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The Role of Unions in the 1980s, Symposium, Filing a Post-Bildisco Chapter 11 Petition to Reject a Labor Contract

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FILING A POST-*BILDISCO* CHAPTER 11 PETITION TO REJECT A LABOR CONTRACT

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INTRODUCTION

Historically, the bankrupt was an object of community pity. Banks and suppliers shunned the bankrupt's efforts to get a fresh start because credibility in the market place, once lost, was forever gone.

We have erased the stigma of bankruptcy and now the worm has turned. Bankruptcy reorganization, designed to be a shield for a financially distressed business against its creditors—to give it time to regroup, adjust debt obligations and reorganize operations—is now a weapon in the hands of corporate strategists seeking a competitive advantage or trying to avoid legal obligations. Intended as a temporary shelter for the cure of the commercially ill and distressed, the bankruptcy laws have become a launching pad for unscrupulous—or incompetent—management. When a billion-dollar giant like Johns Manville can use chapter 11 to escape its moral and legal obligations to tens of thousands of innocent bystanders poisoned with asbestosis, or when a well-known company like Continental Airlines can use chapter 11 to renege on its labor agreements in order to undercut the competition, something in our bankruptcy system has gone awry.

Surely it is not blasphemous to suggest that we have gone well beyond the biblical command that "every creditor shall release the loan which he hath lent unto his neighbor," and that when we "release" those bonded to us we should not let them go away empty, but should "furnish [them] liberally out of [our] flocks, . . . and out of [our] wine-press."[1] There is no requirement in the Bible—or in the constitutional mandate to establish a uniform law of bankruptcy[2]—that, when we release our debtors and provide them with the means to a fresh start, we must treat with the same tender loving care a bully or a sneak—one who wants a "fresh start" so that he can strip the rest of the community bare. Yet, a certain type of management, unable or unwilling to compete fairly in the marketplace, is rewriting national labor policy under the aegis of the bankruptcy court to exempt themselves from obedience to the law.

Our system of labor relations has operated on the principle that employers and unions:

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1. *Deuteronomy* 15:2, 15:14.
2. U.S. CONST. art. I, § 8, cl. 4.

> need not make any concessions as a result of Government compulsion and that they are free from having contract provisions imposed upon them against their will. . . . "[T]he fundamental premise on which the [National Labor Relations] Act is based [is] private bargaining under governmental supervision of the *procedure* alone, without any official compulsion over the actual terms of the contract."[3]

In recent years, however, bargaining freedom has become a mere shibboleth in the mouths of employers who invoke the protection of chapter 11 of the Bankruptcy Code (Code)[4] for the sole purpose of obtaining judicial compulsion of union concessions, otherwise unobtainable in free collective bargaining.

In February 1984, employers were emboldened in their efforts when Justice Rehnquist, writing for a unanimous Supreme Court in *NLRB v. Bildisco & Bildisco* (*Bildisco*),[5] put to rest any remaining question whether collective bargaining agreements subject to the National Labor Relations Act (NLRA)[6] are "executory contracts" pursuant to section 365 of the Code.[7] The decision eviscerates the NLRA by permitting the reorganization process to override the private nature of labor negotiations.[8] Nonetheless, *Bildisco* cannot be read as a mandate for the unscrupulous or the incompetent to invoke the equitable jurisdiction of the bankruptcy court in order to rid themselves of their labor obligations.

I. THE *Bildisco* DECISION

A. *The Issues Before the Court*

The Court decided two issues in *Bildisco*: (1) the standard to be used by the bankruptcy court in determining whether to permit debtor rejection of a labor contract under section 365, and (2) the obligations under the NLRA of a debtor-in-possession with respect to its contract in the period between the filing of its petition and the

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3. NLRB v. Burns Int'l Sec. Servs., Inc., 406 U.S. 272, 287 (1972) (quoting H.K. Porter Co. v. NLRB, 397 U.S. 99, 108 (1970) (emphasis added)).

4. 11 U.S.C. §§ 101-51, 326 (1982).

5. 104 S. Ct. 1188 (1984).

6. 29 U.S.C. §§ 151-69 (1976 & Supp. V 1981).

7. 11 U.S.C. § 365 (1982); *see* 104 S. Ct. at 1196.

