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TO: Harry Hardnose, GC of Delicious Delights, Inc.

FROM: Shane Sigler, Esq.

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RE: Treatment of Collective Bargaining Agreements in Bankruptcy

Overview

A collective bargaining agreement (a "CBA") is a form of executory contract. In a bankruptcy proceeding, a company (the "debtor") is given wide latitude to "reject" its executory contracts and unexpired leases (these standards are discussed in the legal primer on section 365 of the Bankruptcy Code). However, unlike most other executory contracts, the Bankruptcy Code imposes additional procedural and substantive hurdles upon a debtor before it can reject a CBA.

The procedure to reject a CBA is set forth in section 1113 of the Bankruptcy Code. Prior to seeking authority to reject a CBA, the debtor must first make a proposal to the union seeking modifications of the CBA "that are necessary to permit the reorganization of the debtor while still allowing all creditors, the debtor and all of the affected parties to be treated fairly and equitably." The proposal must be based upon the most complete and accurate information available to the debtor at the time of the proposal. And, thereafter, the debtor must provide the union with information adequate to permit the union to evaluate the proposal and must meet with the union to engage in negotiations over the proposal.

If a debtor has met these requirements and has not been able to reach an agreeable modification of the CBA with the union, a debtor may seek bankruptcy court approval to reject the CBA. The court must approve the proposed rejection if the debtor fulfilled the procedural requirements outlined above, the union refuses to accept the proposed modification "without good cause," and the balance of the equities "clearly favors rejection" of the agreement.

Prior to a bankruptcy court authorizing rejection of a CBA, the debtor must continue to perform under the CBA.[1] Therefore, a debtor must continue to pay wages

[1] The Bankruptcy Code does permit a bankruptcy court to modify a CBA temporarily in certain limited circumstances. Generally, a bankruptcy court will only permit temporary modification if the modification is essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the debtor's bankruptcy

and benefits in accordance with the CBA as they become due, and, if the debtor fails to do so, it will violate the obligations imposed on the debtor under the Bankruptcy Code. Additionally, any such breach by a debtor may result in denial of any relief under a CBA by a bankruptcy court.

"Necessary Modifications"

As noted above, a debtor's proposal to a union must include only those modifications necessary to permit the reorganization[2] of the debtor. Most courts recognize that a "necessary" modification may be one that goes beyond the bare minimum needed to avoid liquidation. Some courts take a stricter approach and find that "necessary" is synonymous with "essential," and a debtor's proposal may include only those items absolutely necessary for the debtor's reorganization.

To show that a modification is "necessary" a debtor must introduce financial evidence showing that the modifications will have a significant monetary impact on improving the debtor's financial condition. At issue should be the economic items contained in a CBA, not its noneconomic provisions. Economic items include those 'directly susceptible to monetary evaluation, such as wages, vacations, holidays, and pension and welfare contributions.' Noneconomic items include such things as a 'management rights' clause, grievance and arbitration provisions, union security, a no-strike promise, and seniority provisions. Changes in noneconomic items, such as work rules, seniority, and grievance and arbitration procedures, generally do not come within the scope of a "necessary" modification unless a debtor can establish a clear monetary impact on reorganization.

Fair and Equitable Treatment

A proposed modification must treat all affected parties fairly, to ensure that the burden of reorganization will be borne by all groups. "Fair and equitable" does not mean identical or equal treatment as between the union and other constituents. Rather, equity means fairness under the circumstances, not a dollar for dollar concession. The purpose

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estate. Bankruptcy courts will ordinarily only permit temporary modifications of a CBA if, absent such modification, the debtor will be forced to liquidate.

[2] The necessity requirement presumes that the debtor will continue to operate the business which is employing those who work under the CBA. The necessity requirement does not contemplate the liquidation or sale of the business to a new employer. The debtor may sell the business to a new employer as a functioning operation. Under the Supreme Court's labor law successorship doctrines, a buyer of a business concern is not bound by the seller's CBA unless the buyer expressly assumes the contract. If a successor employer continues to employ a majority of the former owner's employees, it may be under a duty to recognize and bargain with the employees' union, but it is not bound by the debtor's CBA.

is to spread the burden of saving the company to every constituency while ensuring all sacrifice to a similar degree. Courts do not look favorably on proposals which fail to require other groups, especially managerial and other non-union employees, to bear their share of concessions. In analyzing whether a proposal satisfies the "fair and equitable" requirement, some courts have focused on whether the proposal includes a "snap-back" provision that provides that benefits will be reinstated if the reorganization succeeds.

The Balance of Equities Must "Clearly Favor" Rejection

Courts look at a number of factors to determine whether the equities favor rejection, including: the extent of the savings to be realized by the debtor and any alternate means of cost reduction; the relative amount of management salaries compared to union wages; the identity of the other creditors and the amounts of their claims; the likelihood and consequences of a strike if rejection is allowed; the possibility of employee claims for breach of contract if rejection is approved; the possibility of liquidation; the impact of the losses suffered by the individual employees in proportion to the losses suffered by the other creditors; and the good faith of the parties.

Other Considerations

<u>If Rejection is Denied</u>

If the bankruptcy court denies the debtor's rejection motion, the CBA continues in effect during the bankruptcy case until it expires by its own terms. The contract rates in the CBA will continue to set the rates for the valuation of any claims filed in the bankruptcy, whether they are administrative expense claims or priority claims. The union will continue to be bound by the CBA and by any agreement not to strike during its term.

<u>If Rejection is Granted</u>

If rejection is granted, the CBA will ordinarily be terminated. After termination, no CBA will be in effect between the parties, and the parties will be subject to normal labor law obligations, which may require bargaining for a new contract. The employer may make unilateral changes in the prevailing status quo, but only after it has bargained to an impasse with the union. If the court has approved interim changes, these interim changes along with the unilateral provisions of the CBA, constitute a new, temporary, status quo in the terms of conditions of employment. Any changes imposed by a debtor must be consistent with the debtor's last offer to union.

As soon as rejection is granted, regardless of whether the debtor is allowed to implement any unilateral changes immediately, the union is free to call a strike because it is as if there is no CBA in place. Once the contract ends, the union is released from any no-strike obligation imposed by the rejected CBA.