

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF ILLINOIS

IN RE:)	
)	
FLEMING PACKAGING CORP., a Delaware corporation,)	No. 03-82408
Debtor.)	
<hr style="border: 0.5px solid black;"/>		
IN RE:)	
)	
FP LABEL COMPANY, INC., a California corporation,)	No. 03-82410
Debtor.)	
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IN RE:)	
)	
FP ESTATE INCORPORATED, a California corporation,)	No. 03-82411
Debtor.)	

OPINION

Before the Court are three different motions for administrative claims and the objections thereto filed by the Debtors, Fleming Packaging Corporation, fp Label Company, Inc., and fp Estate Incorporated (collectively known as the "DEBTORS"). Both Local 458-3M and Local 568-M of the Graphic Communications International Union, AFL-CIO (together, "GCIU"), have filed motions for administrative claims for holiday, vacation and bereavement pay accruing after the filing of the bankruptcy petition, as well as for severance pay due upon termination of their members' employment, in accordance with the provisions of their collective bargaining agreements. The Graphic Communications International Union Supplemental Retirement & Disability Fund ("SRDF") has also filed a motion for an administrative claim for monthly contributions during that same period.

FACTUAL AND PROCEDURAL BACKGROUND

Fleming Packaging Corporation and its two wholly owned subsidiary corporations, fp Estate Incorporated and fp Label Company, prominent makers of labels for the wine, spirits and liquor markets, as well as a distributor of packaging machinery to wineries, filed Chapter 11 petitions on May 13, 2003. Collectively, the DEBTORS employed slightly more than two hundred workers at that time. Collective bargaining agreements, entered into by the DEBTORS and GCIU, covered less than one hundred of those employees.

Just prior to the bankruptcy filing, the DEBTORS, acting with the consensus of their key creditors, entered into an agreement for the sale of substantially all of their assets to RM-FP Acquisition Corporation (RM-FP). Although the purchase agreement provided that RM-FP would not assume any of the DEBTORS' obligations under any collective bargaining agreement or employee benefit plan, \$1,000,000.00 of the purchase price was to be allocated to pay stay bonuses. Recognizing that retention of the employees during the short duration of the Chapter 11 proceeding was both necessary to preserve the going concern value and crucial to the closing of the impending sale, the DEBTORS proposed payments from the stay bonus pool to employees who remained employed through the date of the sale ranging from \$524.00, for temporary employees, to \$18,861.00, for certain key employees. Within days of the filing of the petition, the Court approved procedures for a Section 363 sale.¹ The sale, subject to a higher and better offer through bidding by qualified bidders, was scheduled to occur on July 9, 2003. The DEBTORS continued to operate pursuant to

¹By order entered that same day, FLEMING PACKAGING'S Motion for Joint Administration of the cases for procedural purposes only, was granted.

Sections 1107 and 1108 of the Bankruptcy Code, as debtors in possession, and the sale ultimately took place on July 18, 2003. Prior to the sale, none of the DEBTORS attempted to reject the collective bargaining agreements with GCIU. Subsequently, the agreements were rejected with the effective date of rejection ordered to be July 18, 2003. RM-FP took over the operations immediately following the sale.

The administrative claims that are presently before the Court were filed during the pendency of the Chapter 11 proceedings. The DEBTORS objected to all three claims and after hearing argument, the Court took the matters under advisement, requesting briefs that have now been submitted by the parties. The cases were converted to Chapter 7 on January 13, 2004. Gary T. Rafool was appointed the Chapter 7 Trustee (TRUSTEE) in each case.

ANALYSIS

1. General Principles of Law

The Motions raise issues of law and of fact. An evidentiary hearing has not been held. The Court will resolve the disputed issues of law, to the extent possible in the absence of evidence, and will identify the issues of fact that remain to be determined. In this way, the Court hopes to give the parties a roadmap for resolution of these priority claims.

