

This article was published in a slightly different form in the October 2008  
*Norton Annual Survey of Bankruptcy Law*

## Sections 1113 and 1114—Recent Developments in the Law Regarding the Rejection of Collective Bargaining Agreements and the Modification of Retiree Benefits

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The rejection of collective bargaining agreements or modification of retiree benefits under Bankruptcy Code §§ 1113 and 1114, respectively, were again of central importance in a number of airline cases. This article provides a brief overview of these cases as well as others that addressed Bankruptcy Code §§ 1113 and 1114 and clarified this area of the law.

### I. Overview Of Bankruptcy Code § 1113

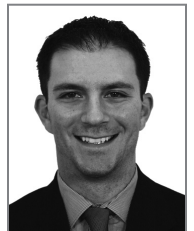
Bankruptcy Code § 1113 permits an employer in a Chapter 11 case to reject its prepetition collective bargaining agreements. A debtor must meet the substantive and procedural elements of this section before it will be permitted to reject a collective bargaining agreement. With respect to procedural requirements, § 1113 requires that before filing a motion to reject a collective bargaining agreement the debtor must serve each affected union with a proposal to modify its collective bargaining agreement that is based on the “most complete and reliable information available at the time of such proposal, which provides for “those necessary modifications in the employees benefits... that are necessary to permit the reorganization of the debtor.”<sup>1</sup> After serving its proposal, the

debtor must provide each union “with such relevant information as is necessary to evaluate the proposal.”<sup>2</sup> From the date that the proposal is first made until the time of the hearing, the debtor must meet with the union representative “at reasonable times... to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.”<sup>3</sup> After making the proposal, the debtor can file a motion to reject the collective bargaining agreement with the bankruptcy court.<sup>4</sup> There is no set period of time that must pass between making the proposal and filing the motion. The court must schedule a hearing on the debtor’s motion within 10 to 14 days after the motion is filed.<sup>5</sup>

With respect to the substantive requirements of Bankruptcy Code § 1113, the bankruptcy court will approve the rejection of the collective bargaining agreement only if: (i) rejection is “necessary” to the debtor’s ability to reorganize and “all creditors, the debtor, and all of the affected parties are treated fairly and equitably”; (ii) the debtor has made a proposal to the authorized representative who has refused to accept the proposal without “good cause”; and (iii) “the balance of the equities clearly favors rejection.”<sup>6</sup> Ultimately, § 1113 is designed to force the debtor-employer



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and its unionized labor constituencies to resolve their disputes by agreement by a process of goodfaith negotiations.<sup>7</sup>

Section 1113 was passed in 1984 in direct response to the Supreme Court's holding in *N.L.R.B. v. Bildisco and Bildisco*<sup>8</sup> that allowed a debtor to reject a collective bargaining agreement by showing that the collective bargaining agreement burdens the estate and that, after careful scrutiny, the equities balance in favor of rejecting the labor contract.<sup>9</sup> In addition, *Bildisco* held that the debtor was not required to engage in collective bargaining before modifying or rejecting provisions of the collective bargaining agreement and that such unilateral action did not constitute an unfair labor practice in contravention of the National Labor Relations Act (NLRA).<sup>10</sup> Section 1113 "replace[d] the *Bildisco* standard with one that was more sensitive to the national policy favoring collective bargaining agreements."<sup>11</sup> The statute ensures that a Chapter 11 debtor cannot unilaterally shed its labor obligations, and instead, mandates goodfaith negotiations with the union before rejection may be approved.

After enactment of § 1113, it was debatable whether the protection afforded under this section extended to retirees, and it was apparent that such protection did not extend to nonunion retirees.<sup>12</sup> Chapter 11 debtors took the position that the Bankruptcy Code did not authorize the postpetition payment of retiree health and life insurance benefits that were incurred prepetition and, therefore, discontinued or suspended the payments until court approval could be obtained.<sup>13</sup> After the LTV Corporation filed its Chapter 11 case on July 17, 1986, and suspended retirement benefits to 78,000 former employees, Congress began the process of amending the Bankruptcy Code and enacted § 1114 to protect the interests of retired employees.<sup>14</sup>

### II. Overview Of Bankruptcy Code § 1114

Section 1114 requires a debtor to timely pay and not modify any retiree benefits unless the court orders modification in accordance with § 1114 or unless the debtor and the retirees' authorized representative

agree to a modification.<sup>15</sup> The statutory requirements under § 1114 are virtually identical to those of § 1113.<sup>16</sup>

Section 1114 also requires that before filing an application to modify or terminate retiree benefits, the trustee (or debtor) shall make:

a proposal to the authorized representative of the retirees [the union or appointed committee], based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the retiree benefits 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.<sup>17</sup>

The debtor is also required to provide the representative of the retirees with "such relevant information as is necessary to evaluate the proposal."<sup>18</sup> From the date that the proposal is first made until the time of the hearing, the debtor must meet "at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such retiree benefits."<sup>19</sup> There is no set time period that must pass between making the proposal and filing the motion. The court must schedule a hearing on the debtor's motion within 14 days after the motion is filed.<sup>20</sup>

The bankruptcy court is required to enter an order providing for modification in the payment of retiree benefits if the court finds that: (1) the trustee has, prior to the hearing, made a proposal that fulfills the above requirements; (2) the authorized representative of the retirees has refused to accept such proposal without good cause; and (3) such modification is necessary to permit the reorganization of the debtor, assures that all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and is clearly favored by the balance of the equities.<sup>21</sup>

Section 1114 was added to the Bankruptcy Code as part of the Retiree Benefits Bankruptcy Protection Act of 1988 (Retiree Benefits Act), Pub.L. No.

