Hearing on H.R. 4677 the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010"

Before the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary

U.S. House of Representatives

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May 25, 2010

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Introduction

Good morning, Mr. Chairman, Ranking Member, and members of the Subcommittee. I would like to express our appreciation to you, to the members of the Subcommittee and to Chairman Conyers for convening this hearing on H.R. 4677, the "Protecting Employees and Retirees in Business Bankruptcies Act of 2010." I am appearing today on behalf of the AFL-CIO, a labor federation with affiliates representing over 10.5 million workers. H.R. 4677 (like its predecessor, H.R. 3652, introduced in the 110th Congress)[1] represents the most significant effort to address the interests of employees and retirees in business bankruptcies in over 20 years and would provide vital and long-overdue protections for employees and retirees. This is a comprehensive bill that would increase workers' recoveries in bankruptcy, reset the rules for using bankruptcy to address labor and benefit obligations, restore job preservation as a principal goal of reorganization, and stop the unseemly growth of executive pay schemes in bankruptcy cases.

Congress comprehensively revamped the bankruptcy laws in 1978, and designed the business reorganization system with the goal of preventing the liquidation of viable businesses. As envisioned by Congress, the fundamental purpose of reorganization is "to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders."[2] Since that time, business bankruptcy, and chapter 11 in particular, has grown into a sophisticated arena for addressing financial distress and bringing about business change. Businesses, the banks that lend to them, and prospective investors and buyers very often make a strategic choice to use the bankruptcy system to bring about a transaction or address particular debts through a restructuring. The credit market freeze

and the current recession have led to sharp increases in business bankruptcy filings, a trend which shows no signs of reversal in the near future.[3]

As the reach and uses of the bankruptcy system have grown, it has become clear that the system functions very well for powerful, moneyed constituencies, but has been disastrous for workers and retirees. Despite Congress's deliberate emphasis on the preservation of jobs as a fundamental goal of reorganization, business bankruptcy has become a threat to workers' living standards and retirement security. For workers, their employer's bankruptcy has come to mean the loss of good jobs, decent wages, pensions and healthcare.[4] The bankruptcy system has also embraced a wholly indefensible double-standard: while workers and retirees are sustaining huge losses, company executives are being rewarded with bonuses and other pay schemes that reflect executive compensation practices at their worst.

Bankruptcy Law Is Intended to Strike a Balance Between Debtors and Their Stakeholders

While the bankruptcy system offers a debtor enormous advantages in aid of its restructuring, the law does not allow a debtor unfettered discretion to conduct its affairs, nor are its stakeholders without significant rights and protections. The bankruptcy process requires a debtor to deal with many different creditors and stakeholders – its lenders, property lessors, key suppliers and other vendors, equipment financiers, the Pension Benefit Guaranty Corporation, state and local governments, as well as labor groups. General unsecured creditors have official representatives that actively participate in all aspects of the case and negotiate on their behalf.[5] By design, creditors and other stakeholders retain important rights – both under bankruptcy law and under non-bankruptcy law—to balance the rights of the debtor.

Congress has incorporated a number of provisions intended to protect employees, in particular, from the effects of an employer's bankruptcy and to counter-balance the rights given to the debtor. Early business bankruptcy laws established a payment priority for wages. The

wage priority has been increased and expanded over the years to take into account different forms of payroll and deferred compensation and the employee benefit plans that pay workers' health, pension and other benefits.[6] Most recently, in 2005, Congress increased the wage priority[7] and added other amendments to safeguard employee payroll deductions for health and pension plan contributions and improve recovery for back-pay awards where companies violated federal and state laws.[8]

Congress has also acted to balance the basic tenets of federal labor policy with bankruptcy policy. Taking aim at companies that were using bankruptcy as a strategic weapon in collective bargaining, Congress passed Section 1113 of the Bankruptcy Code in 1984.[9] Through Section 1113, Congress sought to protect collective bargaining agreements and the collective bargaining process by devising a new section of the Bankruptcy Code that set out the rules that would apply when a debtor sought changes to a labor agreement in bankruptcy. This new section was intended to recognize, and give effect to both labor policy and bankruptcy policy. Congress stepped in again in 1986 as a matter of health care policy, when one of the Big Steel companies filed a bankruptcy case and stopped paying health benefits for 70,000 retired steelworkers. That action led Congress to pass Section 1114, which protects retiree health and life insurance benefits.[10]

In spite of these efforts, protections for employees and retirees have not kept pace with the growth and reach of the business bankruptcy system and have been severely weakened by the courts. Court rulings have limited workers' recoveries under the wage priority.[11] Other rulings have rewritten the rules for severance pay and WARN Act damages in bankruptcy, depriving workers of pay they are entitled to – and need – when businesses shut down.[12] Courts have approved settlements that have allowed debtors to box up their pension plans and ship them

off to the Pension Benefit Guaranty Corporation, while other rulings deny employees and retirees bankruptcy claims when their pension plans have been terminated in bankruptcy.[13] Many court rulings have hollowed out the safeguards Congress built into Sections 1113 and 1114.[14] Court rulings also have gone so far as to prohibit airline workers from exercising their fundamental right to engage in self-help when their labor contracts were rejected and suggest that, even though the Bankruptcy Code provides for a damages claim for rejected contracts, workers may not assert a damages claim for rejection of a labor agreement.[15]

Inadequate provisions in the bankruptcy law, compounded by adverse court rulings on matters of vital concern to employees and a zealous growth in the use of bankruptcy as a strategic tool brought to bear against workers' interests have heavily tipped the scales against employees and retirees and virtually destroyed any semblance of the balance among stakeholders that bankruptcy law is intended to reflect. Adding insult to injury, debtors opportunistically continue to promote executive pay schemes – little more than thinly veiled efforts to give management more money – oblivious to (or simply unconcerned with) the damage these programs inflict on employee morale, particularly where a debtor expects concessions from its workforce. In short, the bankruptcy system is at a point where "open season" has been declared on workers and retirees in ways that can only be effectively corrected through comprehensive reform.

