining agreement," but rather "whether it is *necessary* for Wheeling-Pittsburgh to pay the $15.20 rate found in its proposal in order to successfully reorganize," the court stated that under the substantive standard of § 1113, the bankruptcy court must decide whether the company has shown that *any* modifications are necessary.[92]

The court held that, under the correct interpretation of the "necessary" standard, a debtor may propose only those modifications which are essential

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89. *See Am. Provision*, 44 B.R. at 910.

90. 791 F.2d 1074 (3d Cir. 1986).

91. *See* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074, 1091 (3d Cir 1986).

92. *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1085 (emphasis removed and emphasis added).

to permit reorganization.[93] In so doing, the court, noting the absence of the usual Committee Reports, looked to "contemporaneous remarks of the conferees" and found that the "necessary" provision of § 1113 was based on Senator Packwood's proposal that allowed only minimum modifications in the employees' benefits and protections that would permit reorganization.[94] The court found that the inquiry into whether the debtor's proposal provides for those "necessary modifications . . . that are necessary to permit . . . reorganization"[95] has two aspects. The first is "how necessary" the proposed modification must be; the second is "necessary to what?"[96]

In deciding how necessary the modification must be before it can be permitted under § 1113, the court stated that the standard "cannot be satisfied by a mere showing that it would be desirable for the [debtor] to reject a prevailing labor contract so that the debtor can lower its costs."[97] Rather, the court stated, the necessity must be "directly related" to the company's financial condition and reorganization.[98] Moreover, in making the second inquiry, the language that the debtor may propose only these modifications "necessary to permit . . . reorganization" places the emphasis on the short-term goal of preventing the company's liquidation, not the long-term issue of the debtor's ultimate future.[99] Thus, under the Third Circuit's interpretation, a court may approve any proposed modification under § 1113 only where the company can show that, absent approval of the modification or rejection of the existing collective bargaining agreement, the company would face imminent liquidation.[100]

B. The Second Circuit's "Successful Reorganization" Approach

Conversely, the Second Circuit in *Truck Drivers Local 807, International Brotherhood of Teamsters v. Carey Transportation, Inc.*[101] rejected the union's argument that the correct reading of § 1113 was that of the Third Circuit in *Wheeling-Pittsburgh.*[102] Instead, the Second Circuit found the "necessary" requirements in § 1113 to be more flexible in determining

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93. *See id.* at 1088.
94. *Id.* at 1086-87.
95. 11 U.S.C. § 1113(b)(1)(A) (1994).
96. *Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1088.
97. *Id.*
98. *See id.*
99. *Id.* at 1089.
100. *See id.*
101. 816 F.2d 82 (2d Cir. 1987).
102. *See* Truck Drivers Local 807, Int'l Bhd. of Teamsters v. Carey Transp. Inc., 816 F.2d 82, 89-90 (2d Cir. 1987).

whether a debtor is permitted to modify or reject the existing collective bargaining agreement.[103] In affirming the district court's judgment upholding the bankruptcy court's approval of the company's rejection of its collective bargaining agreements, the Second Circuit disagreed with the Third Circuit's reading of § 1113's legislative history and found instead that Congress had not adopted the "minimum modifications" language proposed by Senator Packwood.[104] This would suggest, the court found, that "necessary" should *not* be equated with "essential" or "bare minimum."[105] The court reasoned that an interpretation equating "necessary" with "essential" or "bare minimum" would be unworkable, since under § 1113's requirement that a debtor negotiate in good faith over the proposed modifications, a debtor who proposed only minimal changes would have no room for good faith negotiating, and a debtor who proposed substantive changes to the agreement would not be able to prove that its initial proposals were minimal.[106] The court further found that the Third Circuit did not adequately consider the provisions in § 1113(e), which permit a debtor seeking only short-term relief from the terms of a collective bargaining agreement to obtain "interim changes in the terms, conditions, wages, benefits, or work rules" in the agreement if essential to continuation of the debtor's business.[107]

Under the Second Circuit's interpretation of § 1113, the focus is not on preventing liquidation, but rather on enabling the debtor to complete reorganization.[108] The court's holding is best presented in its own words: "In sum, we conclude that the necessity requirement places on the debtor the burden of proving that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully."[109]

In addition to analyzing the necessity requirement, the *Truck Drivers Local 807* court also analyzed the "balance of the equities" requirement that is found in § 1113(c)(3) and part nine of the *American Provision* test.[110] The *Truck Drivers Local 807* court listed six equitable factors which it drew from *Bildisco* and other cases.[111] The six factors are:

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103. *See Truck Drivers Local 807*, 816 F.2d at 88-89.
104. *See id.* at 89.
105. *See id.*
106. *See id.*
107. *Id.* (quoting 11 U.S.C. § 1113(e)).
108. *See id.* at 90.
109. *Truck Drivers Local 807*, 816 F.2d at 90.
110. *See id.*
111. *See id.* at 93.