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100-334 and provides the standards that must be followed before retiree benefits may be modified.<sup>22</sup> The Retiree Benefits Act was enacted by Congress in response to LTV Corporation's unilateral termination of the health and life insurance benefits of its retirees upon the commencement of its Chapter 11 bankruptcy.<sup>23</sup> Congress enacted this broad legislation to address the issue of a Chapter 11 debtor's obligation to continue paying retiree benefits during the pendency of the reorganization proceeding.<sup>24</sup> This legislation was meant "to ensure that the debtors did not seek to effect reorganization 'on the back of retirees' for the benefit of other parties in interest."<sup>25</sup> Section 1114 "provides a status quo safeguard during the plan negotiation process" and requires a debtor to continue timely paying retirement benefits in full unless modified in accordance with § 1114(e)(1)(A) or (B).<sup>26</sup>

### III. Case Law Developments—Bankruptcy Code § 1113

The following is a brief discussion of the significant cases from 2007 that expounded upon the procedural and substantive requirements of Bankruptcy Code § 1113.

#### A. Rejection of a Collective Bargaining Agreement Under Bankruptcy Code § 1113 Is an Abrogation of the Agreement Without Breach

Northwest Airlines, like many airlines that file for bankruptcy under Chapter 11, sought to modify its collective bargaining agreement (CBA) with certain of its employees.<sup>27</sup> Prior to company's Chapter 11 filing in September 2005, Northwest had been negotiating with its flight attendant's union and, unable to resolve the dispute, sought relief from the US Bankruptcy Court for the Southern District of New York to reject the CBA.<sup>28</sup> Judge Gropper granted the rejection and permitted Northwest to impose the terms of a previously proposed agreement that had been rejected by the flight attendants (the March 1 Agreement).<sup>29</sup> The flight attendants responded to this imposition by notifying Northwest of their intent to strike.<sup>30</sup> Northwest moved to enjoin the strike, and the bankruptcy court denied the motion on the basis that the rejection of the CBA was a

"unilateral action in changing the status quo that in turn free[d] the employees to take job action," such as a strike.<sup>31</sup> On appeal, the district court reversed the bankruptcy court's decision and granted the preliminary injunction.<sup>32</sup> The flight attendants appealed the district court's ruling to the Second Circuit Court of Appeals.<sup>33</sup>

The Second Circuit, in deciding an appeal from a preliminary injunction, noted at the outset that the "appeal turn[ed] on Northwest's likelihood of success on the merits"<sup>34</sup> and that the decision regarding whether the district court could enjoin the flight attendants' strike involved the interplay of three different statutes, Bankruptcy Code § 1113, the Railway Labor Act of 1926 (RLA),<sup>35</sup> and the Norris LaGuardia Act of 1932 (NLGA).<sup>36</sup> The NLGA deprives federal courts of jurisdiction to grant an injunction in a case involving a labor dispute, with limited exceptions;<sup>37</sup> however, the "NLGA does not preclude courts from enforcing the mandates of the RLA."<sup>38</sup> Under the RLA, parties are required to make every reasonable effort to resolve disputes before taking actions such as strikes.<sup>39</sup> However, as the flight attendants union argued, a union may be able to strike if the employer unilaterally alters the contractual status quo.<sup>40</sup> Therefore, the question before the Second Circuit was whether the rejection of the CBA under Bankruptcy Code § 1113 and the imposition of the new terms of the March 1 Agreement was a unilateral alteration of the status quo and whether such alteration would allow the flight attendants to strike under the RLA.

In deciding this issue, the Second Circuit first needed to determine the legal consequences of a rejection under Bankruptcy Code § 1113. The court stated that there were three possible outcomes:

- (1) Northwest abrogated the CBA in its entirety and replaced it with the March Agreement;
- (2) Northwest replaced certain terms of the CBA with the more favorable terms of the March 1 Agreement, but the CBA otherwise continued in force and Northwest did not breach it; or
- (3) Northwest replaced certain terms of the CBA with the more favorable terms of the March 1 Agreement, but the CBA otherwise continued in force and Northwest did breach it.<sup>41</sup>

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The Second Circuit held that the latter two interpretations “ignore[d] the unique purpose of § 1113.”<sup>42</sup> Unlike rejection under § 1113, when a contract is rejected under § 365, the contract remains in force, and the rejection permits nonperformance by the debtor, which merely constitutes a breach of the contract.<sup>43</sup> The Second Circuit distinguished rejection under Bankruptcy Code § 1113, stating that § 1113 “permits more than non-performance; it allows one party, with the court’s approval, to establish *new terms* that were not mutually agreed upon.”<sup>44</sup> The Second Circuit found a carrier’s obligation to comply with the new terms impossible to reconcile with the notion that the contract still existed because “[i]f a rejected CBA were to somehow remain in force (to whatever extent), a carrier’s adherence to a new, bankruptcy-court-approved contract would surely violate... the RLA.”<sup>45</sup> Given that Congress was aware of the RLA when it drafted Bankruptcy Code § 1113, the Second Circuit believed that Congress could not have intended for such a result.