H.R. 4677 Would Improve Recoveries for Employees and Retirees, Stem Their Losses, and Rein in Executive Pay Schemes

1. H.R. 4677 Would Increase Workers' Recoveries

Despite recent improvements, the current wage priority, which imposes a per employee dollar limit for wages and fringe benefits earned within 180 days prior to the bankruptcy filing, remains deficient in three ways. *First*, the per-employee dollar limit, which is $11,725 as of

April 1, 2010, remains inadequate. Employee compensation takes many forms: payroll wages and fringe benefits, many types of deferred compensation, and an increasingly varied array of benefit programs make up total employee compensation. The constraints of the wage priority limits are evident in bankruptcy cases where money for ongoing operations is not particularly scarce, as well as in leaner cases where pitched battles can erupt over payment entitlements.

In larger bankruptcies where debtors expect to conduct the case without operational disruption, debtors routinely ask to continue their employee-related compensation practices and programs unaffected by the bankruptcy filing in order to maintain employee morale and allay the employees' concerns regarding the continuation of their pay. The restrictions in the current wage priority can get in the way of these requests. To address the current limits, some debtors expressly seek authority to exceed them. Others assert that, on average, the requested authority will not likely exceed the per-employee limits.[16]

These ad hoc, but now routine, practices indicate that many practitioners favor the seamless continuation of employee compensation policies and programs in bankruptcy. Given the widespread acceptance of "first day" wage motion practice, the statutory wage priority lags behind current practices and should be updated accordingly. H.R. 4677 would increase the wage priority amount to $20,000 per employee, an improvement that would permit more forms of compensation to be treated on a priority basis.[17]

Second, outdated court decisions have reduced the amount that can be collected under the wage priority by treating some earned compensation – such as vacation, sick leave and severance pay – less favorably than payroll wages.[18] These rulings have created artificial limits that have cost employees hard-earned pay, whether in the form of vacation pay a court deemed to be "earned" too early to qualify for priority treatment, or severance pay, which is recognized in only

one Circuit Court of Appeals as compensation for termination of employment and earned in full at termination.[19] When an employer is in bankruptcy, employees continue to perform their jobs the same way they did before bankruptcy. The company receives the full benefit of their tenure and experience every day and they should earn the full complement of their compensation each day. H.R. 4677 would eliminate the 180-day "earning" period and provide greater certainty regarding the amount that can be paid as a priority.

Third, the wage priority pits payroll compensation against pension, health and other benefits employees received through employee benefit plans. Unpaid contributions owed to these plans are entitled to priority only to the extent the per- employee amount hasn't been exhausted by payroll compensation.[20] As a result, valuable benefits compete with straight payroll compensation for priority dollars that are already inadequate. The current system relegates benefit plans to the wage priority leftovers, even though employee benefits are integral to overall employee compensation and often reflect trade offs from straight pay. H.R. 4677 would remedy this inequity by establishing a separate $20,000 per-employee priority for unpaid contributions to employee benefit plans, de-linked from the priority for wages and fringe benefits.

Improving recoveries and eliminating wage priority disputes bolster the key purposes of establishing a priority, which is to pay a meaningful sum certain to employees on a priority basis. H.R. 4677 would increase employees' recoveries and greatly simplify the application of the priority by providing certainty and by eliminating disputes that cost employees valuable compensation, create delay and waste resources expended on disputes over priority claims.

H.R. 4677 also rectifies an ongoing problem regarding the payment of severance pay in bankruptcy. Most courts erroneously classify severance benefits that are calculated with

reference to an employee's length of service as pay that is earned over time, and assign only a small portion to a priority "earning" period.[21] But as the Court of Appeals for the Second Circuit has recognized, severance pay is a form of compensation for the termination of employment. It is triggered upon employment termination and should be paid in full so that workers can pay their bills and living expenses if they should lose their jobs.[22] H.R. 4677 provides that the full amount of severance pay owed to employees who are terminated during the bankruptcy (other than insiders or senior management) qualifies as an administrative expense of the estate.[23] H.R. 4677 also clarifies the treatment of WARN Act damages where a layoff occurs on the eve of bankruptcy. In 2005, Congress amended Section 503(b) to add a provision protecting back pay awards resulting from violations of state or federal law.[24] Even though WARN Act damages fit well within the letter of the new section, four courts have now rejected administrative expense status for any portion of the damages awarded under the WARN Act.[25] Under H.R. 4677, where a WARN Act event occurs just prior to a bankruptcy filing, the damages will be treated as back pay in violation of federal law, in the same way as other back pay violations.[26]

2. <u>H.R. 4677 Would Limit Workers' and Retirees' Losses</u>

As bankruptcy has become a well-established mechanism for business change, the issues that are addressed in bankruptcy have become more diverse and often implicate significant non-bankruptcy policies. The protections enacted by Congress for labor agreements in Section 1113 and for retiree health benefits in Section 1114 reflect two instances in which Congress recognized that bankruptcy policy must be balanced with important, non-bankruptcy policies.[27] The balance struck by Congress between bankruptcy and non-bankruptcy policy in these provisions is now all but gone, and protections intended to reflect important non-bankruptcy

concerns have been written out of the application of these statutes.[28] To restore a true balance, these provisions must be rewritten to more explicitly reflect non-bankruptcy policy.

