American Bankruptcy Institute
Commission to Study the Reform of Chapter 11

March 14, 2013

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At its core, Chapter 11 is largely about breaking economic promises in the interest of promoting the rehabilitation of a financially troubled business. Some promises, however, implicate social policies that historically have been judged of special importance. Prominent among these are collective bargaining agreements, pension plans, and retiree health and disability plans. It is not surprising, therefore, that the Bankruptcy Code and the Employee Retirement Income Security Act of 1974 ("ERISA") limit the discretion of a reorganizing company to modify or abrogate such benefits and agreements. The question that might fairly be asked is whether the protections afforded by the Code and (in the case of pensions, by ERISA) have proved to be workable in practice and whether they go far enough in protecting current and retired employees without unduly undermining an ailing business's ability to reorganize.

I stress at the outset that I do not claim to be an expert with respect to these issues, since my direct experience with them, despite 16 years as a bankruptcy judge, is limited to successive cases filed by a single airline debtor. At the same time, even that limited involvement has given me an appreciation for the difficulty a judge encounters in balancing the interest of the reorganizing debtor in cutting costs in order to turn itself around financially, and the profound – indeed sometimes devastating – impact those cuts can have on current and former employees and their survivors.

Let me briefly address the statutory provisions with respect to collective bargaining agreements, retiree health and disability benefits, and, finally, pensions.

The ability of a reorganizing debtor to reject a collective bargaining agreement is governed by

Section 1113 of the Bankruptcy Code, which was enacted in response to the Supreme Court's 1984 decision in *NLRB v. Bildisco & Bildisco.* [1] The bankruptcy court may place its imprimatur on rejection of a collective bargaining agreement only if it finds that the debtor (or trustee, if one has been appointed) has made a "qualifying proposal" that the union has refused to accept "without good cause" and that the "balance of equities" favors rejection.[2] A "qualifying proposal," in turn, is one that has been made by the debtor to the union after the filing of the chapter 11 case but before the filing of the application for rejection; contains modifications "necessary to permit reorganization" of the debtor; and assures that all creditors, the debtor, and all affected parties "are treated fairly and equitably."[3] The debtor must provide the union "with such relevant information as is necessary" to evaluate the proposal and must meet and confer in confer in good faith with the union to reach "a mutually satisfactory" modification.[4] The statute requires uncommonly prompt consideration of the application for rejection: a hearing must be held within 14 days, with the court having authority to extend that period for only seven additional days unless both the debtor and the union consent to a further extension.[5] The court is required to rule within 30 days after the commencement of the hearing. Even prior to ruling on the application for reflection, the court may authorize the debtor or the trustee to impose interim changes if the court finds that such changes are "essential to the continuation of the debtor's business" or otherwise necessary "to avoid irreparable damage to the estate."[6]

The modification or termination of retiree health, disability, and death benefits – whether or not provided under a collective bargaining agreement – is governed by Section 1114 of the Bankruptcy Code, which embodies essentially the same procedures (including the possibility of interim relief) and same legal standards as Section 1113 does for collective bargaining agreements. The chief difference is that if the retirees are not represented by a union with respect to the benefits, the court must order the appointment of a committee of retirees to act as their representative; and the court's ruling must be made within 90 rather than 30 days after the commencement of the hearing.

The modification or termination of a pension plan is not (unless embodied in a collective bargaining agreement) governed by the Bankruptcy Code but by ERISA. A pension plan subject to ERISA may be terminated by an employer in one of two ways. In a standard termination, the employer purchases a close-out annuity that pays the benefits promised under the plan. While this gets the employer out of the business of managing the plan's investments and paying beneficiaries, it likely saves no money. In a distress termination, by contrast, the funds are turned over to the Pension Benefit Guaranty Corporation, which is responsible for making payments to the beneficiaries up to a specific dollar amount. To the extent the funds turned over are insufficient, in actuarial terms, to pay the promised benefits, the PBGC has a claim for the shortfall, but the claim has no special priority and will often be paid at only pennies on the dollar.[7] To effect a distress termination, the employer must give the Pension Benefit Guaranty Corporation and each affected party at least 60 days notice of the proposed termination. If the employer is a chapter 11 debtor, the ability to terminate requires a finding by the bankruptcy court that absent termination, the employer will be "unable to pay all its debts pursuant to a plan of reorganization" and will be "unable to continue in business outside the chapter 11 process."[8] Additionally, the termination of the plan must not violate an existing collective bargaining agreement, and the bankruptcy court must "approve" the termination.

