Federal Labor Laws

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XXI. Bankruptcy Law Considerations in Collective Bargaining

A. The Bankruptcy Reform Act of 1978

1. The goal of federal bankruptcy law is to assist individuals and businesses to obtain relief, if possible, from debts which could render the debtor insolvent. If rehabilitation is impossible, bankruptcy law also provides a means for determining the appropriate distribution of assets to the outstanding creditors of the debtor. To accomplish these goals, there are three distinct types of bankruptcy:[1]

    a. Chapter 13 bankruptcy is personal bankruptcy, under which individual debtors seek relief from personal obligations.

    b. Chapter 11 bankruptcy provides for the reorganization of the debts of a business. The goal of Chapter 11 bankruptcy is to limit the number of business failures by allowing reorganization rather than forcing liquidation of debtor businesses.

    c. Chapter 7 bankruptcy is for the liquidation of businesses which cannot be saved. Under Chapter 7, the objectives are to provide rational distribution of the assets of the insolvent firm among its creditors.

2. The Bankruptcy Reform Act of 1978 was enacted in an effort to slow the pace of business failures by making it easier for financially troubled companies to seek protection from their creditors.

    a. While the purpose of this legislation was to provide some help to companies before their financial problems required liquidation, relatively stable companies found within its provisions an effective strategy for undermining the bargaining process.

    b. There are three aspects of Chapter 11 reorganization which made it an attractive strategy for avoiding bargaining obligations:

        1) Since 1978, it is not necessary for a company to be insolvent before seeking reorganization. It is sufficient

[1] Federal bankruptcy law is found in Title 11, United States Code.

to establish that the business could become insolvent if forced to pay all outstanding and potential debts.

2) The chief executive officer of a business can seek protection under Chapter 11 without giving up control of the business. Instead of requiring a trustee to be appointed to operate the business while in reorganization, Chapter 11 allows the appointment of a "debtor in possession" to supervise the reorganization plan and the operation of the business.

3) Subject to the approval of the bankruptcy court, a debtor in possession is permitted, as part of the reorganization, to reject outstanding executory contracts if rejection would assist in the reorganization. An executory contract is any contract under which obligations are dependent upon future performance.

B. Rejection of Collective Bargaining Agreements under Federal Bankruptcy Law

1. As they relate to the enforcement or rejection of collective bargaining agreements, the provisions of Taft-Hartley and the Bankruptcy Reform Act of 1978 are in conflict.

   a. Under Chapter 11 reorganization, it is possible, with court approval, for a debtor to reject executory contracts. Collective bargaining agreeements, to the extent that they govern future terms and conditions of work, are executory.

   b. Under Taft-Hartley, the employer is prohibited from unilaterally terminating a collective bargaining agreement.

2. In 1984, the Supreme Court considered the conflict between federal bankruptcy law and federal labor law in the important *NLRB v. Bildisco and Bildisco*[2] case. Three distinct issues were addressed concerning the conflict:

   a. The principle issue was one of jurisdiction, specifically, which of the two conflicting laws should take priority. This issue was resolved in favor of the Bankruptcy Code, with the Bankruptcy Court enforcement of that law superceding the jurisdictional power of the NLRB to enforce Taft-Hartley. Therefore, the Bankruptcy Court, in considering a reorganization plan under Chapter 11, may allow rejection of a collective bargaining agreement, despite the restrictions imposed by Taft-Hartley.

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[2] *NLRB v. Bildisco and Bildisco*, 465 U.S. 513 (1984).

b. If allowed, the rejection of the collective bargaining agreement could be made effective retroactively to the date the employer filed its petition for reorganization.

c. A balancing test was established as the standard for determining whether rejection should be permitted. If efforts at voluntary modification (*i.e.,* negotiated relief) are not likely to resolve the burden on the employer, and if rejection would help the employer obtain a successful reorganization, rejection will be allowed.

C. The Bankruptcy Amendments of 1984

1. Because of the controversy surrounding the *Bildisco* case, efforts to obtain reform of the bankruptcy law were immediately undertaken in Congress. The result was the Packwood-Rodino bill[3] which made reorganization a little less attractive as a union busting device.