Through Section 1113, rules were established to protect the collective bargaining process and impose a more stringent legal standard for rejection of labor agreements than the standard applied to other contracts. The events leading to the enactment of Section 1113 have been well-documented by commentators.[29] A review of those accounts should leave no serious doubt that Section 1113 was crafted to reflect both bankruptcy policy and non-bankruptcy policies favoring collective bargaining. But the courts' reaction to Section 1113 was deeply divided from the outset. Notably, the few court opinions that took the statutory history and context into consideration recognized the dual policies reflected in the statute and interpreted the statutory requirements strictly.[30] Over time, however, a legal standard informed by both labor policies and bankruptcy policies has been rejected by most courts in favor of a bankruptcy-centered standard that has disregarded the labor policies Congress undertook to protect.[31] As a result, debtors face few effective limits in seeking to reject a labor agreement. [32] Stripping out labor policies that recognize the process and product of collective bargaining leaves the Section 1113 process completely dominated by bankruptcy goals and the debtor's perspective of its problems. As a result, business bankruptcies have been "disastrous for labor."[33]

A recently published study of large publicly held chapter 11 cases filed in the Southern District of New York and in the District of Delaware between 2001 and 2007 has confirmed what the labor organizations appearing at today's hearing all know from their own experiences: debtors have been virtually assured of favorable court rulings when they bring motions to reject labor contracts under Section 1113 because the current legal standard does not adequately protect collective bargaining interests. In the bankruptcy cases that were studied, thirty debtors brought

a total of 103 motions under Section 1113. In the thirty- two motions that resulted in court rulings, the debtor prevailed in all cases. The study's author concluded that Section 1113 as currently drafted does not serve its intended purpose-- to protect labor agreements--because the current standards do not provide sufficient guidance to the courts. In the absence of clearer statutory guidance regarding the protection of labor agreements, the courts have ruled on these motions simply on the basis of whether rejecting the agreement facilitates the reorganization, applying a standard virtually no different than the courts apply to other administrative matters under the Bankruptcy Code.[34]

Outside of the bankruptcy cases reviewed in this particular study, there have been cases where debtors have not prevailed in rejection motions under Section 1113, although such decisions tend to involve more technical requirements of the statute which the courts find have not been followed.[35] But these decisions have not changed the overwhelmingly bankruptcy-centered approach to the statute.[36] The courts long ago stopped debating whether the statute should be read solely with bankruptcy policy in mind or as a balance between labor policies and bankruptcy policies. Bankruptcy policy has clearly overtaken countervailing concerns.[37] Without a true balance between labor policies and bankruptcy policy, Section 1113 becomes a potent negotiating weapon in the debtor's arsenal – precisely the result Congress sought to avoid – rather than a process guiding both parties to a fair solution that provides relief for a financially strapped debtor without destroying workers' standards of living in the process.

In addition to thwarting Congressional intent, the debtor-centered practices that have gained ground under Section 1113 and Section 1114 are bad policy. First, bankruptcy is meant to function – and can only realistically function – as a "breathing spell" which recognizes that bankruptcy may offer temporary solutions to financial distress but is not a substitute for a long-

term viable business plan, a rational industry model or an economic policy. And it was never meant to define a new framework for labor relations. The complete disregard for labor policies in applying Section 1113 has left labor groups with no effective means to halt the onslaught by debtors who see bankruptcy as a means of "transforming" their businesses through the eliminations of jobs, deep cuts in labor costs, pension funding and retiree health obligations.[38] These obligations become attractive targets to a large degree because systemic industry and economic forces adversely affecting the business are beyond the company's control.

Bankruptcy cannot lower commodities prices or impose a more rational airfare structure. Bankruptcy cannot reverse trade policies that disadvantage American manufacturers, restore newspaper circulation or boost media ad revenues. But because bankruptcy offers a powerful arsenal of remedies that allows a debtor to shed its obligations, companies have aimed these tools at their employees and retirees to compensate for forces that are battering their business models but are outside their control. As a result, workers and retirees have paid dearly in lost jobs, lower pay and benefits, harsher working conditions and weakened retirement security, but these sacrifices cannot solve systemic problems that continue to confront a particular industry and cannot prevent the adverse effects of a massive economic slowdown.[39]

Recent economic conditions point to another significant consequence of harsh labor cost cutting: employees taking home less pay and losing benefits and retirement security cannot productively participate in the economy. The current recession has exposed the dangers of relying on cheap credit and ignoring the implications of a low wage economy.[40] Bankruptcy should not further aggravate trends which are detrimental to the economy as a whole.

Permitting companies a largely unchecked means of eliminating pension funding and retiree health benefits obligations in bankruptcy also interferes with the development of

comprehensive pension and health care policy. After a spate of bankruptcy-induced pension plan terminations that dramatically increased projected deficits in the government's pension insurance system, Congress took steps to discourage plan terminations in bankruptcy through several provisions of its most recent pension funding legislation, the Pension Protection Act of 2006.[41]As a deterrent to plan terminations in bankruptcy, companies that terminate defined benefit pension plans while in bankruptcy must pay a post-reorganization Termination Premium to the Pension Benefit Guaranty Corporation.[42] However, workers pay a steep price as well, through a provision of the PPA that ties critical pension guarantee calculations to the bankruptcy petition date rather than the plan termination date that would occur later in time, a difference that can significantly affect the benefits employees recover as a result of plan termination.[43] Employer-provided retiree health care coverage has also eroded steadily as companies, motivated by accounting disclosure requirements and cyclical cost spikes have curtailed these benefits or eliminated them altogether.[44] Now that comprehensive healthcare reform has become law, the bankruptcy system should not be the place to conduct health care policy choices one company at a time.[45]

Pension funding, the availability of affordable health care and industry transformations that drastically reduce U.S-based jobs implicate major policy questions that are more appropriately addressed through legislative choices that take into consideration the range of policy and legislative options.[46] But labor groups have had to contend with these difficult problems in the context of bankruptcy cases, where time and resources are limited and other creditor interests must be accommodated as well. Not surprisingly, the same "solutions" are repeated in case after case: job loss, lower pay and benefits, termination of pension funding obligations, and cuts in retiree health benefits. Bankruptcy cannot function –and should not be

administered – as a substitute for a pension funding system, a national health care policy, or an economic policy.

H.R. 4677 would correct the severe imbalance in the system through amendments that would make clear that bankruptcy policy must be effectively balanced with other policies that protect workers, labor agreements, and retirees.

