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LABOR AND CHAPTER 11

by Allen Cheadle

The highly publicized cases of Braniff and Continental Airlines have made Chapter 11 bankruptcy a hot topic in industrial relations. Recently, the legal issues surrounding the use of Chapter 11 to escape collective bargaining contracts were discussed at a conference sponsored by the Institute of Industrial Relations, U.C. Berkeley. The participants included an attorney from each side of the bargaining table: Ned Fine of the management firm of Fisher and Phillips, and David Rosenfeld of Van Bourg, Allen, Weinberg and Roger. This article will summarize some of the points made at the conference.

The Chapter 11 Process — A “financially troubled firm” (basically, a firm whose liabilities exceed its assets—though there is no generally accepted definition) has two options under the U.S. Bankruptcy Code. Chapter 7 is filed when the firm is irretrievably in debt. The firm’s assets are liquidated and distributed to creditors according to a schedule of priorities, and the firm then ceases to exist. Chapter 11 is a much less harsh remedy. Under Chapter 11, the firm becomes a “debtor in possession,” essentially a new company, whose actions are now partially controlled by a bankruptcy court.

The debtor in possession then petitions the court to reject (or assume) contracts negotiated by the old company. These may include contracts with customers, suppliers and labor unions. For all contracts, the court determines whether it makes “good business sense” to reject the agreement. This is a very weak standard and permits the rejection of virtually any contract.

Until recently, collective bargaining agreements enjoyed a special status in this process. The standards for rejecting a labor contract were generally held by the courts to be stricter than those applied to customers and other suppliers. This privileged position has been eroded, however, by a recent Supreme Court decision. It is worthwhile to look at the *Bildisco* case in some detail since it illustrates many of the labor issues connected with Chapter 11.

Supreme Court’s Bildisco Decision — Bildisco is a small New Jersey building supply company employing approximately 100 people, 40-45% of whom are represented by Teamsters Local 408. In January 1980, one year into a three year agreement, the company stopped making pension and welfare contributions. In May 1980, the company refused to grant a scheduled wage increase. At the same time, Bildisco filed for Chapter 11 and petitioned to have the Teamsters agreement set aside by the bankruptcy court which ruled that the company was entitled to reject the contract. The Teamsters appealed the decision.

Simultaneously, the union filed a suit with the NLRB charging that the company had committed an unfair labor practice by unilaterally rejecting the contract. The NLRB agreed and the company appealed the decision. The suits were combined and eventually wound up before the Supreme Court.

The court was asked to resolve a number of questions in the Bildisco case, including:

- (1) Was the bankruptcy court acting within its authority in rejecting the Teamsters contract?
- (2) Should a different standard (other than “good business sense”) be applied in rejecting a labor contract? Two alternatives were possible: (a) “balancing the equities,” i.e., consider the gains and losses to creditors, suppliers and employees before rejecting the agreement, or (b) a strict standard that would set aside the contract only if meeting its terms would lead to a Chapter 7 bankruptcy.
- (3) Does a firm reorganizing under Chapter 11 commit an unfair labor practice by unilaterally rejecting a contract? Further, can the rejection of the contract apply retroactively, or must the company obtain approval of the bankruptcy court before breaking the agreement?
- (4) What is the duty of the employer to bargain before breaking an agreement?

On points 1 and 2 the court ruled unanimously that a bankruptcy court could reject a collective bargaining agreement and that the standard of “balancing the equities” should apply. On point 3, by a

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5-4 vote, the court rejected the argument that a firm commits an unfair labor practice by unilaterally breaking an agreement. The majority argued that the bankruptcy law which provides "flexibility and breathing space" for the debtor in possession takes precedence over the National Labor Relations Act. On the second part of point 3, the court ruled that the company need not obtain prior approval of the bankruptcy court before violating the agreement.

On point 4, also by a 5-4 vote, the court held that "reasonable efforts" should be made to negotiate a voluntary modification of the existing contract. However these "reasonable efforts" need not be up to the standards of Section 8(d) of the NLRA, which sets out duties of the parties involved in negotiating modifications to an existing contract (60 day written notice, meet and confer, notify Federal Mediation Service, continue to follow the terms of the existing contract for at least 60 days).

Unresolved Issues — Several major issues relating to the treatment of collective bargaining agreements under Chapter 11 are up in the air pending action by Congress and the courts. Legislation before Congress would tighten the conditions under which a firm can file for Chapter 11 and perhaps address the contract rejection issue directly.

However, the courts will have a more immediate impact on the process, because the *Bildisco* decision left somewhat vague two important questions. First, what weights should be given to the various parties (creditors, suppliers, employees, etc.) in balancing the equities? According to the Supreme Court: "In striking the balance the court must consider not only the degree of hardship but also any qualitative differences between the types of hardships they may face." Presumably this means that employees might be given special consideration even though the absolute amount of their loss is relatively small. Second, the courts must decide the standard of bargaining that constitutes a "reasonable effort." The standard must lie somewhere between no bargaining at all (i.e., what *Bildisco* did) and the NLRA standard.

Labor Response — Both participants in the workshop agreed that the use of Chapter 11 solely as a tool for escaping union contracts is not likely to be widespread. In filing for Chapter 11, the company sacrifices too much control over its operations to make this a useful tactic. For unions faced with a company that is already filing for Chapter 11, Mr. Rosenfeld first stressed that the union is still the certified bargaining representative and then outlined several options:

(1) Aggressively use the union's membership on the Creditors Committee (set up to advise the bankruptcy court) to have management come before the committee; have management removed; advise that the terms of the collective bargaining agreement be met.

(2) If the Creditors Committee is unsuccessful, form a separate Labor Committee to pursue the same goals. Legal fees for these activities may be paid for by the debtor in possession.

(3) File a claim for the difference between the wages under the contract and the wages actually paid when the contract is broken.

(4) Exercise the right to strike if the contract is rejected.

In general the union should take advantage of the fact that, under Chapter 11, the final authority for major company decisions rests with the bankruptcy court and not with management.

Remedial legislation beneficial to labor would force a Chapter 11 company to obtain prior approval before breaking a collective bargaining agreement. As the law stands after the *Bildisco* ruling, the company can break an agreement and then stall in bankruptcy court. By the time the case is resolved the effect of paying accumulated wages and benefits might actually bankrupt the company. Therefore the judge might approve the rejection of a collective bargaining contract that would not have been rejected if it had been reviewed early in the reorganization process.

-- Allen Cheadle

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