The Second Circuit viewed § 1113 in connection with the RLA and Congress’s intent in enacting the statute. The Second Circuit noted that if rejection under § 1113 was a breach, as it would be under § 365, then the union may be free to strike, regardless of whether the carrier violated the RLA.<sup>46</sup> The problems associated with treating rejection of a CBA as a breach was the “impetus behind” the enactment of § 1113.<sup>47</sup> Section 1113 was enacted to permit CBA rejection in favor of alternative terms without fear of liability.<sup>48</sup> As such, the Second Circuit held that “Northwest, acting pursuant to the authority conferred to it by the bankruptcy court, *abrogated* its CBA.”<sup>49</sup>

Following the court’s holding that the CBA was abrogated, the court concluded that the status quo that had been established by the CBA was also terminated.<sup>50</sup> Therefore, the flight attendants could not base the strike on a change in the status quo created by the CBA.<sup>51</sup> Finally, the court held that rejection under § 1113 left intact the requirement under the RLA that the parties make reasonable effort to reach an agreement, and such a duty was independent of the status quo requirements.<sup>52</sup> While

Northwest’s rejection of the CBA was “necessary,” as required for rejection under § 1113, the flight attendants had not made the reasonable efforts required by the RLA to be permitted to strike.<sup>53</sup> As such, the Second Circuit affirmed the grant of the preliminary injunction.<sup>54</sup>

### **B. A Union Cannot Recover on a Claim for Damages for Breach of a Collective Bargaining Agreement Based on a Rejection of Such Agreement Under Bankruptcy Code § 1113**

In *In re Northwest Airlines Corp.*,<sup>55</sup> Judge Gropper was called on to build upon the Second Circuit’s ruling in *In re Northwest Airlines*<sup>56</sup> described above. The flight attendants’ union had filed proofs of claim for damages as a result of the debtor’s rejection of the collective bargaining agreement.<sup>57</sup> Prior to the Second Circuit’s ruling, “the question of damages for a § 1113 rejection order was an open one.”<sup>58</sup> Northwest argued that the proofs of claim should be expunged because Bankruptcy Code § 1113 does not provide for damages arising out of a rejection of a collective bargaining agreement.<sup>59</sup> The flight attendants responded by pointing to the lead-in sentence of § 1113, which refers to assumption or rejection, and that collective bargaining agreements should be viewed under the general provisions of § 365.<sup>60</sup>

Judge Gropper stated that the bankruptcy court may have considered this argument prior to the Second Circuit’s ruling; however, the Second Circuit opinion in *In re Northwest Airlines* “expressly excludes the possibility of damages for the lawful rejection of a collective bargaining agreement pursuant to § 1113.”<sup>61</sup> As discussed above, the Second Circuit held that rejection of a collective bargaining agreement under § 1113 abrogates the agreement without breaching the agreement. Judge Gropper, continuously referencing the Second Circuit’s opinion, followed the reasoning of the Second Circuit and held that the flight attendants’ “proofs of claim must be disallowed insofar as they seek general rejection damages as a consequence of the [rejection] order under § 1113.”<sup>62</sup>

In addition to the question regarding proofs of claim, the bankruptcy court was also faced with the

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question of whether changed facts subsequent to the entry of the rejection order under § 1113 allowed for reconsideration of such order.<sup>63</sup> The court stated that “there is no indication that a second § 1113 process is available under the statute.”<sup>64</sup> The court referenced the fact that the collective bargaining agreement was abrogated by the rejection order but went on further to state that even a § 365 rejection (breach) “is not a tentative step to be confirmed at a later stage of the bankruptcy case, but a final act that has immediate consequences.”<sup>65</sup> Additionally, the court stated that the debtor’s ability to formulate a feasible plan would be undermined if the § 1113 process could be restarted when economic conditions changed.<sup>66</sup> As such, the court concluded that changed conditions do not entitle reconsideration of a motion to reject a collective bargaining agreement under § 1113.

### C. An Order Granting Interim Relief Under Bankruptcy Code § 1113(e) Is Not a Final Order for Purposes of Appeal

It is well recognized that district courts have jurisdiction to hear appeals from final orders of bankruptcy judges and that such orders are appealable as a matter of right.<sup>67</sup>

The issue of whether an interim order under § 1113(e) constitutes a final order that may be appealed as of right was addressed by the district court in *In re Allied Holdings*.<sup>68</sup> At the outset of that case, Allied Holdings, Inc., the largest transporter of new motor vehicles in North America, sought and obtained debtor-in-possession (DIP) financing from a consortium of lenders.<sup>69</sup> In connection with the DIP financing, Allied provided projections of its expected results of operations during the 18-month term of the loan.<sup>70</sup> Shortly thereafter, Allied realized it was unable to meet its financial projections and breached the financial covenants that it had made in connection with its DIP financing.<sup>71</sup>

In an attempt to obtain alternative means of financial relief, Allied sought to negotiate with the Teamsters, the collective bargaining representatives for approximately 4800 of Allied’s employees,

for changes to the parties’ collective bargaining agreement pursuant to 11 U.S.C.A. § 1113(b).<sup>72</sup> However, the negotiations were not immediately successful, and faced with Allied’s perceived cash flow shortfall in July 2006, Allied filed an emergency motion seeking interim relief from its wage payment obligation due to its Teamsters employees.<sup>73</sup> Following an evidentiary hearing on the emergency motion, the bankruptcy court determined that Allied demonstrated that it required emergency relief to continue operating beyond July 30, 2006.<sup>74</sup> The bankruptcy court held that Allied satisfied the requirements of § 1113(e) and granted Allied’s request for interim relief.<sup>75</sup>