A. Amendments to Section 1113

H.R. 4677 proposes a number of changes in the operation and application of Sections 1113 intended to reset the balance between bankruptcy and non-bankruptcy policy.[47] Changes proposed for Section 1113 are designed to restore the collective bargaining process as the principal means of addressing an employer's demand for concessions in bankruptcy. The amendments are also designed to insure that workers and retirees do not bear disproportionate burden of a company's – or an industry's – restructurings. In response to recent court decisions, H.R. 4677 clarifies the remedies available upon rejection of a labor contract, including the right to engage in economic self help. Hearing and scheduling rules that have become unduly burdensome for the parties – and for the courts – would also be modified.[48] Other changes would equalize the provisions of Section 1113 and Section 1114, which were intended to operate in a similar manner.[49]

Changes that would stop overbroad cost cutting aimed at workers' pay and benefits

Because courts that have addressed Section 1113 have favored a bankruptcy-centered legal standard that permits a debtor wide latitude in proposing concessions and ignores labor policies, Section 1113 does not provide effective protection against broad cost cutting aimed at jobs, pay and benefits. H.R. 4677 would correct this imbalance in several ways. The bill makes explicit that a debtor proposing modifications, and a court reviewing a request to reject a labor agreement, must take into consideration federal policy encouraging the practice and process of

collective bargaining. Proposals by the debtor for labor cost concessions must be part of a general program of cost cuts that is not limited labor groups, or even to labor costs. In addition, the proposal must define the amount of labor savings sought for each labor group so that labor groups can address and evaluate a specific share of the necessary sacrifice, rather than open-ended "labor transformation" demands.[50]

H.R. 4677 would also prohibit modifications that disproportionately affect the employees, either in the amount or the nature of the modifications and would shift the focus from unrealistic, long-term concessionary agreements to contributions that can be made to aid the reorganization in the short term. These limits recognize that bankruptcy is not a "silver bullet" that can solve all of a business's problems. The amendments would also insure that employees and retirees are not singled out for sacrifices, nor expected to "make up for" the adverse effects of a bad economy or poor industry conditions by sacrificing their jobs and benefits.

In reviewing a motion for rejection, the court must consider the financial implications of the debtor's proposal on the employees, whether the proposal adversely affects the debtor's ability to retain an experienced and qualified workforce and whether it would impair the debtor's labor relations such that the company's ability to achieve a feasible reorganization would be compromised.[51] In this way, a debtor would be prevented from making short-term decisions to slash costs that could work against the restructuring in the long run.

Changes to promote the bargaining process

H.R. 4677 proposes changes to restore Congressional intent to promote good faith collective bargaining, rather than litigation, where a debtor seeks labor contract modifications. Debtors now routinely embark upon litigation before exhausting the statutory bargaining requirement.[52] A so-called "two-track" system where parties are bargaining at the same time they are engaged in litigation seriously detracts from, and undermines, the bargaining process.

In addition, a process where negotiations and litigation intersect improperly draws the court into the give and take of the parties' bargaining over proposals.[53] H.R. 4677 would require that a debtor demonstrate that further negotiations are not likely to produce an agreement in order to obtain court-authorized rejection. In addition, to ensure that both parties' proposed solutions are given due consideration as part of a process of good faith bargaining, the court would be required to consider whether an alternative proposal by the labor group would meet the statutory requirements, something courts do not have to do now.

Contract rejection remedies

H.R. 4677 would correct the ruling of the Court of Appeals for the Second Circuit Court's in the *Norwest Airlines* case that airline workers could be denied their most basic right – to withhold their services – when their contracts were rejected in bankruptcy, an unprecedented and deeply flawed court decision that broke with well-settled labor law and bankruptcy principles never before questioned in bankruptcy cases.[54] The bill would restate what was well understood before *Northwest*, that economic self-help by a labor organization is permitted upon a court order rejecting a labor agreement. The bill also clarifies that a labor union – like all other contract counter-parties – is entitled to assert a bankruptcy claim for contract rejection damages, following the majority view of the courts prior to the *Northwest Airlines* ruling.[55]

B. Amendments to Protect Employee Benefits

H.R. 4677 would amend Section 1114, which Congress adopted to protect retiree health benefits,[56] to add new rules similar to those proposed for Section 1113.[57] Strengthened standards would apply to limit a debtor's ability to modify or terminate retiree health benefits and better protect retirees. In addition, H.R. 4677 would halt efforts by debtors to avoid Section 1114 altogether by using "reservation of rights" clauses to claim that unilateral changes can be made

to retiree health benefits under non-bankruptcy law that varies widely by jurisdiction.[58] In addition, the bill would give employees and retirees a general unsecured contract damages claim for benefits lost as a result of the termination of a defined benefit pension plan, in addition to the termination liability claim collected by the Pension Benefit Guaranty Corporation.[59] In recognition of the increasing reliance upon defined contribution plans for employees' retirement security[60] H.R. 4677 would amend the Bankruptcy Code to recognize a claim for losses in the value of employer stock held in individual account plans, where value is lost due to fraud or other breaches of fiduciary duty.[61] This provision addresses the lessons learned by the bankruptcies of companies such as Enron and Worldcom, which focused attention on the devastating losses in retirement savings that can occur when employees must rely on defined contribution plans holding large amounts of the stock of an employer in bankruptcy.

C. Amendments to Restore the Principal Goal of Job Preservation

While the preservation of jobs is at the heart of the business bankruptcy system,[62] the absence of express statutory guidance has left this fundamental goal without a clear role in key bankruptcy transactions. Under H.R. 4677, the preservation of jobs would be an express purpose of chapter 11 and a finding regarding the debtor's efforts to preserve jobs and the productive use of its assets would be required for approval of a reorganization plan.[63] Where competing plans are presented, the court must take into consideration the extent to which each plan would maintain existing jobs and benefits. In addition, in asset sales, the court would be required to consider the extent to which a bidder will maintain existing jobs, preserve retiree health benefits and assume pension obligations in determining whether an offer constitutes the successful bid.[64]

3. H.R. 4677 Would Strengthen Restrictions on Executive Pay Schemes

In 2005, Congress cracked down on "pay to stay" executive compensation plans and oversized severance packages through a new Bankruptcy Code Section 503(c), which was intended to strictly limit the instances in which these programs could be approved.[65] Since that time, debtors have become quite adept in designing pay schemes to bypass the restrictions[66] and courts are generally approving them. Now routinely labeled "incentive plans" of one kind or another, they are often tailored to bankruptcy milestones and reflect little more than court-authorized opportunities to make extra payments to management.[67] These pay schemes unfailingly serve to inflame already difficult circumstances where debtors seek to implement them at the same time they are attempting to cut labor costs and benefit obligations owed to rank and file workers.[68] Notwithstanding the distraction and ill will caused by these programs, restructuring professionals stubbornly insist upon promoting them in case after case.[69]

