CASE NOTE

DISTINGUISHING *BILDISCO* IN MUNICIPAL BANKRUPTCY: WHY THE BUSINESS JUDGMENT STANDARD SHOULD APPLY TO CBA REJECTION IN CHAPTER 9

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INTRODUCTION

Courts and scholars analyzing Chapter 9 of the Bankruptcy Code have been erroneously applying the Supreme Court's opinion in *NLRB v. Bildisco & Bildisco*,[1] asserting that this opinion sets the legal standards by which a bankrupt city may reject its union contracts. This Case Note takes a different view and argues that the traditional business judgment standard rather than *Bildisco* should govern a bankrupt city's rejection of labor contracts.

Cities have made national headlines in recent years by filing for bankruptcy,[2] and one of the biggest issues in this wave of municipal bankruptcies is labor debt.[3] By filing a petition under Chapter 9 of the Bankruptcy Code (Code),

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1 465 U.S. 513 (1984), *superseded by statute*, 11 U.S.C. § 1113 (2012).

2 *See* Mary Williams Walsh & Jon Hurdle, *Harrisburg Sees Path to Restructuring Debts Without Bankruptcy Filing*, N.Y. TIMES (July 24, 2013), http://nytimes.com/2013/07/25/us/harrisburg-sees-path-to-restructuring-debts-without-bankruptcy-filing.html?_r-0, *archived at* http://perma.cc/N2GG-J8XJ (recounting recent municipal bankruptcy filings, including Harrisburg, Pennsylvania's failed attempt to file for bankruptcy).

3 *See generally In re* City of Vallejo, No. 08-26813, slip op. at 5 (Bankr. E.D. Cal. Aug. 31, 2009) (finding that labor cost is the "largest annual . . . expenditure" of Vallejo's general fund); Notice of Motion and Motion of Debtor City of San Bernardino, Pursuant to 11 U.S.C. §§ 365, 901 and 904, for Order Approving: (A) Rejection of Collective Bargaining Agremeents [sic] with San Bernardino Public Employees Assoc., San Bernardino Police Officers Assoc. and San Bernardino City Professional Firefighters; and (B) February 1, 2013 Interim Modifications to Such Collective Bargaining Agreements at 1, *In re* City of San Bernardino, Cal., No. 12-28006 (Bankr. C.D. Cal. Mar. 4, 2013) (noting that "employee wages and benefits are the largest single cost of running the City (constituting approximately 75% of the City's expenditures)"); Richard W.

cities may use 11 U.S.C. § 365(a) to reject labor contracts with public sector employees, subject to the "approval" of a bankruptcy court.[4] The Code, however, does not establish what approval standard a bankruptcy court should apply. Courts that have addressed this issue hold that the appropriate rejection standard is *Bildisco*, a 1984 Supreme Court opinion that dealt with the rejection of private sector labor contracts in Chapter 11 cases.[5] Commentators generally agree that this approach is correct.[6] To the extent that commentators disagree with this approach, they argue that state law should provide the standard for rejecting labor contracts.[7] This Case Note disagrees with all of these courts and commentators, arguing instead for the traditional business judgment standard.

In Part I, this Case Note examines the background of the *Bildisco* rejection standard and its erroneous application in Chapter 9 cases. Arguing that the *Bildisco* standard is not controlling in a Chapter 9 case, Part II explains why it is limited to labor contracts regulated by federal labor law and subject to rejection in Chapter 11 cases. In Part III, this Case Note analyzes Chapter 9 of the Bankruptcy Code and shows why the business judgment standard should control collective bargaining agreement (CBA) rejection.

Trotter, *Running on Empty: Municipal Insolvency and Rejection of Collective Bargaining Agreements in Chapter 9 Bankruptcy*, 36 S. ILL. U. L.J. 45, 46 (2011) (observing that labor costs imposed by collective bargaining agreements "are among the most costly items on local balance sheets").

4 *See* 11 U.S.C. § 365(a) (2012) (giving bankrupt entities the power to reject executory contracts through their trustees, subject to court approval); *see also id.* § 901(a) (listing 11 U.S.C. § 365 among the statutory provisions that apply to Chapter 9 debtors).

5 *See In re* City of Vallejo, 403 B.R. 72, 77-78 (Bankr. E.D. Cal. 2009) (holding that *Bildisco*'s standard applies in a municipal bankruptcy after noting that 11 U.S.C. § 1113 was "not incorporated into chapter 9"), *aff'd* IBEW, Local 2376 v. City of Vallejo (*In re* City of Vallejo), 432 B.R. 262 (E.D. Cal. 2010); Orange Cnty. Emps. Ass'n v. Cnty. of Orange (*In re* Cnty. of Orange), 179 B.R. 177, 183 (Bankr. C.D. Cal. 1995) ("*Bildisco* applies in Chapter 9 since Congress has had numerous opportunities to limit its effect by incorporating § 1113 into Chapter 9.").