8. 104 S. Ct. at 1196-97. Consideration of a motion to reject a labor agreement under § 365 means that the Court must sit in judgment of the substantive terms of the parties' bargain. It also means judicial coercion of new terms and conditions of employment because the employer either has unilaterally established those conditions before rejection, or does so immediately after rejection is authorized.

bankruptcy court's determination of the motion to reject the contract.[9]

With respect to the first issue, a unanimous Court held that a stricter standard than the "business judgment test" for rejection of commercial contracts applies to labor agreements, based on the "special nature" of such contracts under the federal labor law.[10] The Court rejected the strict standard adopted by the Second Circuit in *Brotherhood of Railway, Airline & Steamship Clerks v. REA Express, Inc.*,[11] which permitted the rejection of a collective bargaining agreement only if the debtor could show that its reorganization would fail without such rejection.[12] Instead, the Court adopted the standard set forth in two other circuits,[13] permitting rejection "if the debtor can show that the collective bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."[14] The Court, however, was careful to require that "the national labor policies of avoiding labor strife and encouraging collective baragining" be respected.[15]

With respect to the second issue, however, five justices ignored the labor statute entirely, holding that a debtor-in-possession is not guilty of an unfair labor practice under sections 8(a)(5) or 8(d) of the NLRA[16] when it unilaterally breaches its collective bargaining agreement even before formal bankruptcy court action.[17] The Court justified this holding on the ground that infusions of new capital will be jeopardized if the debtor-in-possession is otherwise bound by its collective bargaining agreement until it receives judicial authorization to reject the agreement.[18] The majority's discussion ignores the ample protections afforded a post-petition lender under section 364 of the Code. Specifically, section 364(c) permits the bankruptcy court to authorize a debtor who is unable to obtain unsecured credit to obtain

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9. *Id.* at 1191.
10. *Id.* at 1195.
11. 523 F.2d 164 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975).
12. *See* 104 S. Ct. at 1195-96.
13. *See In re* Brada Miller Freight Sys., 702 F.2d 890, 898-99 (11th Cir. 1983); *In re* Bildisco, 682 F.2d 72, 80-81 (3d Cir. 1982), *aff'd sub nom.* NLRB v. Bildisco & Bildisco, 104 S. Ct. 1188 (1984).
14. 104 S. Ct. at 1196.
15. *Id.*
16. 29 U.S.C. § 158(a)(5), (d) (1976).
17. 104 S. Ct. at 1198.
18. *See* 104 S. Ct. at 1201. Such reasoning ignores the recent celebrated rise from the ashes of Braniff's "phoenix" through a chapter 11 proceeding. A major element in smoothing the way for Braniff's recapitalization was its acceptance of key provisions of the pilots' agreement with the airline. Moreover, no facts were elicited in *Bildisco* upon which the Court could make such a finding.

secured credit with a priority over all other administrative expenses.[19] Protective financing orders that give lenders such a "super" priority are routinely entered in chapter 11 proceedings, often without notice to any other parties because of alleged exigencies.

Reality compels the recognition that the rejection by the *Bildisco* Court of the strict standard of *REA* in favor of the balancing of equities test will not make much difference in the bankruptcy court. With rare exceptions, bankruptcy judges have never been more than rubber stamps for the debtor.[20] In holding, however, that the NLRB has no authority to enforce section 8(a)(5) or 8(d) of the NLRA against a debtor that unilaterally breaches its labor agreements prior to court authorized rejection, the majority has issued an open invitation to economic warfare. Moreover, the holding is a prescription for chaos because many issues are left unresolved, including the parties' obligations under the dispute resolution mechanisms of the labor agreement.

Those who have praised the *Bildisco* decision have claimed that it will have a salutary effect on the willingness of unions—whose alleged "rejectionism" in the past has forced companies into bankruptcy—to make concessions. These proponents are pitiably ignorant of the economic realities surrounding the recent major chapter 11 liquidations and reorganizations. In the trucking industry, for example, many of the larger companies, such as Maislin Industries and Spector Red Ball, Inc., and several smaller ones, are now being liquidated under chapter 11. Prior to filing under chapter 11, these companies had obtained significant wage "loans" from their employees, over the opposition of the union, by telling them that such concessions were a necessary condition for new infusions of capital from their lender banks that would save the enterprise and their jobs. The enterprises have folded, notwithstanding employee loans that amounted to several million dollars in each case and new infusions of capital. The proceeds from the liquidation of the debtors' assets are being used to pay back the lender banks—heavily secured as they were—and the employees are out-of-pocket and out of jobs.