Administrative expenses are paid “off the top” and have priority over all other claims to assets of the bankruptcy estate. 11 U.S.C. § 507(a)(1). Section 503(b)(1)(A) of the Bankruptcy Code provides that administrative expenses include “the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case” 11 U.S.C. § 503(b)(1)(A). Because priority for administrative claims departs from the Bankruptcy Code’s policy of equality

of distribution, the party seeking administrative priority bears the burden of proving entitlement and the priority is narrowly construed. *In re FBI Distribution Corp.*, 330 F.3d 36 (1st Cir. 2003). In order for a claim to be entitled to treatment as an administrative expense, the claimant must establish that the debt (1) arises out of a transaction with the debtor-in-possession, and (2) benefitted the operation of the debtor's business. *Matter of Jartran, Inc.*, 732 F.2d 584 (7th Cir. 1984); *In re Pre-Press Graphics Co., Inc.*, 300 B. R. 902 (Bankr.N.D. Ill. 2003).

The Bankruptcy Code draws a clear distinction, for priority purposes, between wages earned prepetition and those earned postpetition. Subject to a cap, third priority is accorded wages earned within ninety days before bankruptcy. 11 U.S.C. § 507(a)(3). Wages earned after the filing enjoy first priority status, 11 U.S.C. § 507(a)(1) and § 503 (b)(1)(A), on the theory that services rendered to a debtor help preserve the value of the estate. Section 507(a)(3) expressly includes vacation, severance, and sick leave pay, to the extent earned within ninety days prepetition, within the category of compensation entitled to the third priority. Those subsets are not expressed in Section 503(b)(1)(A). Nevertheless, courts uniformly hold that vacation pay, severance pay and sick leave pay, as well as other forms of compensation, are eligible for administrative priority status. *See*, 4 COLLIER ON BANKRUPTCY ¶ 503.06[7] (15th ed. rev. 2004). Section 503(b)(1)(A) does not impose a statutory maximum on administrative wage claims. Courts police against excessive wage claims by requiring that the amount claimed as compensation be reasonable and not disproportionate to the value of the services rendered. *In re Pre-Press Graphics Co., Inc.*, 310 B.R. 893, 903 (Bankr.N.D.Ill. 2004).

It is quite clear that it is only wages owing for services actually rendered postpetition that are to be granted administrative priority. *In re Continental Airlines, Inc.*, 148 B.R. 207, 212 (D.Del. 1992) (only those wage claims which are paid to induce employees to continue to work for an employer who has filed a petition for Chapter 11 are necessary for the preservation of the estate and thus are an administrative priority). A similar rationale applies to the related forms of compensation. Vacation pay is an administrative expense only to the extent earned during the postpetition employment period. *In re Roth American, Inc.*, 975 F.2d 949, 957 (3rd Cir. 1992); *Matter of Schatz Federal Bearings Co., Inc.*, 5 B.R. 549 (Bankr.S.D.N.Y. 1980). Vacation pay is deemed to be earned continuously, regardless of any particular contractual vesting schedule. *Pre-Press Graphics Co.*, 300 B.R. at 912. Therefore, simply because vacation pay becomes payable postpetition, does not mean that the full amount due under the employment agreement automatically qualifies for administrative priority status. Instead, it must be determined what portion was earned after the bankruptcy filing.

Courts have distinguished between two types of severance pay: (1) pay at termination in lieu of notice, and (2) pay at termination based on length of employment. Severance pay claims based on length of employment, like vacation pay claims, have administrative priority only to the extent that they are “earned” postpetition based on services provided to the bankruptcy estate. *Roth American*, 975 F.2d at 957 (citing *Matter of Health Maintenance Foundation*, 680 F.2d 619, 621 (9th Cir. 1982) and *In re Public Ledger*, 161 F.2d 762, 768-69 (3rd Cir. 1947)). Severance pay in lieu of notice is usually considered to be earned at termination, while severance pay based on length of employment is earned over the entire term of the employee’s tenure.

2. The Effect of a CBA.

A layer of complexity is added to the analysis where a collective bargaining agreement (“CBA”) is involved. A CBA, and the obligations arising thereunder, enjoy special protection under Section 1113 of the Bankruptcy Code. That section requires a debtor to honor the terms of its CBA unless changes are bargained for (subsection (b)), or changes are ordered upon a showing of necessity or irreparable harm (subsection (e)). Otherwise, the debtor is not permitted to “unilaterally terminate or alter any provisions of a collective bargaining agreement.” 11 U.S.C. § 1113(f). *See, Shugrue v. Air Line Pilots Ass’n Int’l (In re Ionosphere Clubs, Inc.)* 922 F.2d 984 (2nd Cir. 1990).