H.R. 4677 would bolster Congress's initial effort to halt these practices by expanding executive pay restrictions to programs proposed in anticipation of, or during a bankruptcy case. The bill would expand the strict criteria that now apply to so-called retention payments to other forms of payment that would replace or enhance compensation set prior to bankruptcy.[70] Pay schemes would no longer be reviewed under the lenient, deferential business judgment standard that courts have continued to apply, notwithstanding the rigorous scrutiny required under the 2005 amendment. In addition, the bill would halt the use of inappropriate comparison data and other questionable criteria employed by for- hire compensation consultants.[71]

The bill would also increase court oversight of executive compensation disclosed as part of a plan of reorganization, where debtors have used reorganization plans as opportunities to propose generous grants of stock in the reorganized entity, cash and other "perks"[72] To avoid eve of bankruptcy awards that might otherwise escape the scrutiny of the court or creditors, the

bill also provides that a compensation arrangement made in anticipation of bankruptcy can be recovered as a preferential transfer.[73]

Other provisions of the bill address the lack of shared sacrifice these pay schemes represent. A debtor seeking labor cost relief would have to overcome a presumption that its proposal would overly burden the employees if the debtor had implemented an executive pay scheme.[74] In addition, a debtor would be required to treat pension and retiree health benefit plans for rank and file employees the same as those for senior management in the bankruptcy. If workers' pension plans have been terminated, or retiree health benefits have been modified, then senior management pension plans and retiree health programs cannot ride through the bankruptcy unaffected.[75]

Other technical changes

H.R. 4677 also contains amendments of a more technical nature, which would codify two widely accepted practices, the filing of a proof of claim by a labor organization on behalf of its members and an exception to the automatic stay for ordinary course grievances and labor arbitrations pending at the time of the bankruptcy case.[76]

Concluding Remarks

Unique among stakeholders in a bankruptcy case, workers experience the bankruptcy process in ways that are very different and far more consequential than financial and commercial stakeholders. Workers cannot limit their exposure to the risk of their employer's bankruptcy by diversifying portfolios. They do not get collateral for providing their services. Among the least able to absorb deep cuts in pay and benefits, workers have become the most vulnerable stakeholders in a bankruptcy process, with much to lose and with far more long-lasting consequences.

You will likely hear that this bill would hamper a debtor's ability to reorganize, and perhaps worse. Unsupportable critiques of this nature are little more than arguments against *any* change in the status quo – fear-mongering in an effort to ward off perceived threats to vigorously guarded bankruptcy prerogatives. Charges of that nature are not at all surprising given the enormous advantages debtors have been able to wield over employees. It is simply unrealistic to suggest that companies would forego the potent remedies afforded by the bankruptcy system rather than adapt to rules that better protect employees and retirees.

Labor groups and the employees who show up to work every day for a company in bankruptcy know that their company's future depends on the success of the reorganization. No group works harder to achieve pragmatic outcomes under the extraordinarily difficult conditions of a bankruptcy case, yet workers are sacrificing too much to too many other interests in bankruptcy. H.R. 4677 is desperately needed to correct a serious imbalance in the bankruptcy process that has taken away the financial security of far too many workers, and will continue to strip away good, middle class jobs and decent standards of living unless Congress acts to put a stop to these practices. We urge Congress to take prompt action on this bill. Thank you once again for the opportunity to appear today in support of this important legislation.

[1] H.R. 3652, 110th Cong. (2007).

[2] H.R. Rep No. 95-595 at 220 (1977) ("The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is 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 …. It is more economically efficient to reorganize than to liquidate because it preserves jobs and assets.").

[3] For the 12-month period ending December 31, 2009, business bankruptcy filings increased 40% compared to filings in calendar year 2008. Chapter 11 filings for the 12-month period ending December 31, 2009 were up 50% compared to chapter 11 filings in calendar year 2008. *See* www.uscourts.gov/Press_Releases/2010/BankruptcyFilingsDec2009.cfm (visited March 21, 2010). *See also* Nelson D. Schwartz, "Tight Credit Seen as Corporate Debts Come Due," *The New York Times* (March 16, 2010) A1 (potential overload in debt markets as many high yield debt issues come due could increase bankruptcy filings as companies seek credit renewals).

[4] *See Association of Flight Attendants-CWA v. Mesaba Aviation, Inc.* (*In re Mesaba Aviation, Inc*.), 350 B.R. 435, 443 (D. Minn. 2006) (describing the impact of airline bankruptcies on employees).

[5] *See* 11 U.S.C. §§ 1102, 1103 (describing official creditors committees and their duties and powers).

[6] *See Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, 514 U.S. 651 (2006) (reviewing the expansion of the wage priority to include contributions to employee benefit plans).

[7] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 212 (2005), codified at 11 U.S.C. §§ 507(a)(4),(5).

[8] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, §§ 323, 329 (2005), codified at 11 U.S.C. § 541(b)(7) and § 503(b)(1)(A).

[9] The Bankruptcy Amendments and Federal Judgeships Act of 1984, Pub. L. No. 98-353, § 541 (1984) codified at 11 U.S.C. § 1113.

[10] The Retiree Benefits Bankruptcy Protection Act of 1988, Pub. L. No. 100-334, §2, (1988), codified at 11 U.S.C. § 1114.

[11] *See* note 18 *infra*.

[12] *See* notes 21, 25 *infra*.

[13] *In re UAL Corp*., 428 F.3d 677 (7th Cir. 2005); *In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006)(affirming decisions authorizing multiple pension plan terminations); s*ee United*

Steelworkers of Am. v. United Eng'g, Inc., 52 F.3d 1386 (6th Cir. 1995) (rejecting plan termination contract claim by employees).