Thus, the threat of unilateral termination of collective bargaining agreements under *Bildisco* may have little impact on the processes of pre-petition concession bargaining. The salutary effects of *Bildisco* must result instead from a stringent application of that decision's

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19. 11 U.S.C. § 364(c) (1982).

20. There is, however, not a little irony in the fact that the Court's opinion effects a grant of authority to the bankruptcy courts to interfere in private labor disputes possessed by no other court in our system, state or federal, at a time when that court's very existence is in question.

standard for rejection to determine the debtor's motivation in seeking to reject its labor agreement.

B. *Debtor Rehabilitation as Ultimate Goal in* Bildisco

Although the *Bildisco* decision gives scant consideration to the policies underlying a half century of labor legislation, it nonetheless should give little comfort to those who would find in the decision a carte blanche to invoke chapter 11 for the purpose of shedding their labor agreements. The *Bildisco* standard for labor contract rejection requires the bankruptcy court to find that rejection is sought in the context of rehabilitation and will further that overall goal.[21]

The argument is made that because section 365 encompasses labor contracts, rejection of a collective bargaining agreement is a permissible "rehabilitative" purpose of a chapter 11 petition. This argument begs the question because it fails to distinguish between the rejection of a labor contract that is sought incident to the larger goal of rehabilitating an ailing business by equitably restructuring obligations and streamlining operations, and a petition for relief under chapter 11 that is filed solely to enable management to solve its economic problems by coercing labor concessions. Under *Bildisco*, the former raises difficult issues requiring proof of economic hardship and a balancing of the equities among the many competing interests affected in the chapter 11 proceedings, while the latter raises the question whether the petition should be dismissed for bad faith.[22] Although *Bildisco* did not address the bad faith issue, the guidelines it establishes presume that rejection is being sought in the context of rehabilitation.

Moreover, the *Bildisco* standard focuses on the role of the bankruptcy court as a court of equity.[23] It is not sufficient for the debtor to show that its labor agreements are economically unfavorable. It must further show that it has made reasonable efforts to reach an agreement with the union before rejection may be authorized. Bargaining to impasse, however, is not required.[24] In addition, rejection may not be authorized unless the court finds that the purpose of chapter 11—a successful rehabilitation of the debtor—would be served.[25] Lastly, the

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21. 104 S. Ct. at 1197.

22. The Court in *Bildisco* cited with approval the Second Circuit's decision in Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698 (2d Cir. 1975), *see* 104 S. Ct. at 1196, in which a debtor's motivation in seeking to reject its labor agreement was of critical concern. *See* 519 F.2d at 706-07.

23. 104 S. Ct. at 1197.

24. *Id.* at 1196-97.

25. *Id.* at 1197.

bankruptcy court must balance the interests of all the affected parties—employees, equity shareholders, and other creditors—and take into account the relative hardships faced by each, as well as the qualitative differences among the types of hardships.[26] The legislative history of the Code establishes that Congress afforded the debtor extraordinary relief in chapter 11 for the purpose of facilitating adjustment of the debtor's debt and capital structure, not to enable the debtor to obtain an economic advantage by shedding its labor and other obligations.[27]

II. POST-*Bildisco*

The *Bildisco* Court was not faced with the issue whether chapter 11 is available to an enterprise whose sole purpose in filing is to obtain relief under section 365 to force upon its employees wage concessions that it could not achieve through collective bargaining. There is clear support, in the line of cases that has dismissed chapter 11 petitions for bad faith in other contexts, for the proposition that a petition filed for the sole purpose of repudiating a labor agreement must be dismissed as lacking in good faith.[28]

The relief afforded a debtor under section 365 is only one of several provisions that Congress has enacted to provide a financially distressed business with flexibility and power to deal with its property and third-party interests not otherwise available outside of bankruptcy.[29] Several courts have considered and granted motions to dismiss chapter 11 petitions on bad faith grounds when it has been shown that the debtor's purpose in filing was not the adjustment of its debt and equity obligations, but solely to obtain relief under those sections of the Code. In *In re Nancant, Inc.*,[30] for example, the court dismissed a petition as filed in bad faith when it was shown that the sole purpose of the filing was to challenge a property tax assessment in the bankruptcy court so that the debtor would be relieved of its obligation under state law to prepay the tax.[31]

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26. *Id.*

27. H.R. Rep. No. 595, 95th Cong., 2d Sess. 221 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6180.

28. The bad faith issue appears to be one of first impression in the chapter 11 proceedings commenced by Continental Airlines. *See In re* Continental Airlines Corp., 11 Bankr. Ct. Dec. (CRR) 623, 625 (S.D. Tex. Jan. 17, 1984).