2. The 1984 amendments to the Bankruptcy Code added three standards which must be met before a bankruptcy court can allow rejection of collective bargaining agreements.

   a. The debtor in possession must make concessionary proposals to the union, under §1113(b)(1)(A),

   b. The union must be furnished with relevant information required to determine whether the proposal is equitable and necessary, under §1113(b)(1)(B), and

   c. The debtor in possession must bargain in good faith with the union over the concessions requested, under §1113(b)(2).

3. Procedurally, the amended law requires that a debtor in possession make the proposed modifications to the collective bargaining agreement prior to filing an application for rejection with the court. The debtor's obligation to bargain in good faith over that proposal includes disclosure of the most complete financial data available to show that the modifications are necessary for the successful reorganization of the debtor.

   a. If the debtor fulfills its bargaining obligation and the union rejects the proposed modifications, the debtor may petition for rejection of the agreement.

   b. In considering the application for rejection, the bankruptcy court is required to determine whether:

      1) The union rejected the proposed modifications without good cause, §1113(c)(2),

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[3] Bankruptcy Amendments and Federal Judgeship Act of 1984, 98 Stat. 333 (July 10, 1984).

2) Whether the modifications are necessary for the successful rehabilitation of the debtor, §1113(c)(1), and

3) Whether the "balance of equities" clearly favors rejection, §1113(c)(3).

4. In a leading decision, the Minnesota District Bankruptcy Court articulated a nine part test for determining the conditions under which rejection of the collective bargaining agreement should be permitted. Under this test, rejection should be permitted only if (1) the debtor makes a proposal to modify the agreement, (2) the proposal is based on the most complete and reliable information available at the time, (3) the proposed modifications are necessary to permit reorganization, (4) the proposed modifications assure that all creditors, the debtor, and other affected parties are treated fairly and equally, (5) the debtor provides the union with relevant information necessary to evaluate the proposal, (6) the debtor meets at reasonable times with the union between the time of the proposal and the time of the hearing, (7) the debtor negotiates with the union in good faith, (8) the union refuses to accept the proposal without good cause, and (9) the balance of equities favor rejection.[4]

5. The courts are not in agreement over whether a collective bargaining agreement can be modified by the debtor-in-possession rather than rejected.[5] However, if a bankruptcy court does permit modification, for example by extending an existing collective bargaining agreement for a period of time, the Board will regard the extension as a bar to a representation petition.[6]

6. The circuit courts are split on the appropriate standard to apply when considering whether rejection should be permitted. The code allows rejection if the proposed modifications are "necessary to permit the reorganization."[7]

   a. The Third Circuit Court of Appeals has interpreted the concept of "necessary modifications" to mean that rejection should be permitted only if the modifications are necessary to prevent liquidation of the firm.[8]

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[4] *In re American Provision Co*., 44 B.R. 907 (Bkrtcy. D. Minn. 1984).

[5] *See, e.g*., *In re Garafalo's Fine Foods, Inc*., 117 B.R. 363 (Bkrtcy. N.D. Ill. 1990) (allowing modifications), *and In re Alabama Symphony Association*, 155 B.R. 556 (Bkrtcy. N.D. Ala. 1993)(modifications not accepted as alternative to rejection).

[6] *Direct Press Modern Litho*, 328 NLRB 860 (1999).

[7] 11 USCA § 1113(b)(1)(A).

[8] *Wheeling Pittsburgh Steel Corp. v. Steelworkers*, 791 F.2d 1074 (3rd Cir. 1986).

b. The Second Circuit Court of Appeals has taken a position more favorable to rejection, by allowing rejection if rejection would be useful in reorganization and if the modifications are reasonable.[9]

7. In addition to permitting rejection of the collective bargaining agreement, the law permits the debtor-in-possession to implement interim changes in the terms and conditions of employment. The bankruptcy court can order such interim changes only after notice and an opportunity for a hearing, and only if the interim changes are essential to the continuation of the debtor's business or necessary to avoid irreparable damage.[10]

[9] *In re Century Brass Products*, 795 F.2d 265 (2d Cir. 1986). See also, *Truck Drivers Local 807 v. Carey Transportation, Inc.*, 816 F.2d 82 (2d Cir. 1987), in which the court rejected the *Wheeling Pittsburgh* interpretation.

[10] 11 USCA § 1113(e).