> (1) the likelihood and consequences of liquidation if rejection is not permitted; (2) the likely reduction in the value of creditors' claims if the bargaining agreement remains in force; (3) the likelihood and consequences of a strike if the bargaining agreement is voided; (4) the possibility and likely effect of any employee claims for breach of contract if rejection is approved; (5) the cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry; and (6) the good or bad faith of the parties in dealing with the debtor's financial dilemma.[112]

What we are left with then is two interpretations of § 1113(b)(1)(A). The first is the *Wheeling-Pittsburgh* standard, that the debtor may propose only those modifications which are essential to prevent immediate liquidation.[113] The second is the *Truck Drivers Local 807* standard, that the "necessary" requirement focuses instead on the long-term goal of the debtor's successful reorganization.[114]

IV. INTERPRETATION OF § 1113 IN THE SIXTH CIRCUIT

The Sixth Circuit Court of Appeals has not yet addressed the issue of what is the correct interpretation of § 1113 when applied to rejection of a collective bargaining agreement, though it peripherally addressed § 1113 in *United Steelworkers v. Unimet Corp. (In re Unimet Corp.)*,[115] where it held that § 1113 protects the interest of retirees under a collective bargaining agreement.[116] Like the circuit courts generally, the bankruptcy courts within the Sixth Circuit are themselves split on the proper interpretation of § 1113. Of the seven most widely cited bankruptcy cases on this issue within the Sixth Circuit, five expressly adopt the nine-part *In re American Provision Co.* standard,[117] while two follow the language of § 1113 itself.[118]

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112. *Id.*

113. *See Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1089.

114. *See Truck Drivers Local 807*, 816 F.2d at 90.

115. 842 F.2d 879 (6th Cir. 1998).

116. *See* United Steelworkers v. Unimet Corp. (*In re* Unimet Corp.), 842 F.2d 879, 885-86 (6th Cir. 1988).

117. *See In re* Sun Glo Coal Co., 144 B.R. 58, 62 (Bankr. E.D. Ky. 1992) (finding courts have historically applied the nine-part test of *American Provision*, and further finding the Second Circuit's interpretation of the "necessary" provisions of § 1113 in *Truck Drivers Local 807* to be the correct standard for interpretation of § 1113); *see also In re* Blue Diamond Coal Co., 131 B.R. 633, 643 (Bankr. E.D. Tenn. 1991); *In re* Amherst Sparkle Mkt. Inc., 75 B.R. 847, 849 (Bankr. N.D. Ohio 1987); *In re* Walway Co., 69 B.R. 967, 972 (Bankr. E.D. Mich. 1987); *In re* Ky. Truck Sales, Inc., 52 B.R. 797, 800 (Bankr. W.D. Ky 1985).

118. *See In re* Valley Kitchens, Inc., 52 B.R. 493 (Bankr. S.D. Ohio 1985); *In re* Allied Delivery Sys. Co., 49 B.R. 700 (Bankr. N.D. Ohio 1985).

This part begins by discussing how Sixth Circuit bankruptcy courts have applied the nine-part *American Provision* test. This is important because it illustrates the general approach that Sixth Circuit bankruptcy courts take to § 1113 cases. This part next turns to the split of authority within Sixth Circuit bankruptcy courts on how the "necessary to reorganization" language of § 1113 should be interpreted. Finally, this Part recommends that the Sixth Circuit – and ultimately the Supreme Court – adopt the "successful reorganization" approach to the "necessary to reorganization" issue *and* the *Truck Drivers Local 807* six-factor approach to balancing the equities.