In light of the mandate of Section 1113, courts have struggled with the question of the payment priority to be assigned to the debtor-in-possession’s obligations under a CBA that remain unperformed or unpaid as of the time the rejection of the agreement is approved. The tension is between the obligations mandated under Section 1113 and the payment priorities set out in 11 U.S.C. §§ 503 and 507. There is a split of federal circuit authority as to whether Section 1113(f) trumps the priorities established in Section 507. *See, In re Certified Air Technologies, Inc.*, 300 B.R. 355 (Bankr.C.D.Cal. 2003). Although the issue has yet to be addressed by the Seventh Circuit, three of four Courts of Appeals have held that Section 1113 does not conflict with or alter the priority scheme set forth in Sections 503 and 507. *Adventure Resources Inc. v. Holland*, 137 F.3d 786 (4th Cir. 1998); *Airline Pilots Ass’n v. Shugrue (In re Ionosphere Clubs)*, 22 F.3d 403 (2nd Cir. 1994); *In re Roth American, Inc.*, 975 F.2d 949 (3rd Cir. 1992). *Contra, United Steelworkers v. Unimet Corp. (In re Unimet Corp.)*, 842 F.2d 879 (6th Cir. 1988).

This Court agrees with the Circuit majority. There is nothing in the language of Section 1113 or its legislative history to indicate that Congress intended it to override Section 507. Because Congress neither included explicit language in Section 1113 to supercede Section 507 nor amended Section 507 to specifically create a super-priority status for such claims, this Court concludes that claims for wages and benefits due under a CBA are not, *ipso facto*, entitled to treatment as administrative expenses but are to be accorded priority consistent with Section 507. See, *Certified Air Technologies, Inc., supra; In re Kitty Hawk, Inc.*, 255 B.R. 428 (Bankr.N.D.Tex. 2000). Accordingly, just because unpaid obligations arise out of a CBA that is rejected or otherwise terminates postpetition, does not mean that they are automatically accorded administrative priority status. Rather, the obligations still must satisfy the usual requirements of resulting from a postpetition transaction with the debtor-in-possession or trustee that actually benefitted the debtor-in-possession or the estate.

Notwithstanding that Section 1113 does not create a super-priority for unpaid obligations under a CBA, it still has a role to play. Because a debtor-in-possession must honor all of the terms of an unrejected CBA, and cannot dissect the agreement and discard those provisions it finds objectionable, to the extent the union employees provide postpetition services to the debtor-in-possession, whatever compensation for those services that accrues under the CBA is entitled to administrative priority, without being subject to reduction. In other words, to the extent the union members establish a valid claim to administrative priority status, the amount of the priority claim is equivalent to the entire compensation package provided for by the terms of the CBA, to the extent earned on

account of the postpetition services, without regard to reasonableness. *In re Colorado Springs Symphony Orchestra Ass'n.*, 308 B.R. 508 (Bankr.D.Colo. 2004); *In re Kitty Hawk, Inc.*, *supra*. The debtor-in-possession or trustee does not have the option, for example, of paying a reduced wage rate or of excising extra items of compensation such as holiday pay or vacation pay, that are above and beyond the minimalist formula of a day's wage for a day's work.

3. Vacation, Holiday and Bereavement Pay

GCIU requests that the employees' claims for vacation, holiday and bereavement pay which accrued during the postpetition period of approximately ten weeks from May 13, 2003 to July 18, 2003, be entitled to administrative expense treatment. Pursuant to the foregoing analysis, the employees are entitled to an administrative priority for vacation pay, holiday pay and bereavement pay that was "earned" postpetition and that remains unpaid. Holiday pay and bereavement pay, in the nature of paid leave and being tied to the occurrence of a particular event, a holiday or family death, are allowable as an administrative priority so long as the time off on account of the event was taken postpetition. Vacation pay, on the other hand, is usually subject to a mathematical calculation that distinguishes vacation pay earned prepetition from that earned postpetition. In order to establish how much was earned over a given period of time, it is necessary to determine the rate at which each employee's entitlement to vacation pay was accruing.

