Putting Teeth into Section 1113(f)?

Staking Out a Middle Ground for Awarding Administrative Priority to Claims under Collective Bargaining Agreements

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Courts have wrestled for 20 years over the priority of claims asserted by workers if a chapter 11 debtor-in-possession fails to comply with its obligations under a collective bargaining agreement ("CBA"). Some courts, reasoning that such claims do not meet the traditional standards for administrative priority, relegate them to the pool of general unsecured claims. Other courts focus on the special protections afforded workers covered by a CBA under section 1113 of the Bankruptcy Code as grounds for granting such claims priority. The Tenth Circuit Court of Appeals recently injected its voice into this debate and staked out an interesting middle-ground position. In *Peters v. Pikes Peak Musicians Association*, the Court of Appeals ruled that the debtor's obligation under a CBA for payments to employees that became due between the chapter 11 petition date and the date that the debtor rejected the agreement were payable as priority administrative expenses.

A Brief History of Section 1113

Section 1113 of the Bankruptcy Code contains procedures and standards governing any proposed rejection of a CBA in a chapter 11 case. The provision was not a part of the original Bankruptcy Code enacted in 1978, but was later added in response to the Supreme Court's 1984 decision in *NLRB v. Bildisco & Bildisco*. In that case, the Supreme Court ruled that a chapter 11 debtor's decision to reject a CBA should be subject to the same standard applicable to any other

executory contract under section 365 of the Bankruptcy Code. The Court also determined that, like any counterparty to an executory contract with a debtor, covered employees could not enforce the provisions of an executory CBA pending the debtor's decision to assume or reject the agreement.

Congressional response to this decision was swift and decisive, through the enactment of section 1113. Much of the provision addresses the portion of the Supreme Court's ruling pertaining to the standard governing rejection, and makes it comparatively more difficult for a debtor to reject a CBA. The final subsection, however (section 1113(f)), speaks directly to the other prong of *Bildisco* — namely, a chapter 11 debtor's post-petition, pre-rejection obligations under a CBA:

> No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provision of a collective bargaining agreement prior to compliance with the provisions of this section.

This means that a chapter 11 debtor may not "terminate" or "alter" a CBA by not paying benefits or paying less than what the CBA requires. What Congress failed to specify, however, is what the penalty would be for a debtor who chooses to ignore the clear dictates of the new law.

Varying Interpretations of Section 1113(f)

The first appellate court at the circuit level to address the issue was the Sixth Circuit in its 1988 decision in *United Steel Workers of America v. Unimet Corp*. In that case, the applicable CBA required the debtor to pay workers' health and life insurance premiums. The debtor failed to pay these both before and after the bankruptcy court denied its request to reject the CBA. The employees' bargaining representative sought an order directing the debtor to pay these amounts as administrative expenses, but the bankruptcy court denied the request, ruling that the

obligations did not pass muster as administrative claims under the standards traditionally applied in gauging the propriety of conferring administrative status on a claim under section 503 of the Bankruptcy Code.

The Sixth Circuit reversed on appeal, explaining that whether or not the amounts in question would qualify as administrative expenses is irrelevant. Instead, the Court of Appeals ruled, the fact that section 1113 "unequivocally prohibits the employer from unilaterally modifying any provision of the [CBA]" means that the debtor has to abide by the dictates of the provision and make appropriate payments, even if the claims in question did not qualify for administrative status under other applicable provisions of the statute. In other words, the remedial purpose of section 1113 trumps the literal language of section 503, and a chapter 11 debtor is required to specifically perform the terms of a CBA prior to rejecting it.

Although a handful of bankruptcy and district courts followed the Sixth Circuit's lead, many did not. The first circuit court of appeals to stake out an alternative approach was the Third Circuit in its 1992 decision in *In re Roth American Inc.*

In that case, a chapter 11 debtor failed to pay vacation and severance pay earned by its workers in accordance with the terms of a CBA on the ground that certain of the amounts related to services rendered pre-petition. The employees sought administrative expense priority for the entire amount of their claims, but the bankruptcy court ruled that only vacation and severance pay earned after the debtor filed for chapter 11 qualified for administrative status. The Third Circuit upheld that determination on appeal, reasoning that because the remainder of the claims

did not qualify for priority treatment under sections 503 and 507 of the Bankruptcy Code, and because nothing in section 1113 provided such a remedy, claims based upon pre-petition services were not entitled to priority as administrative expenses.