A. The *American Provision* Standard

Within the Sixth Circuit, illustration of the *American Provision* standard is best expressed by the bankruptcy court in *In re Kentucky Truck Sales, Inc.*[119] There, the company was in the business of selling, leasing and servicing trucks and was a party to a collective bargaining agreement with the General Drivers Warehousemen and Helpers Union, Local No. 89.[120] After experiencing financial difficulties, the company approached the union with proposed modifications to the agreement.[121] The union agreed to several concessions, but ultimately the company filed for protection under Chapter 11 and subsequently met several times with the union in an effort to negotiate additional modifications to the agreement.[122] Specifically, the company's proposal called for: (1) a ten to twelve percent cut in worker's pay; (2) a change in the worker's health insurance coverage; (3) reducing paid vacation time; (4) eliminating one paid holiday; and (5) no increase in the debtor's contribution to the union's pension fund.[123] According to an outside accountant, these changes would result in savings of about $100,000 per year.[124]

The union rejected the proposed modifications and the debtor filed a motion under § 1113 to reject the collective bargaining agreement.[125] After noting that the debtor bears the burden of persuasion by a preponderance of the evidence and that once the burden is met it shifts to the union to produce evidence contradictory to the debtor's compliance with one or more of these elements, the court proceeded to apply the nine requirements of *American Provision* as follows:[126]

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119. 52 B.R. 797 (Bankr. W.D. Ky. 1985).
120. *See Ky. Truck Sales*, 52 B.R. at 798-99.
121. *See id.* at 799.
122. *See id.*
123. *See id.* at 799-800.
124. *See id.*
125. *See id.*
126. *See Ky. Truck Sales*, 52 B.R. at 800-01.

1. *"The debtor . . . must make a proposal to the union to modify the collective bargaining agreement."*[127]

Here, the debtor met several times with the union attempting to modify the existing agreement.[128] While no settlement was reached, the court nonetheless held that this provision was satisfied because the debtor submitted several proposals for modification.[129]

2. *"The debtor . . . must meet at reasonable times with the union prior to the date of the § 1113 hearing."*[130]

Here, the debtor met with union representatives on four separate occasions prior to the hearing to discuss modifications.[131]

3. *"[T]he debtor must bargain in good faith with the union in attempting to reach mutually satisfactory modifications of the . . . agreement."*[132]

Here, although the union contested the debtor's good faith, the court found that Congress did not intend bankruptcy courts to interpret the "good faith" element in terms of compliance with labor law precedent, but rather that the good faith requirement is satisfied under § 1113 by the debtor's showing that it has attempted seriously to negotiate reasonable modifications.[133] On the major issues of health care benefits and salary reductions, the court found that the parties were unable to reach a compromise because of differing interests, not lack of good faith.[134]

4. *"The proposals made by the debtor . . . must be based on the most complete and reliable information available at the time."*[135]

The parties did not dispute that the debtor's proposal was made on the most complete and reliable information available.[136]

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127. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(1)(A)).
128. *See id.*
129. *See id.* at 801.
130. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(2)).
131. *See id.* at 801.
132. *Ky. Truck Sales*, 52 B.R. at 800 (citing 11 U.S.C. § 1113(b)(2)).
133. *See id.* at 801.
134. *See id.* at 801-02.
135. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(1)(A)).
136. *See id.* at 801.

5. "*The proposed modifications must be necessary for the reorganization . . . .*"[137]

The company president testified that the proposed modifications "represented the minimum cost savings necessary to allow the debtor to successfully reorganize."[138] Also, an independent CPA testified that the proposed concessions were critical to the company's survival and that reduction of $100,000 per year in labor expenses was necessary for the debtor to show enough profit to meet current expenses and begin to reduce trade debt.[139] Moreover, the union did not affirmatively demonstrate that any of the debtor's proposed modifications were not necessary, nor did the union offer "evidence to rebut the debtor's showing of the necessity [for] a major reduction in labor costs in order to successfully reorganize."[140]

6. "*The proposed modifications must assure that all creditors, the debtor, and all other affected parties are treated fairly and equally.*"[141]