The Teamsters filed a motion for leave to appeal the bankruptcy court’s order with the US District Court for the Northern District of Georgia, arguing that it was improper for the bankruptcy court to enter interim relief under § 1113(e) because Allied had not filed an application to reject the collective bargaining agreement pursuant to Bankruptcy Code § 1113(b).<sup>76</sup> Specifically, the Teamsters contended that the bankruptcy court’s § 1113(e) order was “arguably” final, and therefore appealable to the district court, because Allied had not applied to reject the collective bargaining agreement pursuant to § 1113(d), and the order would not be subsumed in any future order regarding rejection of the collective bargaining agreement.<sup>77</sup> As a practical matter, the Teamsters argued to the district court that the interim relief should be appealable now because it “effectively terminates this litigation” since “[t]here is no other motion pending concerning the collective bargaining agreement, and while the Debtor may file one, it is not obligated to do so and may never do so.”<sup>78</sup> Allied countered that, as a matter of settled law, the bankruptcy court’s § 1113(e) order was not a final order appealable as of right.<sup>79</sup> Allied further argued, that if the district court determined that the § 1113(e) order was not a final order, the district court should not grant the Teamsters leave to file an interlocutory appeal.<sup>80</sup>

The initial question before the district court was whether the bankruptcy court’s interim order was a final order or an interlocutory order.<sup>81</sup> Ultimately, District Court Judge William S. Duffey Jr. held that

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the order was not a final order.<sup>82</sup> On this issue, Judge Duffey stated:

[T]he interim order in this case was for a limited period of time—60 days. The Court agrees with the *Landmark* court that an interim order under § 1113(e) is not appealable as a final order because the terms of the statute allow for changes to be made to the order in the future. It permits a debtor to continue to seek authority to reject a collective bargaining agreement even after a bankruptcy court has granted interim relief, and the provision “seems to permit a court to order further interim relief if necessary.” In the absence of express precedent from the Eleventh Circuit on this issue, the Court finds that the bankruptcy court’s interim order under § 1113(e) is not a final, appealable order.<sup>83</sup>

The district court further declined to exercise its discretion to allow an interlocutory appeal because the Teamsters failed to meet the second requirement for granting an interlocutory appeal, namely establishing that substantial grounds for a difference of opinion exist as to a controlling issue of law.<sup>84</sup> The Teamsters argued that an interlocutory appeal was warranted because substantial grounds for a difference of opinion exist on whether a motion to reject the collective bargaining agreement must be pending as a prerequisite to allowing interim relief under § 1113(e).<sup>85</sup> The court disagreed, citing numerous authorities as ample support for the conclusion that an interim order under § 1113(e) may be brought without a pending application to reject.<sup>86</sup>

### **D. Prepetition Obligations Cannot Receive Administrative Expense Status Under Bankruptcy Code § 1113(f) in a Chapter 7 Context**

In *In re Liberty Fibers Corp.*, Liberty Fibers Corporation filed its Chapter 11 bankruptcy petition on September 29, 2005.<sup>87</sup> On November 21, 2005, the case was converted to a Chapter 7 proceeding, and a Chapter 7 trustee was appointed.<sup>88</sup> The

United Food and Commercial Workers International Union and its subordinate Local Union 815T (the UFCW) subsequently filed two motions to designate Liberty Fiber’s prepetition obligations for vacation pay and health insurance benefits as Chapter 11 administrative expenses.<sup>89</sup> These obligations concerned employees of Liberty Fibers who obtained healthcare services and employees who became entitled to certain vacation benefits prior to the bankruptcy filing pursuant to a collective bargaining agreement (CBA).<sup>90</sup>

The Honorable Marcia Phillips Parsons of the US Bankruptcy Court for the Eastern District of Tennessee first noted that for a claim to receive administrative expense status under Bankruptcy Code § 503(b)(1)(A), the “benefit to the estate test” must be satisfied.<sup>91</sup> Under this test, a debt qualifies as an actual and necessary administrative expense only if “(1) it arose from a transaction with the bankruptcy estate and (2) directly and substantially benefitted the estate.”<sup>92</sup> The bankruptcy court then noted that the benefit-to-the-estate test limits administrative claims to those where the consideration for the claim was received during the postpetition period.<sup>93</sup> However, the bankruptcy court recognized that there was controlling precedent from the Sixth Circuit, *In re Unimet Corp.*,<sup>94</sup> holding that § 1113(f) created an exception to the requirement that consideration for an administrative expense claim be received postpetition.<sup>95</sup> In *Unimet*, the Sixth Circuit concluded that “section 1113 unequivocally prohibits the employer from unilaterally modifying any provision of the collective bargaining agreement” and stated that the debtor “cannot escape its obligations... merely because the requirements of section 503 arguably have not been satisfied.”<sup>96</sup> Ultimately, the Sixth Circuit granted administrative expense treatment to prepetition retiree insurance premiums.<sup>97</sup>

Based on this precedent, the UFCW argued that the CBA obligations of the debtor were similarly entitled to be paid as administrative expenses.<sup>98</sup> In response, the trustee argued that § 1113(f) did not apply in Chapter 7 cases, and therefore, the *Unimet* decision was not controlling.<sup>99</sup>

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After careful consideration of § 1113 and the *Unimet* decision, the bankruptcy court concluded that the trustee's position was well-founded.<sup>100</sup> The bankruptcy court determined that, under the statutory scheme of the Bankruptcy Code, § 1113 applies only in a Chapter 11 case.<sup>101</sup> The bankruptcy court further stated that:

While § 1113(f) is broadly written in that it states that “no provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement,” it is clear from the use of the word “trustee” in other subsections of § 1113 that trustee is a chapter 11 trustee or debtor-in-possession.<sup>102</sup>

The bankruptcy court stated that there was simply no language in *Unimet* that suggested that § 1113(f)'s statutory exception to the general requirement that administrative expense status is limited to postpetition claims should be extended to the Chapter 7 context.<sup>103</sup> For these reasons, the bankruptcy court sustained the trustee's objection to the motion.<sup>104</sup>

### IV. Case Law Developments— Bankruptcy Code § 1114

The following is a brief discussion of the significant cases from 2007 that expand upon the procedural and substantive requirements of § 1114 of the Bankruptcy Code.