[14] E.g., *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 848 F.2d 345 (2d Cir. 1988); *Truck Drivers Local 807 v. Carey Transportation, Inc*. (*In re Carey Transportation, Inc.*), 816 F.2d 82 (2d Cir. 1987).

[15] *Northwest Airlines Corp. v. Association of Flight Attendants*, 483 F.3d 160 (2d Cir. 2007).

[16] For a recent representative example of a comprehensive "first day" wage motion, *see* Debtors' Motion for Entry of Interim and Final Orders (A) Authorizing, but not Directing, Debtors (I) to Pay Certain Prepetition Wages and Reimbursable Employee Expenses, (II) to Pay and Honor Employee Medical and Other Benefits and (III) to Continue Employee Benefits Programs and (B) Authorizing Financial Institutions to Honor all Related Checks and Electronic Payment Requests [Docket No. 6, Mar. 18, 2009], *In re Chemtura Corp, et al.*, Case No. 09-11233 (REG) (Bankr. S.D.N.Y.). Obtaining authority to maintain pay and benefit programs uninterrupted by the bankruptcy case allows debtor companies to stabilize the business, maintain employee morale, and mitigate economic hardships. *See* Eisenberg and Gecker, "The Doctrine of Necessity and Its Parameters," 73 Marq. Law Rev. 1 (Fall, 1989).

[17] H.R. 4677, 111th Cong. § 101 (2010).

[18] Vacation pay is typically allocated by the court to earnings periods, even where fully earned as of a specified date. *See, e.g., In the Matter of Northwest Engineering Co.*, 863 F.2d 1313 (7th Cir. 1988); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992). Court decisions that allow priority payment only for an allocated portion of the total amount of earned compensation, limit the collection of the wage priority to less than the full per-employee amount.

[19] *See Straus-Duparquet, Inc. v. Local Union No. 3, Int'l Brotherhood of Electrical Workers*, 386 F.2d 649 (2d Cir. 1967).

[20] 11 U.S.C. § 507(a)(5)(B) (describing calculation of priority for unpaid benefit plan contributions, which subtracts "the aggregate amount paid to such employees under paragraph 4 of this subsection….").

[21] Most courts distinguish between "length of service" severance pay and "pay in lieu of notice" severance *See In re Public Ledger*, 161 F.2d 762 (3d Cir. 1947). Where courts make this distinction, severance pay in which the amount is based on length of service is allocated between "earned" periods. Under *Roth*-type cases, employees are left with a small fraction of their contractual severance pay if they lose their jobs during a bankruptcy.

[22] *See Straus-Duparquet, Inc. v. Local Union No. 3, Int'l Brotherhood of Electrical Workers*, 386 F.2d at 650-51. *See also Supplee v. Bethlehem Steel Corp*., 479 F.3d 167 (2d Cir. 2007)(supplemental retirement plan payment was not severance pay entitled to be paid as an administrative expense).

[23] H.R. 4677, 111th Cong. § 103 (2010).

[24] 11 U.S.C. § 503(a)(1)(A)(ii).

[25] *See In re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. June 20, 2008); *In re Powermate Holding Corp.*, 394 B.R. 765 (Bankr. D. Del. Oct. 10, 2008); *In re Continental AFA Dispensing Company*, 403 B.R. 653 (Bankr. E.D. Mo. 2009); *See also In re Circuit City Stores, Inc.*, 2010 WL 120014 (Bankr. E.D. Va. 2010).

[26] H.R. 4677, 111th Cong. § 105 (2010).

[27] *See Adventure Res., Inc. v. Holland*, 137 F.3d 786, 797-98 (4th Cir. 1998) (Congress acted to halt use of "bankruptcy law as an offensive weapon in labor relations") (*quoting In re Roth American, Inc.*, 975 F.2d 949, 956 (3d Cir. 1992)); *see also Century Brass Prods., Inc. v. Int'l Union* (*In re Century Brass Prods. Inc.*), 795 F.2d 265, 272 (2d Cir. 1986) (noting that statute imposed "several safeguards" on a debtor seeking rejection "to insure that employers did not use Chapter 11 as medicine to rid themselves of corporate indigestion"); *see also, Shugrue v. Air Line Pilots Association, Int'l* (*In re Ionosphere Clubs, Inc.*), 922 F.2d 984, 990 (2d Cir. 1990); *In re Tower Automotive, Inc.*, No. 06-CV4996(VM), 2006 WL 3751360, at *4 (S.D.N.Y. 2006) (describing Congress's intent in enacting Section 1114 to "ensure that the debtors did not seek to effect reorganization 'on the backs of retirees' for the benefit of other parties in interest'").

[28] Babette A. Ceccotti, "Lost in Transformation: The Disappearance of Labor Policies in Applying Section 1113 of the Bankruptcy Code," 15 ABI Law Rev. 415 (Winter 2007) ("Lost in Transformation"). A copy is submitted with this hearing statement. *See also* Andrew B. Dawson, "Collective Bargaining Agreements in Corporate Reorganizations," 84 Am. Bankr. L.J. 103, 119 (Winter 2010) (concluding that consistently pro-debtor rulings under Section 1113 demonstrate that the statute has provided "very little protection at all" for labor agreements, and recommending statutory modifications to cure the statute's defective ambiguity).

[29] *See, e.g.*, Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement – A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 AM BANKR. L. J. 293, 306, 316 (1984); Bruce Charnov, *The Uses and Misuses of Legislative History of Section 1113 of the Bankruptcy Code*, 40 SYRACUSE L. REV. 925, 948–50 (1989).

[30] *See Wheeling-Pittsburgh Steel Corp. v. United Steelworkers Of Am.* (*In re Wheeling-Pittsburgh Steel Corp.*), 791 F.2d 1074 (3d Cir. 1986)(overruling rejection of labor agreement); *N.Y. Typographical Union No. 6 v. Royal Composing Room, Inc.* (*In re Royal Composing Room, Inc.*), 848 F.2d 345, 351-8 (2d Cir. 1988) (Feinberg, J., dissenting from majority decision affirming rejection of labor agreement).