"[T]he evidence show[ed] that the proposed reductions in wages and benefits [were] not disproportionate to . . . concessions already made by the debtor's clerical and management employees."[142] The debtor's nonunion employees had received no salary increases, had limited paid vacation days, and also had their health insurance coverage changed.[143] Moreover, the proposed modifications did not impose a greater burden on the union than on any other creditors, and the union presented no evidence to the contrary.[144] Finally, the debtor's principal owner also made concessions.[145] Although the owner owned the building that the debtor used for its business, and the owner leased it to the debtor for a profit, the court found that the owner was not taking unfair advantage of the debtor.[146] The court held that while transactions between the controlling shareholder and the corporation are subject to close scrutiny, they are not per se invalid, so the court found that this element was met.[147]

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137. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(1)(A)).
138. *Ky. Truck Sales*, 52 B.R. at 802.
139. *See id.*
140. *Id.*
141. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(1)(A)).
142. *Id.* at 802-03.
143. *See id.* at 803.
144. *See Ky. Truck Sales*, 52 B.R. at 803.
145. *See id.*
146. *See id.*
147. *See id.* at 803-04.

7. "*The debtor must provide to the union such relevant information as is necessary to evaluate the proposal.*"[148]

Although the information was at times late in reaching the union, all delays were attributable to putting the information in usable form.[149]

8. "*The union must have refused to accept the debtor's proposal without good cause.*"[150]

The court held that it would review the union's rejection using an objective standard, narrowly construing "without good cause" in light of the main purpose of Chapter 11 – reorganization of financially distressed businesses.[151] Applying this standard, the court found that "the main reason behind the union's rejection of the . . . proposal . . . was due to a [union] policy determination that the union could not . . . negotiate away the medical coverage provided by its Health and Pension Fund."[152] Though the court found that the union's position was not unreasonable, the court also found that it did not constitute "good cause" to reject the debtor's proposal.[153]

9. "*The balance of the equities must clearly favor [the] agreement.*"[154]

The court pointed out that the Supreme Court in its *NLRB v. Bildisco & Bildisco*[155] decision stated that this balancing of the equities must focus on the ultimate goal of Chapter 11 – reorganization of the debtor.[156] Under this standard, rejection of the present collective bargaining agreement would give this debtor a chance to rehabilitate itself.[157] The debtor clearly has shown that even after all non-labor cost reductions it is still losing money.[158] Thus, the debtor has met its burden.[159]

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148. *Id.* at 800 (citing 11 U.S.C. § 1113(b)(1)(B)).
149. *See id.* at 804.
150. *Ky. Truck Sales*, 52 B.R. at 800 (citing 11 U.S.C. § 1113(c)(2)).
151. *See id.* at 804 (citing *In re* Salt Creek Freightways, 47 B.R. 835, 840 (Bankr. D. Wyo. 1985)).
152. *Id.* at 805.
153. *See id.*
154. *Id.* at 800 (citing 11 U.S.C. § 1113(c)(3)).
155. 465 U.S. 513 (1984).
156. *See Ky. Truck Sales*, 52 B.R. at 804 (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984)).
157. *See id.* at 806.
158. *See id.* at 807.
159. *See id.*

The court then sustained the debtor's motion to reject the agreement, but not before pointing out that the status of the union as representative of the employees is unchanged, that the employees retain their right to strike, that the debtor remains obligated to bargain in good faith with the union, and that the debtor is obligated to operate its business in a fair and commercially responsible manner.[160]

Though a number of the bankruptcy courts within the Sixth Circuit have adopted the nine-part *American Provision* standard,[161] it is not clear whether this accommodates the competing interests of both labor and bankruptcy any more than any other standard thus far suggested. For example, after specifically adopting the nine-part test, the bankruptcy court in *In re Blue Diamond Coal Co.*[162] found the fundamental issue to be whether the proposed modifications were "necessary" to the debtor's *reorganization.*[163] The court went on to add that it need not concern itself with the differing interpretations of "necessary."[164] This clearly would seem to favor the debtor's interests over those of labor.

This imbalance in favor of the debtor was widened further when the court went on to address the "balance of the equities" prong of the nine-part test.[165] Citing the Supreme Court's *Bildisco* decision, the bankruptcy court in *Blue Diamond Coal* found the primary question in a balancing test to be the effect rejection will have on the debtor's prospect for *reorganization.*[166] The court's focus in balancing the equities therefore was on the interests of reorganization, not the interests of labor.

