Law

Justices okay rip-up of labor contracts

by Edward Spannaus

In a ruling which has sent tremors throughout the labor movement, the U.S. Supreme Court has ruled that a company may abrogate its labor contracts by filing a bankruptcy petition. The ruling came in the cases *National Labor Relations Board v. Bildisco and Bildisco*, decided Feb. 22, 1984.

The Court ruled unanimously that a company which has filed a bankruptcy petition may break a union contract, and further ruled by a 5-4 decision that the company need not even wait for the approval of a bankruptcy court to abrogate a collective bargaining agreement.

Bildisco & Bildisco, a building supply company in New Jersey, filed a Chapter 11 petition in April 1980. About half its labor force was represented by Local 408 of the Teamsters, with a three-year contract expiring in 1982 which expressly said that the contract was binding even in the event of bankruptcy.

In January 1980 Bildisco stopped paying some fringe benefits, and in May 1980 it refused to pay a wage increase called for under the contract. The union filed a complaint with the National Labor Relations Board (NLRB), which found the company guilty of an unfair labor practice for unilaterally changing the terms of the contract and for refusing to bargain with the union.

The Bildisco case was being watched closely after the recent cases of Continental Airlines and Wilson Foods, in which both companies filed Chapter 11 petitions and then cut wages by as much as 50%.

What the Court said

The majority decision, written by Associate Justice William Rehnquist, said that collective bargaining contracts are included within the provision of the 1978 Bankruptcy Reform Act which permits the rejection of "executory contracts." The Teamsters and the NLRB had argued that a company must prove that it will otherwise go under and be liquidated before the union contract can be broken. Rehnquist and the rest of the court disagreed, saying that "the Bankruptcy Court should permit rejection of a collective-bargaining agreement under Sec. 365(a) of the Bankruptcy Code 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."

Rehnquist argued:

"Determining what would constitute a successful rehabilitation involves balancing the interests of the affected parties—the debtor, creditors, and employees. The Bankruptcy Court must consider the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors' claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees.

"The Bankruptcy Court is a court of equity, and in making this determination it is in a very real sense balancing the equities. . . . The Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization."

As to the NLRB side of the case, the four dissenting Justices said that before breaking a union contract, the debtor has to get the permission of the court or it is guilty of an unfair labor practice. The other five judges said that a company could break a union contract immediately upon the filing of a Chapter 11 petition without even asking for the approval of the court. But despite the dissent on this aspect, all nine judges unanimously agreed that labor contracts can readily be broken during a Chapter 11 proceeding.

Previously, employees and wages have always held a favored position in a bankruptcy proceeding. The first statute giving wages a priority was enacted in 1841. Under the 1978 Bankruptcy Reform Act, back wages are given a priority above all general creditors, shareholders, and even taxes owing to the government.

The principles in question

Even more fundamental is that the bankruptcy court is indeed a court of equity, in which justice according to natural law, not the letter of the law, is to prevail. This does not imply the arbitrary abrogation of contracts—as Rehnquist would permit—nor does it mean that labor stands on a mere equal footing with all other creditors in a "balancing of the equities." Bankruptcy law recognizes the special importance of labor power, and places the paramount importance on rehabilitation of a business rather than payment of past debts to creditors. Rehabilitation of a debt-ridden business does not mean paying off the creditors at the expense of the employees—it should mean preserving labor power at the expense of the creditors, if necessary.

The decision gives a green light to financially embarrassed companies who want to file bankruptcy petitions solely for the purpose of breaking contracts. Middle-level labor officials are now complaining that the leadership of the AFL-CIO has been so busy trying to salvage the Mondale electoral disaster that it has paid scant attention to the priority of seeking legislative reform which would override the Supreme Court's ruling.