6 *See, e.g.*, Ryan Preston Dahl, *Collective Bargaining Agreements and Chapter 9 Bankruptcy*, 81 AM. BANKR. L.J. 295, 321 (2007) ("[A] municipal debtor's motion to reject its CBAs should be governed by § 365 and the Court's decision in *Bildisco*.").

7 *See, e.g.*, Barry Winograd, *San Jose Revisited: A Proposal for Negotiated Modification of Public Sector Bargaining Agreements Rejected Under Chapter 9 of the Bankruptcy Code*, 37 HASTINGS L.J. 231, 319 (1985) (arguing that "[u]nilateral employer action modifying or repudiating terms established by public sector collective bargaining agreements should be barred," whether before or after court approval, "until, if required by state law, the parties have renegotiated in good faith, reached an agreement or impasse, or a fiscal emergency excuses contract impairment").

I. THE BACKGROUND FACTS OF *BILDISCO* AND ITS (ERRONEOUS) USE IN CHAPTER 9

Bildisco & Bildisco, a New Jersey partnership, filed for Chapter 11 bankruptcy in 1980.[8] Bildisco's employees were represented by a union,[9] which had negotiated a CBA with Bildisco under the National Labor Relations Act (NLRA)[10] that established wages and health benefits for Bildisco employees.[11] Once Bildisco filed for bankruptcy, it petitioned the Bankruptcy Court for approval of its plan to reject the labor agreement under 11 U.S.C. § 365(a).[12] Section 365(a) provides that "subject to the court's approval" debtors in bankruptcy may "reject any executory contract."[13] As a traditional rule in bankruptcy, courts considering such motions would approve rejection under a deferential business judgment standard.[14]

The union challenged Bildisco's decision to reject the agreement, arguing that if Bildisco rejected the agreement under § 365(a), it would violate another federal statute: section 8(a) of the NLRA,[15] which requires collective bargaining between employer and employees before changing contract terms.[16] Thus, a conflict arose between two federal statutes: the Bankruptcy Code and the NLRA.[17] The Code allowed a Chapter 11 debtor-in-possession to reject contracts, while the NLRA shielded labor contracts from rejection.

To resolve this conflict, the Supreme Court decided to create a new rejection standard that would replace the traditional business judgment standard. This new standard, derived from policies surrounding both the

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8 NLRB v. Bildisco & Bildisco, 465 U.S. 513, 517 (1984), *superseded by statute*, 11 U.S.C. § 1113 (2012).

9 *Id.* at 517-18.

10 *See* 29 U.S.C. §§ 151–69 (2012) (establishing employees' right to organize and defining unfair labor practices). The National Labor Relations Act, enacted in 1935, established the workers' right to unionize and bargain collectively with their employers. *See generally* NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 22-24 (1937) (describing the act's statutory scheme).

11 *See Bildisco*, 465 U.S. at 518 (noting how the CBA required "payment of health and pension benefits" and "wage increases").

12 *Id.*

13 11 U.S.C. § 365(a).

14 *See, e.g.*, Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1047 (4th Cir. 1985) (holding that under the business judgment test, the debtor's decision to reject a contract must be "accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion"), *superseded by statute on other grounds*, 11 U.S.C. § 365(n) (establishing a special rejection standard for intellectual property licenses).

15 29 U.S.C. § 158(a).

16 *See Bildisco*, 465 U.S. at 518-19 (describing how Local 408 filed unfair labor practice charges with the NLRB).

17 *See* Century Brass Prods., Inc. v. UAW (*In re* Century Brass Prods., Inc.), 795 F.2d 265, 274 (2d. Cir. 1986) (referring to the issue in *Bildisco* as an "unavoidable conflict between federal labor law and bankruptcy law").

NLRA and Chapter 11, would resolve the conflict between the Code and the NLRA by giving effect to both statutes.[18]

The Court first reasoned that, given Chapter 11 policy, a debtor-in-possession must be able to reject collective bargaining agreements under § 365(a).[19] The Court explained that "[s]ince the policy of Chapter 11 is to permit successful rehabilitation of debtors, rejection should not be permitted without a finding that that policy would be served by such action."[20] Thus, guided by Chapter 11 policy, the Supreme Court looked to circuit court precedent on standards for approving CBA rejection in Chapter 11 proceedings.[21] The lower courts were split on the issue, but they all relied on tests that were accepted at the time for general contract rejection in Chapter 11 bankruptcies.[22] One of the two tests, the "burden" test, permits rejection only of contracts for which performance will result in a loss.[23] The other, the "balancing" test, permits rejection only if the cost the nondebtor suffers from rejecting the contract is disproportionate to the gain the debtor receives from the rejection.[24] Without examining these underlying tests or discussing their merits, the Supreme Court held that bankruptcy courts should approve a Chapter 11 debtor's request to reject a CBA if the debtor can show that it "burdens the estate" and if "the equities balance" in favor of rejection.[25]

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[18] *Bildisco*, 465 U.S. at 524-26 (citing the "policy of Chapter 11" and the NLRA as the basis for the new standard).