The *Kentucky Truck Sales* court's use of the *American Provision* standard is illustrative of the approach that many courts, both inside and outside the Sixth Circuit, have taken. Courts applying *Amercian Provision* blindly avoid the difficult question concerning the meaning of the "necessary" language of § 1113.[167] These decisions do little to reconcile the competing labor and bankruptcy interests because the rote application of the *American Provision* standard invariably favors the debtor's interests.

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160. *See id.*
161. *See supra* note 117.
162. 131 B.R. 633, 644 (Bankr. E.D. Tenn. 1991).
163. *See Blue Diamond Coal*, 131 B.R. at 644.
164. *See id.* (finding that proposed modification was essential to debtor's reorganization).
165. *See id.* at 647-48.
166. *See id.* at 644 (discussing *Bildisco*, 465 U.S. at 527).
167. *See* 11 U.S.C. § 1113(b)(1)(A).

B. Differing Approaches to the "Necessary to Reorganization" Requirement

Several bankruptcy courts within the Sixth Circuit have broken out of the *American Provision* mold and directly considered the meaning of the "necessary to reorganization" language in § 1113. Like the circuit courts generally, these Sixth Circuit bankruptcy courts differ on how the "necessary" requirement of § 1113(b)(1)(A) should be interpreted.

In *In re Valley Kitchens, Inc.*,[168] the Bankruptcy Court for the Southern District of Ohio found that Congress intended a narrow reading of the statute.[169] The court relied on legislative history and the comments of Senator Packwood in finding support for its conclusions.[170] In denying the debtor's motion to reject the collective bargaining agreement, the court found that the debtor's proposal did not contain only those provisions which are necessary to its reorganization and said there was no need to go further in the application of § 1113.[171] This interpretation appears to be similar to the Third Circuit's "immediate liquidation" approach in *Wheeling-Pittsburgh Steel Corp. v. United Steelworks*,[172] though the *Valley Kitchens* court did not explicitly refer to *Wheeling-Pittsburgh Steel*.[173]

Most bankruptcy courts within the Sixth Circuit, however, have interpreted § 1113 to be consistent with the Second Circuit's "successful reorganization" approach. For example, in *In re Allied Delivery System Co.*,[174] the Bankruptcy Court for the Northern District of Ohio, Eastern Division found that the "necessary" language of § 1113 must be read as a term of lesser degree than "essential."[175] After reviewing the legislative history, the court found that Congress had considered, but rejected, a test akin to "essential."[176] The court granted the debtor's motion to reject the agreement, finding that the modifications proposed by the company would have substantially reduced the company's labor costs and that such a reduction was "absolutely required" if

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168. 52 B.R. 493 (Bankr. S.D. Ohio 1985).
169. *See Valley Kitchens*, 52 B.R. at 497.
170. *See id.*
171. *See id.* at 496.
172. 791 F.2d 1074 (3d Cir. 1986).
173. *See Valley Kitchens*, 52 B.R. at 493.
174. 49 B.R. 700 (Bankr. N.D. Ohio 1985).
175. *See Allied Delivery Sys. Co.*, 49 B.R. at 702.
176. *See id.*

the debtor was to reorganize.[177] This decision seems analogous to the Second Circuit's "necessary to successful reorganization" approach. Other bankruptcy courts within the Sixth Circuit have similarly interpreted § 1113 consistently with the "successful reorganization" approach.[178]

V. EVALUATION OF THE COMPETING APPROACHES AND RECOMMENDATIONS

We believe that the Second Circuit's "successful reorganization" approach is the correct interpretation of the "necessary" requirement in § 1113(b)(1)(A). By itself, however, this approach does not adequately accommodate the policies of the NLRA. For this reason, we believe that courts also should adopt the Second Circuit's six-factor approach to the "balance of the equities" requirement found in § 1113(c)(3).