Other courts quickly followed the Third Circuit's lead, holding that claims for unpaid wages and benefits under a CBA can be conferred with administrative priority only if they fulfill the requirements of sections 503 and 507 of the Bankruptcy Code (*i.e.*, such claims are based upon post-petition services that are deemed to benefit the estate). Over the years, this approach has become the majority position on this issue.

Pikes Peak **and the Tenth Circuit's Solution**

In *Pikes Peak,* the debtor was the Colorado Springs Symphony Orchestra, which was party to a CBA with the orchestra's musicians. The CBA required the musicians to make themselves available for performances, and required the orchestra to pay the musicians whether or not actual performances were scheduled or held. After filing for chapter 11 relief in 2003, the debtor sought to reorganize for a period of several weeks. During this period, the debtor failed to pay the musicians. Ultimately, after its efforts to reorganize proved futile, the debtor obtained court approval to reject its CBA under section 1113. The musicians later sought administrative priority for wages payable under the CBA during the five-week post-petition, pre-rejection period.

At the outset, the Tenth Circuit examined the standard two-pronged test applied to determine whether a claim is entitled to administrative priority: (i) whether the claim arises from a post-petition transaction with the debtor-in-possession; or (ii) whether the claimant provided a benefit

to the chapter 11 estate. The Tenth Circuit noted that the post-petition transaction element of the test commonly requires a post-petition contract or some "inducement" from the debtor-in-possession.

In this context, however, the Tenth Circuit reasoned that to enter into a post-petition transaction with the musicians, the debtor would have to enter into a new CBA with the musicians or alter the current one. Yet taking action to enter into a new CBA or to alter the current agreement, the Court explained, would violate the proscription of such action under section 1113(f). Accordingly, the Tenth Circuit held that in the CBA context, there need be neither a post-petition transaction or post-petition inducement, so long as the workers perform their obligations under the CBA. In this way, the Tenth Circuit ruled, the first prong of the normal administrative expense priority test should be relaxed in the CBA context and is deemed to be satisfied whenever post-petition services are performed under the agreement. Because the musicians made themselves available to perform during the five weeks prior to rejection of the CBA, the Tenth Circuit concluded that their conduct benefited the estate and that their claims were entitled to administrative priority.

Analysis

Pikes Peak skirts the majority approach, but in many respects represents a fresh, result-oriented solution to the problem of reconciling section 1113(f) with the provisions of the statute specifically governing administrative priority. The approaches staked out by both the Sixth and Third Circuits fall short of solving this conflict in a way that does justice to the express terms of the Bankruptcy Code. Courts following the Sixth Circuit's approach essentially ignore the rules in the statute governing administrative priority, finding that the specific protections for pre-

rejection CBA claims built into section 1113(f) trump the more general principles governing administrative priority in section 503 and 507. On the other hand, courts following the majority approach essentially remove all teeth from section 1113(f), imposing no real downside on a debtor that simply ignores the provision.

The Tenth Circuit's middle-ground approach effectively limits the harsh effects of the competing views. While siding with the majority position, it is also clear that the Tenth Circuit has lowered the bar for establishing an entitlement to priority status under sections 503 and 507 of the Bankruptcy Code. Applying a more liberal standard to awarding administrative status to post-petition, pre-rejection claims under a CBA gives teeth to section 1113(f), but it does not solve the underlying problem lurking in the seemingly irreconcilable conflict between the purpose of section 1113(f) and the express language of sections 503 and 507. There now appear be three competing interpretations of section 1113(f). The fact that this circuit split has persisted for well over 15 years makes this issue one ripe for determination by the Supreme Court or for resolution through legislation.

Peters v. Pikes Peak Musicians Ass'n., 462 F.3d 1265 (10th Cir. 2006).

NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984).

United Steel Workers of America v. Unimet Corp. (In re Unimet Corp.), 842 F.2d 879 (6th Cir. 1988).

In re Roth American, Inc., 975 F.2d 949 (3d Cir. 1992).