[31] "Lost in Transformation," 15 ABI Law Rev. at 432; *see e.g. Truck Drivers Local 807 v. Carey Transportation, Inc.* (*In re Carey Transportation, Inc.*), 816 F.2d 82, 89 (2d Cir. 1987); *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc.* (*In re Mesaba Aviation, Inc.*), 350 B.R. 449 (D. Minn. 2006) (approving less stringent interpretation of Section 1113).

[32] *See* Dawson, "Collective Bargaining Agreements in Corporate Reorganizations," 84 Am. Bankr. L.J. at 104.

[33] *See Association of Flight Attendants-CWA v. Mesaba Aviation, Inc.* (*In re Mesaba Aviation, Inc*.), 350 B.R. 435, 443 (D. Minn. 2006) (noting "disastrous" results of airline bankruptcies for labor).

[34] Dawson, "Collective Bargaining Agreements," 84 Am. Bank. L.J. at 104, 119. *see also Id.* at 116 (relating that in one decision in which the debtor did not prevail, the debtor ultimately prevailed in a subsequently filed motion).

[35] E.g., *Teamsters Airline Division v. Frontier Airlines, Inc*., 2009 WL 2168851 (S.D.N.Y. 2009)(overturning the bankruptcy court's rejection order where the court considered proposals made by the debtor after the commencement of the Section 1113 hearing).

[36] *See Teamsters Airline Division v. Frontier Airlines, Inc*., 2009 WL 2168851 (S.D.N.Y. 2009); *Association of Flight Attendants-CWA v. Mesaba Aviation, Inc.* (*In re Mesaba Aviation, Inc*.), 350 B.R. 435 (D. Minn. 2006).

[37] *See, e.g., In re Delta Air Lines, Inc.*, 369 B.R. 468, 475 (Bankr. S.D.N.Y. 2006) ("It is important to bear in mind the context in which this statute operates. Section 1113 is not a labor law, it is a bankruptcy law.").

[38] *See* U.S. Gov't Accountability Office, GAO 07-1101, "Many Factors Affect the Treatment of Pension and Health Benefits in Chapter 11 Bankruptcy" (2007) (identifying companies that rejected labor agreements and terminated pension and/or non-pension benefits obligations in bankruptcy); Lost in Transformation," 15 ABI Law Rev. at 417 and note 10.

[39] "Lost in Transformation," 15 ABI Law Rev. at 417-18 and notes 11, 12, 13 (collecting cases filed to achieve "transformational" goals in light of fundamental industry change).

[40] *See* Damon A. Silvers, "How We Got Into This Mess," The America Prospect (April 21, 2008), available at: www.prospect.org/cs/articles?article=how_we_got_into_this_mess (visited May 19, 2010).

[41] The Pension Protection Act of 2006, Pub. L. No. 109-280 120 Stat. 780 (August 17, 2006) ("PPA"). *See* Testimony of Ron Gebhardtsbauer, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (describing plan terminations in the *Bethlehem Steel* and *UAL Corp*. bankruptcies); Testimony of Richard Jones, Chief Retirement Actuary, Hewitt Associates LLC, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (noting that the defined benefit plan "is a common area to look for cost cutting" when companies are in financial distress and describing how pension values are lost by employer bankruptcies).

[42] *See Pension Benefit Guaranty Corporation v. Oneida, Ltd*., 562 F.3d 154 (2d Cir. 2009) (ruling that the obligation to pay the Termination Premium is not discharged in bankruptcy).

[43] PPA section 404(a), adding Section 4022(g) to the Employee Retirement Income Security. Act. *See* Testimony of David R. Jury, USW, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (calling for repeal of Section 404).

[44] Paul Fronstin, "The Future of Employment-Based Health Benefits: Have Employers Reached a Tipping Point?" Employee Benefit Research Institute Issue Brief No. 312 (December 2007) (describing trends in employer-provided retiree health benefits).

[45] Among other provisions intended to address the cost of retiree health benefits, Section 1102(a)(1) of the Patient Protection and Affordable Care Act, P.L. 111-148 (March 23, 2010) establishes a temporary reinsurance program designed to reimburse a portion of the claims cost for eligible employment-based plans that provide coverage to early retirees.

[46] *See PBGC v. LTV Corp*., 496 U.S. 633, 646–47 (1990) ("Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice") (quoting *Rodriguez v. United States*, 480 U.S. 522, 525–26 (1987)).

[47] H.R. 4677, 111th Cong. § 201 (2010).

[48] *See* "Lost in Transformation," 15 ABI Law Rev. at 426-7 (describing legislators' concerns that led to the inclusion of the time limits in the statute). In addition, adopting a ruling from the Seventh Circuit Court of Appeal in the *United Airlines* case, the bill also clarifies that only the debtor and the affected labor organization may appear and be heard at a Section 1113 hearing. *See In re UAL Corp. (Appeals of Independent Fiduciary Services, Inc.)*, 408 F.3d 847 (7th Cir. 2005)(ruling that the parties to a Section 1113 hearing are those legally capable of modifying the agreement).

[49] *See, e.g., In re Ionosphere Clubs, Inc*., 22 F.3d 403 (2d Cir. 1994); *In re Roth American, Inc.*, 975 F.2d 949 (3d Cir. 1992); *In re Northwest Airlines Corp.*, 366 B.R. 270 (Bankr. S.D.N.Y. 2007) (noting differences in text between Section 1113 and Section 1114).

[50] H.R. 4677, 111th Cong. § 201.

[51] H.R. 4677, 111th Cong. § 201 (2010).

[52] Delphi Corporation, for example, requested a litigation schedule for its section 1113 proceedings against five unions on the very first day of its bankruptcy case. *See* Delphi's Motion for Scheduling Order to Establish Notice Procedures, Briefing Schedule, and Hearing Date Regarding Debtors' Conditional Applications for Relief Under 11 U.S.C. § 1113 if Voluntary Modifications to Collective Bargaining Agreements Cannot Be Reached [Docket # 14, Oct. 11, 2005], *In re Delphi Corporation*, No. 05-44481 (RDD) (Bankr. S.D.N.Y.).