#### A. The Necessity of a Chapter 11 Plan Before Invoking Bankruptcy Code § 1114

Before a debtor can invoke Bankruptcy Code § 1114 to modify or terminate retiree benefits provided under collective bargaining agreements, a debtor likely needs to have a proposed plan before the bankruptcy court. In *In re SAI Holdings Limited*, SAI Holding Limited and its debtor subsidiaries (collectively, the Debtors) filed voluntary Chapter 11 petitions seeking to liquidate through Chapter 11 as a result of cash flow problems caused by several factors, including uncompetitively high wage

and benefit costs and high legacy costs at one of their plants.<sup>105</sup>

Of particular concern to the Debtors was their collective bargaining agreements (the CBAs) with Locals 913 and 1957 of the United Automobile, Aerospace and Agricultural Implement Workers of America (collectively, the Union) that required that the debtors to provide direct payment or reimbursement for covered medical and prescription drug expenses to approximately 95 retired members of the Union (the Retirees).<sup>106</sup> While the Debtors and the Union engaged in active negotiations with respect to employees' rights under the CBAs, the Union rejected all proposals relating to the Retirees, and the parties agreed that the court would decide the motion as it related to retiree benefits.<sup>107</sup>

At the outset, the bankruptcy court disposed of one of two threshold issues, determining that § 1114 is applicable in a liquidating Chapter 11 case, contrary to the Union's contention.<sup>108</sup> The court stated, “[w]hile § 1114 may not have been written with a liquidating chapter 11 plan in mind... the obvious congressional inattentiveness to liquidating Chapter 11 cases does not make § 1114 inapplicable to such cases.”<sup>109</sup> Moreover, the bankruptcy court stated that “Section 1114 itself does not distinguish between a liquidating plan and one in which the debtor seeks to rehabilitate its business—the plain language of the statute requires any debtor-in-possession or trustee to comply with its provisions before being entitled to modify or terminate retiree benefits.”<sup>110</sup>

The second issue of great importance in the case was whether the Debtors had shown that the proposed termination of retiree benefits was necessary to permit their reorganization, one of the prongs of Bankruptcy Code § 1114.<sup>111</sup> The bankruptcy court agreed with the Union that the Debtors failed to establish that termination of retiree benefits was necessary to permit their reorganization.<sup>112</sup> Specifically, the bankruptcy court noted that other courts addressing the meaning of § 1114(g)'s requirement that a proposed modification or termination of retiree benefits be “necessary to permit the reorganization of the debtor” have

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concluded that the requirement must be interpreted to mean “necessary to accommodate confirmation of a Chapter 11 plan” when applied in a liquidating Chapter 11 case.<sup>113</sup>

The bankruptcy court noted that, while the Debtors presented evidence of the cost of Retiree benefits, the Debtors had not yet proposed a liquidation plan, and therefore, it was difficult, although perhaps not impossible, to determine whether the termination of Retiree benefits was necessary to accommodate confirmation of a Chapter 11 plan when no plan had been proposed.<sup>114</sup> For this reason, the bankruptcy court denied the Debtors’ § 1114 motion.

### **B. Medical Claims of Retired Employees Are Priority Claims Under Bankruptcy Code § 507(a)(5)**

In *In re Consolidated Freightways Corp. of Del.*, Consolidated Freightways Corp. of Delaware and its affiliates (the Debtors) operated a freight transport company in North America.<sup>115</sup> Over the Labor Day holiday weekend, the Debtors ceased almost all of their operations, and employees were notified immediately of the termination of their employment.<sup>116</sup> The Debtors filed their bankruptcy cases shortly thereafter and ultimately confirmed their liquidating plan.<sup>117</sup>

Prior to filing bankruptcy, Debtors maintained self-funded health insurance benefit plans for their nonunion employees and retirees (the Benefit Plans).<sup>118</sup> Aetna, Inc. administered the Benefit Plans on the Debtors’ behalf and reimbursed employees for their medical claims.<sup>119</sup> Prior to the petition date, the Debtors terminated their Benefit Plans, leaving both Aetna and the individual employees and retirees with unreimbursed medical claims.<sup>120</sup> Aetna, along with other individual claimants, sought allowance of a priority claim for unreimbursed medical claims.<sup>121</sup> The Chapter 7 trustee objected to these proofs of claim arguing that § 507(a)(5) of the Bankruptcy Code provided for priority treatment “only for employees and not for retired persons.”<sup>122</sup>

The bankruptcy court looked to *Howard Delivery Serv., Inc. v. Zurich Amer. Ins. Co.*<sup>123</sup> and the

legislative history of § 507 for guidance and ultimately determined that Congress intended to define the term “employee benefit plan,” as used in § 507(a)(5), just as all justices of the Supreme Court held, to encompass health coverage benefit plans negotiated for employees, and to the extent that such plans included benefits for the employee after retirement, they too would be afforded the limited priority allowed in § 507(a)(5).<sup>124</sup> The bankruptcy court concluded that the term “employee benefit plan” should not limit beneficiaries to include only active and current employees but would include any participant of an employee benefit plan.<sup>125</sup> Thus medical claims incurred by both active and retired employees established under the Debtors’ Benefit Plan would be entitled to priority under § 507(a)(5).<sup>126</sup>