A. The Third Circuit's "Immediate Liquidation" Approach

The Third Circuit's "immediate liquidation" approach in some ways undercuts, rather than aids, the policy of the NLRA favoring negotiation of collective bargaining agreements.[179] This is so for two reasons. The first involves the requirement that the debtor propose only the "bare minimum" modifications that are necessary to avoid liquidation.[180] If the employer complies with this requirement, then there is no room left for negotiation, and little or no bargaining is likely to occur, since the union must essentially accept or reject a take-it-or-leave-it offer. This creates an incentive for the employer to propose more than the bare minimum, but even so, the employer's ability to bargain is handcuffed because bargaining might be seen as an admission that the original proposal was for more than the bare minimum. One effect of the immediate liquidation approach, therefore, is to impede the

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177. *See id.* Specifically, the court found that the debtor's proposal, which was rejected by the union, to cut a higher percentage of wages of union employees than of nonunion employees, was necessary to reorganization where somewhere between eighty-seven and one hundred percent of the debtor company's gross revenues were required to pay union labor costs. *See id.*

178. *See, e.g., Sun Glo Coal Co.*, 144 B.R. at 63 (citing *Truck Drivers Local 807*, 816 F.2d 82) (finding the Second Circuit's interpretation of the "necessary" provisions of § 1113 in *Truck Drivers Local 807* to be the correct standard for interpretation of § 1113); *see also Amherst Sparkle Mkt., Inc.*, 75 B.R. at 851; *Walway Co.*, 69 B.R. at 973.

179. *See* National Labor Relations Act § 1, 29 U.S.C. § 151 (1994).

180. *See* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074, 1088 (3d Cir. 1986).

ability of the union and the debtor to bargain over modifications to the collective bargaining agreement.

The second way that the immediate liquidation approach can impede bargaining involves the Third Circuit's suggestion that proposals made by a debtor company may relate only to economic provisions of the agreement.[181] This approach prohibits the company from bringing to the table any of the noneconomic matters regularly present in collective bargaining agreements.[182] An employer may not, for example, propose modifications to the seniority system, unless those modifications directly affect the company's bottom line. From the union's perspective, this approach has the salutary effect of preventing a Chapter 11 employer from using reorganization as a tool to accomplish what the employer was not able to accomplish during negotiation of the collective bargaining agreement – i.e., to obtain terms more favorable to the employer. However, from the employer's and creditors' perspectives, this approach requires that the collective bargaining agreement be considered piecemeal, wages and benefits only, rather than as a whole, and precludes consideration of how a "noneconomic" subject of bargaining might affect the company's ability to survive in the long term. Moreover, if the employer includes any noneconomic changes in its proposal, the union simply may reject the proposal, secure in the knowledge that a bankruptcy court will find the debtor company has proposed an "unnecessary" modification.[183] By effectively taking these subjects off the bargaining table, the "immediate liquidation" approach disserves the NLRA policy of joint negotiation.

Likewise, the "immediate liquidation" approach fails to adequately serve the Bankruptcy Code's goal of the successful rehabilitation of debtors. Where the focus is placed only on the short-term goal of preventing liquidation and the debtor's long-term future is not considered in evaluating its proposed modifications, a reorganization that is likely to be successful over the long term would seem less likely. Noting this need to consider the debtor's future in evaluating its proposals, one bankruptcy court has said: "A debtor can live on water alone for a short time but over the long haul it needs food to sustain

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181. *See Wheeling-Pittsburgh Steel Corp.*, 791 F.2d at 1088. The court stated that "[t]he congressional consensus . . . requires that 'necessity' be construed strictly to signify only modifications that the trustee is constrained to accept because they are directly related to the Company's financial condition and its reorganization." *Id.*

182. A debtor would be prohibited from proposing such matters as hours, working conditions, seniority, grievance procedures and the like. *See* Richard L. Merrick, *The Bankruptcy Dynamics of Collective Bargaining Agreements*, 91 COM. L.J. 169, 198 n.121 (1986).

183. *See In re* Royal Composing Room, Inc., 62 B.R. 403, 407 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 671 (S.D.N.Y. 1987).

itself and retain its vigor."[184] Thus, it is unlikely that the approach adopted by the Third Circuit adequately accommodates the policies of either the NLRA or the Bankruptcy Code.

B. The Second Circuit's "Successful Reorganization" Approach

The Second Circuit's "successful reorganization" approach, with its focus on the debtor's long-term reorganization, does a much better job of furthering the long-term policy goal of the Bankruptcy Act, which is the successful rehabilitation of debtors.[185] The Second Circuit correctly recognized that § 1113 requires not only that the debtor prove its proposal is made in good faith,[186] a recognition of labor policy, but also requires that the debtor's proposed changes in the agreement be those which are necessary to allow its successful reorganization,[187] a recognition of bankruptcy policy. Moreover, the court recognized that if short term relief, with its focus on preventing immediate liquidation, is the only concern, then such relief is available to the debtor in § 1113(e).[188] Under the Second Circuit's approach, negotiation between the parties is more likely because it recognizes that if the debtor is permitted to propose only essential or bare minimum modifications, the debtor would have no further room for good faith negotiations.[189]

By itself, however, the successful reorganization approach gives relatively short shrift to the policies of the NLRA. Its focus is on the long-term health of the debtor, not on the interests of labor in enforcing an existing collective bargaining agreement, or in renegotiating a new one. For this reason, we believe that courts adopting the successful reorganization approach should also adopt the Second Circuit's six-factor approach to determining the balance of the equities.