Dana Corporation, another automotive supplier, established a litigation schedule for its Section 1113 and Section 1114 motions having tendered its proposals only days earlier. *See* Motion of Debtors and Debtors in Possession, Pursuant to 11 U.S.C. Section 105(a) for Entry of a Scheduling Order in Connection with Debtors' Section 1113/1114 Process [Docket No. 4278,

Dec. 6, 2006] *and* Joint Objection to Motion on behalf of International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), United Steelworkers [Docket No. 4341, Dec. 14, 2006], *In re Dana Corp.*, No. 06-10354 (BRL) (Bankr. S.D.N.Y.).

[53] *See Teamsters Airline Division v. Frontier Airlines, Inc*., 2009 WL 2168851 (S.D.N.Y. 2009) (describing course of negotiations and information disclosure that continued through a Section 1113 hearing and vacating bankruptcy court's order authorizing rejection of labor agreement because the court considered proposals made after the commencement of the hearing).

See also In re Mesaba Aviation, Inc., 350 B.R. 435 (D. Minn. 2006) *and* Motion to Approve Compromise and For Relief Under 1113(c) Approving Amended Agreements with ALPA, AFA and AMFA, at 5-7, *In re Mesaba Aviation, Inc.*, No. 05-39258 (GFK) (Bankr. D. Minn. Nov. 7, 2006). Mesaba sought a six-year concessionary agreement and a fixed level of savings in its Section 1113 court case and in a later settlement agreed to a lower percentage of cuts, a shorter duration and a form of wage increase snapback it rejected in its court case.

[54] *Northwest Airlines Corp. v. Association of Flight Attendants*, 483 F.3d 160 (2d Cir. 2007). *See* Richard M. Seltzer and Thomas N. Ciantra, "The Return of Government by Injunction in Airline Bankruptcies," 15 ABI Law Rev. 499 (Winter 2007). A copy is submitted with this hearing statement.

[55] *See generally*, Michael St. Patrick Baxter, "Is There a Claim for Damages From the Rejection of a Collective Bargaining Agreement Under Section 1113 of the Bankruptcy Code?" 15 Bankr. Dev. J. 703 (1996).

[56] *See In re Tower Automotive, Inc*., No. 06-CV4996(VM), 2006 WL 3751360, at *4 (S.D.N.Y. 2006) (describing Congress's intent in enacting Section 1114 to "ensure that the debtors did not seek to effect reorganization 'on the backs of retirees' for the benefit of other parties in interest'").

[57] H.R. 4677, 111th Cong. § 202 (2010).

[58] *Compare In re Delphi Corporation.* 2009 WL 637315 (Bankr. S.D.N.Y. March 9, 2009) and *In re Doskocil Cos.,* 130 B.R. 810 (Bankr. D. Kansas 1991)(debtor need not follow Section 1114 procedures) *with In re Farmland Industries,* 294 B.R. 903 (Bankr. W.D. Mo. 2003) (Section 1114 procedures apply even where debtor asserted the right to make unilateral changes in retiree health benefits).

[59] H.R. 4677, 111th Cong. § 204 (2010).

[60] *See* Testimony of Richard Jones, Chief Retirement Actuary, Hewitt Associates LLC, *Pensions in Peril – Helping Workers Preserve Retirement Security Through a Recession*, Hearing before the Senate Committee on Health, Education, Labor and Pensions, Oct. 29, 2009 (describing increase in defined contribution plans).

[61] H.R. 4677, 111th Cong. § 204 (2010).

[62] *See* H.R. Rep No. 95-595 at 220 (1977).

[63] H.R. 4677, 111th Cong. § 206 (2010).

[64] H.R. 4677, 111th Cong. § 203 (2010).

[65] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501 (2005), codified at 11 U.S.C. § 503(c).

[66] *See* Maryjo Bellow and Edith K. Altice, "Tackle §503(c) by Structuring a 'MIP' – And Other Strategies to Have in Your Playbook," 27 APR Am. Bankr. Inst. J. 34 (offering strategies for devising compensation packages in light of the Section 503(c) restrictions).

[67] *E.g., In re Global Home Products, LLC*, No. 06-10340, 2007 WL689747 (Bankr. D. Del. 2007) (approving program as incentive plan and excusing review by an independent consultant); *In re Nellson Neutraceutical Inc.*, 369 B.R. 787 (Bankr. D. Del. 2007).

[68] *See In re Dana Corporation*, No. 06-10354, 2006 WL 3479406 * note 30 (Bankr. S.D.N.Y. 2006) (approving, as modified, revised executive contracts and noting that the CEO, "with curious timing, issued a letter to employees and former employees in the days after the Executive Compensation Motion was filed" indicating that the debtors, in aid of their reorganization "would have to close plants, terminate employees, modify collective bargaining agreements and potentially terminate retiree [health] benefits.").

[69] *See* Peg Brickley, "Banks and Bonuses Still Rule in Delaware Bankruptcy Court," The Daily Bankruptcy Review, October 27, 2008.

[70] H.R. 4677, 111th Cong. § 302 (2010).

[71] *See* "Executive Pay: Conflicts of Interest Among Compensation Consultants," U.S. House of Representatives, Committee on Oversight and Governmental Reform (Majority Staff) (December, 2007).

[72] H.R. 4677, 111th Cong. § 301 (2010). *See In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009)(approving incentive pay program in reorganization plan where bonuses were tied to certain objectives, including a publication "shutdown" objective and emergence from bankruptcy).

[73] H.R. 4677, 111th Cong. § 305 (2010).

[74] H.R. 4677, 111th Cong. § 201 (2010).

[75] H.R. 4677, 111th Cong. § 303 (2010).

[76] H.R. 4677, 111th Cong. §§ 401, 402 (2010). *See, e.g., In re Ionosphere Clubs, Inc.*, 922 F.2d 984 (2d Cir. 1990); *In re Fulton Bellows & Components, Inc.*, 307 B.R. 896 (Bankr. E.D. Tenn. 2004) (automatic stay does not bar contractual arbitration proceedings).