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1. 11 U.S.C.A. § 1113 (b)(1)(A).
2. 11 U.S.C.A. § 1113(b)(1)(B).
3. 11 U.S.C.A. § 1113(b)(2).
4. 11 U.S.C.A. § 1113(c).
5. 11 U.S.C.A. § 1113(d). This period is subject to a seven-day extension that may be granted “in the interests of justice” and any further extensions agreed to between the employer and the union. 11 U.S.C.A. § 1113(d).
6. *In re Northwest Airlines Corp.*, 346 B.R. 307, 314, 46 Bankr. Ct. Dec. (CRR) 226 (Bankr. S.D. N.Y. 2006) (Gropner, J.).
7. *In re Delta Air Lines, Inc.*, 359 B.R. 468, 475, 47 Bankr. Ct. Dec. (CRR) 168 (Bankr. S.D. N.Y. 2006) (Hardin, J.) (“[s]ection 1113 is that, as noted in the legislative history and the case law, the statute is designed to force the debtor-employer and its unionized labor constituencies to resolve their disputes by agreement by a process of good faith negotiations”).
8. *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 104 S. Ct. 1188, 79 L. Ed. 2d 482, 11 Bankr. Ct. Dec. (CRR) 564, 9 Collier Bankr. Cas. 2d (MB) 1219, 5 Employee Benefits Cas. (BNA) 1015, 115 L.R.R.M. (BNA) 2805, Bankr. L. Rep. (CCH) P 69580, 100 Lab. Cas. (CCH) P 10771 (1984).
9. *In re Horsehead Industries, Inc.*, 300 B.R. 573, 583, 42 Bankr. Ct. Dec. (CRR) 39, 51 Collier Bankr. Cas. 2d (MB) 50, 32 Employee Benefits Cas. (BNA) 1655 (Bankr. S.D. N.Y. 2003).
10. *Bildisco*, 465 U.S. at 532-34.
11. *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America*, AFL-CIO-CLC, 791 F.2d 1074, 1089, 14 Bankr. Ct. Dec. (CRR) 795, 14 Collier Bankr. Cas. 2d (MB) 955, 7 Employee Benefits Cas. (BNA) 1529, 122 L.R.R.M. (BNA) 2425, Bankr. L. Rep. (CCH) P 71170, 104 Lab. Cas. (CCH) P 11828, 89 A.L.R. Fed. 263 (3d Cir. 1986).
12. 7-1114 Collier on Bankruptcy ¶ 1114.01[3] (15th ed. rev. 2006); see also Norton Bankr. L. & Prac. 3d § 104.4.
13. 7-1114 Collier on Bankruptcy ¶ 1114.01[3] (15th ed. rev. 2006).
14. 7-1114 Collier on Bankruptcy ¶ 1114.01[3] (15th ed. rev. 2006).
15. 11 U.S.C.A. § 1114(e)(1) requires that a debtor “shall timely pay and shall not modify any retiree benefits, except that—(A) the court, on motion... and after notice and a hearing, may order modification of such payments...; or (B) the trustee and the authorized representative of the recipients of those benefits may agree to modification of such payments,... after which such benefits as modified shall continue to be paid by the trustee.”
16. *Horsehead Indus.*, 300 B.R. at 583; *In re Ionosphere Clubs, Inc.*, 134 B.R. 515, 519-20, 22 Bankr. Ct. Dec. (CRR) 464, 26 Collier Bankr. Cas. 2d (MB) 797, 14 Employee Benefits Cas. (BNA) 1897, 120 Lab. Cas. (CCH) P 11051 (Bankr. S.D. N.Y. 1991) (“compliance with § 1114 is substantively and procedurally the same as compliance with § 1113”).
17. 11 U.S.C.A. § 1114(f)(1)(A).
18. 11 U.S.C.A. § 1114(f)(1)(B).
19. 11 U.S.C.A. § 1114(f)(2).
20. 11 U.S.C.A. § 1114(k)(1).
21. 11 U.S.C.A. § 1114(g).
22. *Ionosphere Clubs*, 134 B.R. at 521.
23. *Ionosphere Clubs*, 134 B.R. at 521.
24. *Ionosphere Clubs*, 134 B.R. at 521.
25. *Ionosphere Clubs*, 134 B.R. at 523 (“Congress drafted § 1114 to insure that debtors did not seek to effect reorganizations ‘on the back of retirees’ for the benefit of other parties in interest”).
26. *Ionosphere Clubs*, 134 B.R. at 523.
27. *In re Northwest Airlines Corp.*, 483 F.3d 160, 48 Bankr. Ct. Dec. (CRR) 12, 57 Collier Bankr. Cas. 2d (MB) 1442, 181 L.R.R.M. (BNA) 2752, Bankr. L. Rep. (CCH) P 80896, 154 Lab. Cas. (CCH) P 10826 (2d Cir. 2007).
28. *Northwest Airlines*, 483 F.3d at 164-65.
29. *Northwest Airlines*, 483 F.3d at 165. “The bankruptcy court conditioned its decision on Northwest’s agreement to negotiate for an additional two weeks before it would allow the March 1 Agreement to take effect.” *Northwest Airlines*, 483 F.3d at 165. The flight attendants again rejected the proposed terms, and the bankruptcy court imposed the agreement. *Northwest Airlines*, 483 F.3d at 165.