C. Balancing the Equities

By using the Second Circuit's six-factor approach to determining the balance of the equities in conjunction with the Second Circuit's successful

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184. *Royal Composing Room*, 62 B.R. at 418.

185. *See supra* note 3 and accompanying text.

186. *See* Truck Drivers Local 807, Int'l Bhd. of Teamsters v. Carey Transp. Inc., 816 F.2d 82, 90 (2d Cir. 1987).

187. *See Truck Drivers Local 807*, 816 F.2d at 90.

188. *See id.* at 89. By invoking § 1113(e), a debtor may be permitted to make interim changes in the terms, conditions, wages, benefits or work rules provided in a collective bargaining agreement if essential to the continuation of the debtor's business. *See* 11 U.S.C. § 1113(e) (1994).

189. *See Royal Composing Room*, 62 B.R. at 418.

reorganization approach to interpreting the "necessary" requirement, bankruptcy courts will be better able to achieve an equitable recognition of both bankruptcy and labor policies and of management, labor, and creditor interests.

For example, the first *Truck Drivers Local 807* factor requires the court to consider not only the likelihood of liquidation if rejection is not permitted, but its consequences as well.[190] This would require the court to consider the effect of liquidation on the debtor company (a lost business), the employees (lost jobs), the creditors (claims now much less likely to be paid), and the surrounding community (impact on the economy and employment rates). The second factor examines the impact on the creditors if the collective bargaining agreement remains in force.[191] The third factor considers the "likelihood and consequences of a strike if the [collective] bargaining agreement is voided;"[192] this accommodates the NLRA policy of promoting industrial peace. The fourth factor examines the "possibility and likely effect of any employee claims for breach of contract if rejection is approved."[193] The fifth factor considers the cost-spreading abilities of all the various parties, and it explicitly takes into account the "number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry."[194] Finally, the sixth factor examines the relative "good or bad faith of the parties in dealing with the debtor's financial dilemma."[195]

These factors provide a methodology by which bankruptcy courts can achieve a true balance of the equities. They complement the "successful reorganization" approach by expanding the court's focus beyond the debtor to include employees covered by the collective bargaining agreement and the policies of the NLRA. Moreover, they do so without compromising the policy of the Bankruptcy Act, which is the long-term rehabilitation of debtors.[196]

CONCLUSION

The NLRA imposes an obligation to bargain collectively upon both the employer and the representative of the employees respecting terms and conditions of employment. The Bankruptcy Code allows a debtor company

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190. *See Truck Drivers Local 807*, 816 F.2d at 93.
191. *See id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*
196. *See supra* note 3 and accompanying text.

to reject or modify an existing collective bargaining agreement upon a showing that rejection or modification is necessary to the debtor's reorganization. The policy of the NLRA is to encourage good faith negotiations of the collective bargaining agreement; the policy of the Bankruptcy Code is to promote successful reorganization of the debtor.

The competing statutory provisions and policies create a strong need for a uniform standard to guide bankruptcy courts in their determinations of the circumstances under which a debtor company can reject or modify a collective bargaining agreement. Legislative and judicial efforts thus far have failed to provide such a standard.

Courts should adopt an expansive definition of the Bankruptcy Code's requirement that rejection or modification be "necessary;" further, courts should focus on the debtor's long-term rehabilitation rather than merely on the short-term avoidance of liquidation. However, courts should temper this focus on the debtor's interests by adopting a "balance of the equities" test that focuses more on the interests of labor in preserving the integrity of the collectively-bargained agreement. This approach accommodates not only the policies of the NLRA and the Bankruptcy Act, but also the interests of the debtor, the creditors, the employees covered by the collective bargaining agreement, and the community at large.