Under the provisions of the CBA with LOCAL 458-3M, union employees with less than one year of employment earned two days of paid vacation for each five weeks of work,

up to a maximum of ten days. Employees with more than one year of employment were entitled to two additional weeks of vacation.² The amount of an employee's vacation was determined as of May 1st, based on the preceding year, and was taken by the employee in the ensuing year.³ The contract provided that an employee is entitled to payment of any unused vacation upon termination at the rate of two days' pay for each five weeks of employment, with one day's pay for any major fraction of five weeks' employment, from the preceding May 1st.

Similarly, the DEBTORS' employees covered under the contract with LOCAL 568-M, were entitled to vacation time depending upon the number of years worked by the employee. Employees with less than three years' seniority were entitled to ten days' paid vacation and employees with more than three years' seniority were entitled to three weeks' vacation, earning one and one-half days' vacation for every five weeks of work. Employees exceeding that length of service were entitled to four weeks of vacation, earning two days of vacation for every five weeks worked. The contract provided for payment of unused vacation upon an employee's discharge or severance of the employment relationship.

According to the CBA with LOCAL 458-3M, in order to qualify for holiday pay, an employee must have (1) been employed for at least two weeks; and (2) worked the last scheduled regular working day both before and after the holiday, unless ill, injured, or otherwise excused by the employer. Section 8 of the CBA with LOCAL 568-M, governing

²The CBA distinguished between employees and general employees. General employees were entitled to two weeks of vacation after one year, three weeks of vacation after three years, and four weeks of vacation after ten years. Employees having more than twenty years' seniority were entitled to an additional five days of paid lay-off or sick days, with a special provision applicable for employees having more than twenty-five years' seniority.

³ Vacations accrued on a fiscal year beginning May 1st through April 30th under both contracts.

the earning of holiday pay is essentially like the provisions in the contract set forth above. Section 15 of the agreement, governing an employee's right to bereavement pay, affords an employee from one to three days of paid leave, depending on the relationship of the deceased to the employee.

In support of its motions, GCIU attached schedules listing each employee and an individual amount claimed for each of the separate categories of "accrued vacation," "holiday pay," "bereavement pay" and "severance pay."⁴ No specific information as to an individual employee's rate of pay or length of employment was shown. Holiday pay for both May 30 and July 4 is claimed by all but four of the employees.⁵ Only one employee, a member of LOCAL 568-M, asserts a claim for bereavement pay in the amount of \$131.40. In their objection to the motions, the DEBTORS challenged both the evidentiary and legal bases of the claims. After the cases converted, the TRUSTEE adopted the DEBTORS' objections.

In further support of its claims on behalf of the employees, GCIU attached to its brief a more detailed computation of the employees' administrative claims. With respect to their claims for accrued vacation pay, each employee's hourly wage is set forth, as well as the number of hours worked per day. With the exception of the recent hires, GCIU asserts that each employee accrued four days' vacation from the period beginning May 13, 2003 to July 18, 2003. Similarly, the employees' claims for holiday pay show their hourly wages and the

⁴The employees' claims for accrued vacation pay are broken down into prepetition unsecured, prepetition priority and administrative claims.

⁵ The list of named employees for LOCAL 458-3M includes Michael Broshears and David Ryba, and the list for LOCAL 568-M includes Marilyn Johnson and Todd Johnson, but no amounts are claimed for these four employees in any category.

number of working hours per day. The individual employee's date of hire is shown on the calculation of the employees' claims for severance pay.

In their brief, the DEBTORS persist in their contention that the evidentiary basis remains insufficient, noting, for instance, that holiday pay is claimed for every employee without verification that each employee worked the days both preceding and following the holidays. The DEBTORS allude to other unsubstantiated facts and call for an evidentiary hearing after resolution of the legal issues raised by the parties. The Court will first direct its attention to the determination of the legal issues, before addressing the factual concerns.