29. *See, e.g.*, 11 U.S.C. § 362 (1982) (automatic stay provision); *id.* § 505 (determination of tax liability).

30. 8 Bankr. 1005 (Bankr. D. Mass. 1981).

31. *Id.* at 1009; *see In re* Thirtieth Place, Inc., 30 Bankr. 503, 505-06 (Bankr. 9th Cir. 1983); *In re* Landmark Capital Co., 27 Bankr. 273, 280-81 (Bankr. D. Ariz.

Although the Code does not expressly authorize a court to dismiss a petition which is not filed in good faith, section 1112(b)[32] has been held to empower the bankruptcy court to require good faith as a prerequisite to the filing or continuation of a proceeding under chapter 11.[33] The section provides that a court may dismiss a case under chapter 11 "in the best interest of creditors and the estate, for cause, including" nine specific reasons for dismissal.[34] Under the Code's rules of construction, the nine enumerated reasons are not exclusive.[35] As noted by one court, "[t]he legislative history of the Code, widely cited in recent case law, clearly establishes that a lack of good faith constitutes sufficient cause for dismissal regardless of whether it is specifically articulated in § 1112(b)."[36] The power of the bankruptcy court under section 1112(b) to dismiss a petition not filed in good faith has been upheld by every court that has considered the question.[37]

CONCLUSION

The filing of a petition in chapter 11 constitutes a grant of extraordinary relief in equity, permitting a debtor to avoid its contractual and other legal obligations. The legislative history of the Bankruptcy Code and the cases relating thereto establish the proposition that relief should be denied when the debtor seeks avoidance of those obligations as an end in itself and not as a means of adjusting its debt obligations and equity interests.

Therefore, even under the *Bildisco* standard, a petition filed for the sole purpose of repudiating a labor contract has no justification in law. The single important restraint on economic lawlessness to be found in that decision lies in the Court's insistence that the bankruptcy

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1983); *In re* Avan, Inc., 25 Bankr. 121, 123 (Bankr. D. Or. 1982); *In re* 299 Jack-Hemp Associates, 20 Bankr. 412, 413 (Bankr. S.D.N.Y. 1982); *In re* Weathersfield Farms, Inc., 14 Bankr. 574, 575 (Bankr. D. Vt.), *aff'd*, 15 Bankr. 282 (D. Vt. 1981); *In re* Alison Corp., 9 Bankr. 827, 829 (Bankr. S.D. Cal. 1981); *In re* G-2 Realty Trust, 6 Bankr. 549, 554 (Bankr. D. Mass. 1980); *In re* Dutch Flat Inv. Co., 6 Bankr. 470, 471-72 (Bankr. N.D. Cal. 1980); *In re* Fast Food Properties Ltd. #1, 5 Bankr. 539, 540 (Bankr. C.D. Cal. 1980).

32. 11 U.S.C. § 1112(b) (1982).

33. *See* Weathersfield Farms, Inc. v. First Inter-State Bank, 15 Bankr. 282, 283 (Bankr. D. Vt. 1981); *see also* Fidelity Assurance Ass'n v. Sims, 318 U.S. 608, 615 (1943) (construing predecessor to § 1112); Marine Harbor Properties v. Manufacturers Trust Co., 317 U.S. 78, 84 (1942) (same).

34. 11 U.S.C. § 1112(b) (1982).

35. *Id.* § 102(3).

36. Weathersfield Farms, Inc. v. First Inter-State Bank, 15 Bankr. 282, 283 (Bankr. D. Vt. 1981).

37. Ordin, *The Good Faith Principle in the Bankruptcy Code: A Case Study*, 38 Bus. Law. 1795, 1838 (1983).

judge must make a reasoned finding that unilateral repudiation by the debtor of its labor contract serves the ultimate goal of rehabilitation. The decision thus mandates a filing made in good faith for the larger purpose of rehabilitation through adjustment of the debtor's existing debt obligations. Any other conclusion would serve only to strengthen the hands of the weak, inefficient and unscrupulous, while destroying our system of free collective bargaining and repudiating the policies underlying a half century of labor laws.