Given this background, the question presented is how workable the statutory scheme is in practice, and whether it achieves just results. Based on my own admittedly limited experience, I think it works reasonably well, which is to say I would not advocate major changes. This is not to say that authorizing the rejection of a collective bargaining agreement or the termination of retiree health benefits or a pension plan are easy decisions: in fact, they were easily the most difficult decisions I had to make as a bankruptcy judge. But they were tough not because of any defect in the statutory scheme but rather because of the human dimension, namely the financial impact the relief granted would have on the affected employees and retirees.

That said, there are few modest changes that I believe are worthy of consideration.

- The first is the pointless 14-day time frame mandated for a court hearing on Section 1113 and Section 1114 motions, Matters in bankruptcy court tend to be heard pretty quickly (some think too quickly) anyway, and the time required for conducting even modest discovery into the financial need for the relief being requested makes even 21 days (the outside limit unless the parties consent) completely unrealistic, particularly given the gravity and complexity of the issues at stake.

- With respect to the rejection of collective bargaining agreements, the statute is silent on the right of the union members whose agreement is rejected to resort to economic self-help, that is, to strike. Most courts have held that, because rejection is a breach of the collective bargaining agreement, the union members have the right to strike; and further that the Norris-LaGuardia Act bars a bankruptcy court from enjoining a strike. That general understanding was considerably undermined by the Second Circuit's decision in the *Northwest Airlines* case sustaining a district court injunction against a threatened work action by the flight attendants after their contract was rejected.[9] Although the decision relies heavily on the unusual status of airline labor agreements, which are governed by the Railway Labor Act, the surprising aspect of the decision is its holding that rejection of a collective bargaining agreement under Section 1113 "abrogated (without beaching) the existing collective bargaining agreement."[10] This holding must have come as a surprise to most bankruptcy judges, academics, and professionals, who have historically understood that rejection of an executory contract was a breach, not a species of avoidance. Indeed, if rejection is not a breach but an abrogation, then logically there could not even be a damage claim by the union arising from the rejection. There is no good reason that I can see for treating a collective bargaining agreement any differently than other types of executory contracts with respect to the legal effect and consequences of rejection. Accordingly, in light of the *Northwest Airlines* decision, I believe it would be appropriate to amend Section 1113 to expressly state that rejection constitutes a breach of the collective bargaining agreement and does not bar the affected employees from engaging in otherwise legal work actions.

- With respect to the distress termination of a defined-benefit pension plan, the test of not being able to pay *all* debts under a plan of reorganization seems unduly tilted in favor of plan termination. Even in a true reorganization, it is rare that "all" debts will be paid in the sense of being paid at 100 cents on the dollar. Put another way, creditors will often vote in favor of a plan that pays considerably less than 100 cents on the dollar. The test should therefore be whether, absent termination, the debtor will be realistically be able to confirm a plan of reorganization that allows it (or a successor under the plan) to continue in business.

- Given the dramatic shift in recent years away from defined-benefit pension plans toward defined-contribution retirement plans such as 401(k) plans, it seems appropriate to address the status of contributions that have been withheld from employee paychecks but not paid into the plan. Of course a company's own unpaid contributions, if earned within 180 days of the filing or the cessation of business, would be entitled to fifth-level priority up to the amount specified in Section 507(a)(5). The question is whether deductions from an employee's paycheck not paid into the plan should viewed simply as unpaid wages entitled to fourth-level priority, or instead viewed as the equivalent of not paying over withheld income taxes and social security. The Supreme Court has described the latter as being held in a special trust for the United States.[11] It seems appropriate to accord a similar treatment (with the beneficiary of the trust obviously being the employee, not the United States) for withheld 401(k) contributions.[12]

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[1] *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 513, 79 L.Ed.2d 482 (1984).
[2] 11 U.S.C. § 1113(c).
[3] 11 U.S.C. § 1113(b)(1)(a).
[4] 11 U.S.C. § 1113(b)(1)(a) & (2).
[5] 11 U.S.C. § 1113(d).
[6] 11 U.S.C. § 1113(e).
[7] *In re U.S. Airways Group, Inc*., 303 B.R. 784 (Bankr. E.D. Va. 2003).
[8] 29 U.S.C. § 1341; *In re U.S. Airways Group, Inc.*, 296 B.R. 734 (Bankr. E.D. Va. 2003).
[9] *Northwest Airlines Corp. v. Assn. of Flight Attendants (In re Northwest Airlines Corp.)*, 483 F.3d 160 (2nd Cir. 2007).
[10] *Northwest Airlines*, 483 F.2d at 170.
[11] *Begier v. IRS*, 496 U.S. 53, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990) (holding that under 26 U.S.C. § 7501, trustee could not recover, as a preference, payments the debtor had made to IRS on account of withholding tax liabilities within 90 days prior to bankruptcy because the payments were transfers of property held in trust, not property of the estate).
[12] *In re U.S. LAN Systems Corp*., 235 B.R. 847 (Bankr. E.D. Va. 1998).