Asserting that the DEBTORS neither "signed on," nor assumed the CBAs, the DEBTORS dispute, as a matter of law, the employees' entitlement to their claims for vacation, holiday and bereavement pay arising under the CBAs. Based upon the foregoing analysis, the Court rejects the DEBTORS' position and holds that administrative priority status must be accorded to unpaid vacation, holiday and bereavement pay, to the extent earned postpetition. It is clear in the Seventh Circuit that vacation pay is deemed to be earned continuously, as work is performed, regardless of the contractual schedule that determines when paid vacations vest and when they may be taken. *Matter of Northwest Engineering Co.*, 863 F.2d 1313 (7th Cir. 1988). The postpetition period, running from May 14 through July 18, spans sixty-six days, or eighteen percent of a full year. Accordingly, employees who, based on their tenure, were entitled to ten days paid vacation each year, have an administrative priority claim for eighteen percent of ten days' pay, to the extent not previously paid by the DEBTORS. Those employees who received three weeks paid vacation, have an administrative priority claim for eighteen percent of fifteen days' pay, to

the extent not previously paid by the DEBTORS. The applicable rate of pay is each employee's wage rate as of July 18, 2003.

Holiday pay for the Memorial Day and Independence Day holidays is allowable as an administrative expense to each employee who met the contractual requirement for earning such pay by working the day before and the day after the holiday, to the extent that such pay was not paid to the employee by the DEBTORS. Bereavement pay is also allowable as an administrative priority claim to the extent the contractual conditions for such pay were met, and to the extent not previously paid by the DEBTORS.

4. Severance Pay

The employees' claims for severance pay under both CBAs account for the most significant share of their claims for administrative expense. Under Section 20 of the CBA with LOCAL 568-M, an employee who is permanently laid off is entitled to severance pay in the amount of \$525.00 for every four completed years of service. The contract provides that an employee who accepts employment at any Fleming Packaging subsidiary is ineligible for severance pay. Section 19 of the CBA with LOCAL 458-3M provides for a severance allowance in accordance with the following schedule:

Years of Accredited Service	Weeks of Severance Allowance
1-5	2
6-10	4
11-15	6
16-20	8
21-25	10

The contract provides that the allowance is to be computed at thirty-seven and one-half hours per week, multiplied by the rate of pay per hour, calculated in the same manner as

vacation pay. An employee who is transferred to another plant or employed by a purchaser of the DEBTOR is not entitled to a severance allowance under the contract.

In the same manner alluded to previously, GCIU expanded the calculation of the severance claims in an attachment to its brief to include each employee's date of hire, number of weeks of severance allowable and the employee's hourly rate of pay. The DEBTORS, in addition to questioning their continuing obligation under the "unassumed" CBAs, point to the absence of an affirmative statement by each of the employees under the LOCAL 458-3M contract that he or she was not hired by RM-FP and thus became entitled to receive a severance allowance.

Although acknowledging that most courts that have considered claims for severance pay have held that it is earned over the entire term of employment, GCIU, relying on *Trustees of Amalgamated Ins. Fund v. McFarlin's Inc.*, 789 F.2d 98 (2nd Cir. 1986), contends that the employees' severance pay was earned upon termination of their employment and that the full amount is allowable as an administrative claim. As noted by the DEBTORS, this Court, in *In re Redco*, 2003 WL 1785789 (Bankr.C.D.Ill. Apr 02, 2003), siding with the majority rule, held that severance pay is earned over the entire period of the employee's tenure. Affirming that ruling on appeal in an unpublished decision issued December 12, 2003 (No. 03-1164), the District Court rejected the Second Circuit's statutory interpretation of the term "earned," and sanctioned the formula employed in *Redco* for apportioning the severance pay. Because the claims for severance pay are based on length of employment, that ruling is controlling here and the GCIU'S administrative expense claims for severance pay are

limited to those portions earned during the postpetition period. *See, also, In re Russell Cave Co., Inc.*, 248 B.R. 301 (Bankr.E.D.Ky. 2000) (holding that severance pay claims are entitled to administrative priority only to the extent earned postpetition, calculated as the ratio of the numbers of days worked postpetition to a full year).