30. *Northwest Airlines*, 483 F.3d at 165. The flight attendants planned “to disrupt Northwest’s service by using a tactic suitably named CHAOS (“Create Havoc Around Our System”), which entails mass walkouts for limited periods of time and pinpoint walkouts at certain airports or gates.” *Northwest Airlines*, 483 F.3d at 165.
31. *Northwest Airlines*, 483 F.3d at 165 (quoting *In re Northwest Airlines Corp.*, 346 B.R. 307, 344, 46 Bankr. Ct. Dec. (CRR) 226 (Bankr. S.D. N.Y. 2006)).
32. *Northwest Airlines*, 483 F.3d at 165. Judge Marrero held that Northwest had not unilaterally changed the status quo, and therefore the union was bound by the status quo provisions and not entitled to strike without exhausting other options. *Northwest Airlines*, 483 F.3d at 165 (citing *In re Northwest Airlines Corp.*, 349 B.R. 338, 379, 153 Lab. Cas. (CCH) P 10728 (S.D. N.Y. 2006), aff’d, 483 F.3d 160, 48 Bankr. Ct. Dec. (CRR) 12, 57 Collier Bankr. Cas. 2d (MB) 1442, 181 L.R.R.M. (BNA) 2752, Bankr. L. Rep. (CCH) P 80896, 154 Lab. Cas. (CCH) P 10826 (2d Cir. 2007)). As discussed below, a unilateral change in the status quo by the airline may permit a union to strike under certain circumstances.
33. *Northwest Airlines*, 483 F.3d at 165.
34. *Northwest Airlines*, 483 F.3d at 165.
35. 45 U.S.C.A. §§ 151 et seq.
36. 29 U.S.C.A. §§ 101 et seq.
37. *Northwest Airlines*, 483 F.3d at 166.
38. *Northwest Airlines*, 483 F.3d at 168. (citing *Burlington Northern R. Co. v. Brotherhood of Maintenance of Way Employees*, 481 U.S. 429, 445, 107 S. Ct. 1841, 95 L. Ed. 2d 381, 125 L.R.R.M. (BNA) 2073, 106 Lab. Cas. (CCH) P 12285 (1987)).
39. *Northwest Airlines*, 483 F.3d at 168. For a more in depth description of the requirements imposed on parties under the RLA, see *Northwest Airlines*, 483 F.3d at 166-168.
40. *Northwest Airlines*, 483 F.3d at 168.
41. *Northwest Airlines*, 483 F.3d at 170.
42. *Northwest Airlines*, 483 F.3d at 170.
43. *Northwest Airlines*, 483 F.3d at 170-71.
44. *Northwest Airlines*, 483 F.3d at 171 (emphasis in original).
45. *Northwest Airlines*, 483 F.3d at 171.
46. *Northwest Airlines*, 483 F.3d at 172.
47. *Northwest Airlines*, 483 F.3d at 172.
48. *Northwest Airlines*, 483 F.3d at 172.
49. *Northwest Airlines*, 483 F.3d at 172 (emphasis in original).
50. *Northwest Airlines*, 483 F.3d at 173.
51. *Northwest Airlines*, 483 F.3d at 168.
52. *Northwest Airlines*, 483 F.3d at 175.
53. *Northwest Airlines*, 483 F.3d at 175.
54. *Northwest Airlines*, 483 F.3d at 177. Chief Judge Dennis Jacobs, in his concurrence, agreed that the injunction should be upheld but did not agree that the rejection of the CBA under § 1113 terminated the status quo. *Northwest Airlines*, 483 F.3d at 177. He stated his view that that a status quo cannot be terminated based on the abrogation of the CBAs; however, the RLA’s requirement is that a status quo be terminated unilaterally, and so “A debtor-carrier’s rejection of a labor agreement in bankruptcy—subject to strict statutory conditions and court oversight—cannot be described fairly as a unilateral divergence from the status quo, and does not trigger a reciprocal right to strike.” *Northwest Airlines*, 483 F.3d at 178. He further stated, “Northwest’s resort to § 1113 therefore did not affect the AFA’s § 2 (First) duties, which keep the union at the bargaining table and off the picket line.” *Northwest Airlines*, 483 F.3d at 178.
55. *In re Northwest Airlines Corp.*, 366 B.R. 270, 48 Bankr. Ct. Dec. (CRR) 17, 57 Collier Bankr. Cas. 2d (MB) 119 (Bankr. S.D. N.Y. 2007).
56. *Northwest Airlines*, 483 F.3d at 160.
57. *Northwest Airlines Corp.*, 366 B.R. at 275.
58. *Northwest Airlines Corp.*, 366 B.R. at 275.

