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Municipalities Can Void Public Employee Union Contracts Through Bankruptcy

By Jennifer J. Walt

In a case of first impression that could have far-reaching implications, a bankruptcy judge in California recently determined that municipalities that file petitions under Chapter 9 of the Bankruptcy Code (reorganization for municipalities) can reject existing collective bargaining agreements with public employee unions. *In re City of Vallejo*, Case No. 08-26813-A-9 (E.D. Cal. Mar. 13, 2009). Facing a \$9 million budget shortfall, largely from collectively bargained payroll costs and benefits for firefighters and police officers, the City of Vallejo filed a petition for bankruptcy protection under Chapter 9 in May 2008, which allowed the City to attempt to re-negotiate contracts with employees, vendors and others. When efforts to re-negotiate the collective bargaining agreements with the unions representing firefighters (International Association of Firefighters, Local 1186) and electrical workers (International Brotherhood of Electrical Workers, Local 2376) failed, the City petitioned the bankruptcy court to void the contracts with those unions.

The primary issue before the bankruptcy court was whether a particular statutory bankruptcy provision, 11 U.S.C. section 1113 – which prevents outright rejection of union contracts in the private sector by requiring Chapter 11 debtors (reorganization of corporations or partnerships) to satisfy certain procedural and substantive prerequisites before they can void a collective bargaining agreement – is applicable to municipalities seeking protection under Chapter 9. After reviewing the statutory history, the bankruptcy court determined that section 1113 was specifically not incorporated by Congress into Chapter 9, and therefore, was not applicable to municipalities.

However, the bankruptcy court found that other, albeit less stringent, procedural requirements established by the United States Supreme Court in *NLRB v. Bildisco & Bildisco*,¹ did apply to municipalities petitioning for bankruptcy under Chapter 9. In *Bildisco*, the Court determined that a collective bargaining agreement can be voided only if the debtor can establish that: (1) the collective bargaining agreement burdens a debtor's ability to reorganize by proposing and implementing a viable plan of adjustment; (2) after careful scrutiny, the equities balance in favor of contract

rejection; and (3) “reasonable efforts to negotiate a voluntary modification have been made and were not likely to produce a prompt and satisfactory solution.”² Because the City of Vallejo had already successfully re-negotiated contracts with the unions that represented the police officers and managerial employees, and negotiations with the remaining unions were ongoing, the bankruptcy court deferred a final determination on whether those agreements were void.

Some observers believe that if this groundbreaking decision holds up, other financially strapped municipalities will use this decision as a blueprint to void their union obligations.

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¹ 456 U.S. 513 (1984).

² *Bildisco*, 456 U.S. at 525-26.