As with vacation pay, it is necessary to determine the rate at which each employee was accruing severance pay, assuming continuous, or straight-line, accrual. Any employee who was hired by RM-FP, or its successor or assignee, is not entitled to severance pay. As for those employees not so hired, the formula to be applied to determine the amount to which each employee is entitled as an administrative expense is as follows. Those employees under the LOCAL 458-3M contract were earning severance pay at the rate of two weeks' pay for every five years of service, which is equivalent to two days per year. The postpetition operating period spanned sixty-six days or 18% of one year (66/365). Therefore, each employee is entitled to 18% of two days' pay, at their individual rate of pay in effect as of July 18, 2003. Under the CBAs, the normal work week consisted of 37.5 hours or 7.5 hours per day. Therefore, the formula to determine each employee's administrative priority claim for severance pay (X) is :

$$15 \text{ (hours) times the employee's hourly wage rate times } .18 = X$$

Those employees under the LOCAL 568-M contract were earning severance pay at the rate of \$525 for every four completed years of service, which is equivalent to \$131.25 per year. Based on the duration of the postpetition operating period of 18% of one year, each employee is entitled to an administrative priority claim in the amount of \$23.63.

Early on, in their objection to GCIU'S claims, the DEBTORS suggested that they may be entitled to an offset for the "stay bonuses" received by the employees from the "carve-out" of the sale proceeds received by RM-FP. As pointed out by GCIU, there is no support for the DEBTORS' contention, and the DEBTORS' liability under the CBAs is unaffected by the separately negotiated agreement for stay bonuses.

5. SRDF'S Claim

SRDF seeks payment of an administrative expense in the amount of \$4,106.95, representing the monthly postpetition contributions that the DEBTORS were required to make under the unassumed, but not rejected, CBA with LOCAL 358-M, based on six percent of straight time wages earned by its union members. The claimed amount is broken down into \$954.70 for the month of May, \$1,891.35 for June, and \$1,260.90 for July. The DEBTORS do not strenuously oppose this claim and for the fore-going reasons, that claim, incurred during the postpetition period, qualifies as an administrative expense. *See, In re World Sales, Inc.*, 183 B.R. 872 (9th Cir. BAP 1995).

6. Unresolved Factual Issues

Having resolved the legal challenges to GCIU'S request for administrative expenses, the DEBTORS' evidentiary objections remain. The DEBTORS' position that the administrative priority claims are not established as a matter of fact is well taken. Even though GCIU has filed and advocated the administrative claim requests on behalf of its members, each individual claimant bears the burden of proving his or her entitlement to an administrative priority and the amount of such priority. Most of the information necessary to resolve the questions of fact should be available in the DEBTORS' payroll records. Those records

should be obtained and made available for inspection to both the TRUSTEE and GCIU. If GCIU wishes to avoid the necessity of procuring an affidavit from each employee stating that they were not hired by RM-FP or any successor entity, it should endeavor to obtain from the purchaser a list of its new hires.

The Clerk will be directed to schedule a status hearing to be held telephonically with the TRUSTEE and the attorney for GCIU. If GCIU cannot satisfy the TRUSTEE'S evidentiary objections, an evidentiary hearing will be scheduled.

This Opinion constitutes this Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate Order will be entered.

Dated: August 31, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

Copies to:

James Morgan, 191 N Wacker Drive, Suite 1800, Chicago, IL 60606
Scott N. Schreiber, 191 N Wacker Drive, Suite 1800, Chicago, IL 60606
Michael H. Slutsky, 208 S. LaSalle Street, Suite 1880, Chicago, IL 60604
Nancy A. Peterman, 77 W. Wacker Drive, Suite 2500, Chicago, IL 60601
Gary T. Rafool, 411 Hamilton Blvd., Suite 1600, Peoria, IL 61602
Sabrina Petesch, 401 Main Street, Suite 1100, Peoria, Illinois 61602
U.S. Trustee, 401 Main Street, Suite 1100, Peoria, Illinois 61602

UNITED STATES BANKRUPTCY COURT
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ORDER

For the reasons stated in an Opinion filed this day, IT IS HEREBY ORDERED that

1. The motions for administrative claims filed by Local 458-3M and Local 568-M of the Graphic Communications International Union are continued, generally, in accordance with the Opinion, with notice of a telephonic status hearing to issue.

2. The motion for administrative claim filed by the Graphic Communications International Union Supplemental Retirement & Disability Fund is allowed in the amount of \$4,106.95.

Dated: August 31, 2004.

THOMAS L. PERKINS
UNITED STATES BANKRUPTCY JUDGE

Copies to:
James Morgan
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Michael H. Slutsky
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Gary T. Rafool
Sabrina Petesch,
U.S. Trustee