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59. Northwest Airlines Corp., 366 B.R. at 275.
60. Northwest Airlines Corp., 366 B.R. at 275.
61. Northwest Airlines Corp., 366 B.R. at 275.
62. Northwest Airlines Corp., 366 B.R. at 276. The court noted that the flight attendants' claim for damages a result of the interim changes to the CBA were likewise disallowed. Northwest Airlines Corp., 366 B.R. at 276.
63. Northwest Airlines Corp., 366 B.R. at 271.
64. Northwest Airlines Corp., 366 B.R. at 272.
65. Northwest Airlines Corp., 366 B.R. at 272.
66. Northwest Airlines Corp., 366 B.R. at 272. The court further noted that while § 1114 expressly includes a modification, section 1113 does not. Northwest Airlines Corp., 366 B.R. at 272-73.
67. *In re Allied Holdings, Inc.*, 376 B.R. 351, 354, 182 L.R.R.M. (BNA) 2727 (N.D. Ga. 2007) (citing *In re Charter Co.*, 778 F.2d 617, 621, Bankr. L. Rep. (CCH) P 70873 (11th Cir. 1985) (citing 28 U.S.C.A. § 158(a)).
68. *In re Allied Holdings, Inc.*, 376 B.R. 351, 182 L.R.R.M. (BNA) 2727 (N.D. Ga. 2007).
69. Allied Holdings, 376 B.R. at 352.
70. Allied Holdings, 376 B.R. at 352.
71. Allied Holdings, 376 B.R. at 352.
72. Allied Holdings, 376 B.R. at 352.
73. Allied Holdings, 376 B.R. at 352-53.
74. Allied Holdings, 376 B.R. at 353.
75. Allied Holdings, 376 B.R. at 353.
76. Allied Holdings, 376 B.R. at 353.
77. Allied Holdings, 376 B.R. at 354.
78. Allied Holdings, 376 B.R. at 354.
79. Allied Holdings, 376 B.R. at 355.
80. Allied Holdings, 376 B.R. at 353.
81. Allied Holdings, 376 B.R. at 356.
82. Allied Holdings, 376 B.R. at 356.
83. Allied Holdings, 376 B.R. at 356 (citing *In re Landmark Hotel & Casino, Inc.*, 872 F.2d 857, 19 Bankr. Ct. Dec. (CRR) 362, 21 Collier Bankr. Cas. 2d (MB) 60, 131 L.R.R.M. (BNA) 2093, Bankr. L. Rep. (CCH) P 72847, 111 Lab. Cas. (CCH) P 11082 (9th Cir. 1989)).
84. Allied Holdings, 376 B.R. at 362.
85. Allied Holdings, 376 B.R. at 359.
86. Allied Holdings, 376 B.R. at 359.
87. *In re Liberty Fibers Corp.*, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1 (Bankr. E.D. Tenn. 2007).
88. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1.
89. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1.
90. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1.
91. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1.
92. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1 (citing *Pension Benefit Guar. Corp. v. Sunarhauserman, Inc.* (In re Sunarhauserman, Inc.), 126 F.3d 811, 816 (6th Cir. 1997)).
93. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*1.
94. *In re Unimet Corp.*, 842 F.2d 879, 17 Bankr. Ct. Dec. (CRR) 726, 18 Collier Bankr. Cas. 2d (MB) 694, 9 Employee Benefits Cas. (BNA) 1689, 127 L.R.R.M. (BNA) 3139, Bankr. L. Rep. (CCH) P 72227, 108 Lab. Cas. (CCH) P 10384 (6th Cir. 1988) (rejected by, *In re Ionosphere Clubs, Inc.*, 22 F.3d 403, 25 Bankr. Ct. Dec. (CRR) 773, 30 Collier Bankr. Cas. 2d (MB) 1627, 146 L.R.R.M. (BNA) 2095, Bankr. L. Rep. (CCH) P 75799 (2d Cir. 1994)).
95. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*2.
96. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*2.
97. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*2.
98. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*2.
99. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*2.
100. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*3.
101. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*3.
102. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*3.
103. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*5.
104. Liberty Fibers, 58 Collier Bankr. Cas. 2d (MB) 919, 2007 WL 2471446 at \*5.
105. *In re SAI Holdings Limited*, 2007 WL 927936 at \*1 (Bankr. N.D. Ohio 2007) (Whipple, J.).
106. SAI Holdings, 2007 WL 927936 at \*2.
107. SAI Holdings, 2007 WL 927936 at \*2.
108. SAI Holdings, 2007 WL 927936 at \*4.
109. SAI Holdings, 2007 WL 927936 at \*4 (citing *In re Garfinkels, Inc.*, 124 B.R. 3, 4, 21 Bankr. Ct. Dec. (CRR) 737, 24 Collier Bankr. Cas. 2d (MB) 1135, 13 Employee Benefits Cas. (BNA) 1605, Bankr. L. Rep. (CCH) P 73825 (Bankr. D. D.C. 1991)).
110. SAI Holdings, 2007 WL 927936 at \*4 (citing 11 U.S.C.A. § 1114(e)(1)(A)).
111. SAI Holdings, 2007 WL 927936 at \*5.
112. SAI Holdings, 2007 WL 927936 at \*5.
113. SAI Holdings, 2007 WL 927936 at \*6.
114. SAI Holdings, 2007 WL 927936 at \*6.
115. *In re Consolidated Freightways Corp. of Del.*, 363 B.R. 110, 47 Bankr. Ct. Dec. (CRR) 252, 41 Employee Benefits Cas. (BNA) 2119 (Bankr. C.D. Cal. 2007), as amended, (Apr. 25, 2007).
116. Consolidated Freightways, 363 B.R. at 112-113.
117. Consolidated Freightways, 363 B.R. at 113.
118. Consolidated Freightways, 363 B.R. at 113.
119. Consolidated Freightways, 363 B.R. at 113.
120. Consolidated Freightways, 363 B.R. at 113.
121. Consolidated Freightways, 363 B.R. at 113.
122. Consolidated Freightways, 363 B.R. at 113.
123. *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 126 S. Ct. 2105, 165 L. Ed. 2d 110, 46 Bankr. Ct. Dec. (CRR) 177, 55 Collier Bankr. Cas. 2d (MB) 775, 37 Employee Benefits Cas. (BNA) 2743, Bankr. L. Rep. (CCH) P 80624 (2006).
124. Consolidated Freightways, 363 B.R. at 118.
125. Consolidated Freightways, 363 B.R. at 118.
126. Consolidated Freightways, 363 B.R. at 118.