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City can void union contracts

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SAN FRANCISCO — In the first ruling of its kind, a bankruptcy judge held that the city of Vallejo, Calif., has the authority to void its existing union contracts in its effort to reorganize, holding that public workers do not enjoy the same protections Congress gave union workers at private companies.

Municipal bankruptcy is so rare that no judge had ruled on whether congressional reforms in the 1990s that required companies to provide worker protections before attempting to dissolve union contracts also applied to public workers' union contracts.

U.S. Bankruptcy Judge Michael McManus held on March 13 that when Congress enacted 11 U.S.C. 1113 to limit companies from outright rejection of union contracts, it limited the statute to Chapter 11 bankruptcies. By failing to extend the statute's limits to Chapter 9, which covers municipal bankruptcy, McManus said that cities have broader latitude to break existing union pacts. *In re City of Vallejo*, No. 08-26813-A-9 (E.D. Calif.).

"This will have a huge effect nationwide if it is upheld," said Kelly Woodruff of Farella, Braun + Martel in San Francisco, representing the firefighters' and electrical workers' unions.

Woodruff said the unions would certainly appeal if the city ultimately voids the existing contracts with the two unions. "And I think we have a good chance of success," she said.

"My understanding is that a lot of cities are watching this and particularly this motion," said Woodruff. "If the city of Vallejo succeeds in using bankruptcy to void union contracts, I am sure others will follow," she said.

Vallejo attorney Norman C. Hile of Orrick, Herrington & Sutcliffe's Sacramento, Calif., office said, "This is a decision that is somewhat groundbreaking.

"There are a number of other cities and government entities watching it very closely," he said, but declined to speculate on whether others would take the step Vallejo took of seeking bankruptcy protection.

Cities are watching

The decision will be particularly important to cities with large unfunded pension liabilities, according to James Spiotto of Chapman and Cutler in Chicago, a specialist in municipal bankruptcy who helped advise the Senate Judiciary Committee on Chapter 9 reforms.

He said the unfunded pension liabilities for states and cities was \$800 billion a few years ago and may be up to \$1 trillion today.

"The question is whether it is an inability to pay or an unwillingness to pay. If municipalities can't provide basic services and still pay labor costs or pensions, then that is a real issue," Spiotto said.

Chapter 9 should be a last resort, he warned, because it causes problems in the municipal bond market.

There are 50,000 municipalities, but there have been only 567 Chapter 9 filings since 1937, when the law was created, he said. By contrast, there may be 10,000 corporate bankruptcies in a single year.

Vallejo, a suburb of San Francisco, issued a statement saying that the union challenge of the city's insolvency "at a time of an unprecedented economic downturn and the labor groups' ongoing intransigence regarding the modifications of their labor agreements has cost the city more than \$3.5 million in bankruptcy costs. These funds could have provided critical municipal services to the Vallejo community."

Vallejo declared bankruptcy in 2008, which it blamed on spiraling payroll costs and declining revenue. Within weeks, the city asked McManus, who sits in Sacramento, to void all four contracts with 400 police, firefighters, electricians, maintenance workers, secretaries, clerks and other city workers.

Since then, two unions, the police and the city clerks and managers groups, have settled with the city, making concessions in the contracts. Only the firefighters' and electricians' contracts have not been resolved.

McManus held that, because Congress did not impose limits on invalidating union contracts under Chapter 9, cities must only meet the requirements under the U.S. Supreme Court's ruling in *NLRB v. Bildisco*, 456 U.S. 513 (1984), which gives broader discretion to break the contracts in bankruptcy.

"Section 1113 applies in chapter 11 cases and imposes on chapter 11 debtors procedural and substantive requirements that must be met prior to rejection of collective bargaining agreements," he wrote.

"Section 1113, however, is not incorporated into chapter 9," he concluded. He pointed out that Congress considered such an extension in 1991 but did not add Chapter 9, and he would "not presume to do what Congress has not done."

The unions maintained that the city has not proven, as required in *Bildisco*, that the contracts are a burden to the city because it has \$136 million in 100 special-purpose funds, portions of which could be used to pay the wage obligations. In addition, the unions assert that negotiation has not been exhausted.

McManus did not allow for an immediate action by the city but ordered both sides back to court on March 23 to tell him whether negotiations with the two unions have progressed.

Woodruff said that, at this point, the sides are not talking.