[19] *See id.* at 524-25 (holding that, though "the rights of workers under collective-bargaining agreements are important, . . . rejection of the collective-bargaining agreement [may be] necessary to prevent the debtor from going into liquidation").

[20] *Id.* at 527. The Court also stressed: "the authority to reject an executory contract is vital to the basic purpose of a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *Id.* at 528.

[21] *Id.* at 523-26 (discussing cases from the Second, Third, Ninth, and Eleventh Circuits).

[22] *See In re* Carey Transp., Inc., 50 B.R. 203, 205 (Bankr. S.D.N.Y. 1985) (explaining the circuit split prior to *Bildisco*).

[23] *See, e.g.*, Am. Brake Shoe & Foundry Co. v. N.Y. Rys. Co., 278 F. 842, 844 (S.D.N.Y 1922) (holding that contracts should be rejected only when performance would result in an "actual loss" to the performing party).

[24] *See, e.g.*, Robertson v. Pierce (*In re* Huang), 23 B.R. 798, 801 (B.A.P. 9th Cir. 1982) (finding that a "balancing of interests" is acceptable when deciding whether to approve contract rejection).

[25] *Bildisco*, 465 U.S. at 524-26 (citing Local Union 20 v. Brada Miller Freight Sys., Inc. (*In re* Brada Miller Freight Sys., Inc.), 702 F.2d 890 (11th Cir. 1983), and Bhd. of Ry., Airline & S.S. Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir. 1975)). *Bildisco* did not clearly enunciate its reasoning for choosing these tests. Instead, the Court simply cited the relevant appellate authorities and held that both the "balancing" and "burden" tests must be applied to CBA rejection in Chapter 11 proceedings.

The Supreme Court also ruled that "the policies of the NLRA" must be "adequately served" by the rejection standard.[26] The NLRA's policy, the Supreme Court said, was to avoid labor strife and to encourage collective bargaining by "generally requir[ing] that employers and unions reach their own agreements on terms and conditions of employment free from governmental interference."[27] Based on this policy, the *Bildisco* Court held that, before a Chapter 11 debtor-in-possession could reject a collective bargaining agreement, the debtor must show that "reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution."[28]

The *Bildisco* test for rejection of federally protected CBAs can thus be summarized as having three prongs: (1) the labor agreement must burden the bankruptcy estate, (2) a balancing of the equities must favor rejection, and (3) reasonable efforts to negotiate a voluntary modification must have been made and are not likely to produce a prompt and satisfactory solution.[29] This test resolved the conflict between § 365(a) of the Bankruptcy Code as applied to CBAs in Chapter 11 and § 8(a) of the NLRA.

Labor unions strongly objected to the *Bildisco* decision, which they believed made it too easy for bankrupt companies to reject a CBA.[30] Just five months after the *Bildisco* decision was announced, and after significant union lobbying, Congress enacted 11 U.S.C. § 1113, which overruled *Bildisco* by creating a specific procedure for rejection of federally protected CBAs in Chapter 11 cases. [31]

Section 1113, as courts often note, applies to Chapter 11 cases only.[32] This limited application is sensible, given that *Bildisco* confined itself to Chapter 11

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[26] *Id.* at 526.

[27] *Id.*

[28] *Id.*

[29] *See* IBEW, Local 2376 v. City of Vallejo (*In re* City of Vallejo), 432 B.R. 262, 270 (E.D. Cal. 2010) (citing *Bildisco*, 465 U.S. at 526).

[30] *See* James J. White, *The* Bildisco *Case and the Congressional Response*, 30 WAYNE L. REV. 1169, 1191 (1984) (detailing how union representatives sought to overturn *Bildisco* as Congress debated whether and how to extend the bankruptcy courts' jurisdiction).

[31] *See* Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of Am., 791 F.2d 1074, 1082-83 (3d Cir. 1986) (examining Congress's enactment of § 1113 to overrule *Bildisco*); 130 CONG. REC. S8888-8900 (daily ed. June 29, 1984) (detailing the ways § 1113 sought to overturn *Bildisco*).

[32] *See* Carpenters Health & Welfare Trust Funds for Cal. v. Robertson (*In re* Rufener Constr., Inc.), 53 F.3d 1064, 1068 (9th Cir. 1995) ("Reading the language of § 1113 in its entirety, we conclude that it is applicable only to bankruptcies filed under Chapter 11."); *In re* Rufener Constr. Co., Inc., No. 98-0183, 1993 WL 165331, at *2 (N.D. Cal. May 4, 1993) (holding that § 1113 "was intended for application in Chapter 11 cases only" and was therefore inapplicable in a Chapter 7 case); *In re* Liberty Fibers Corp., No. 05-5387, 2007 WL 2471446, at *3 (Bankr. E.D. Tenn. Aug. 27, 2007) ("Under the statutory scheme of the Bankruptcy Code, § 1113 applies only in a chapter 11 case."); *see also In re* Certified Air Techs., Inc., 300 B.R. 355, 359 n.11 (Bankr. C.D. Cal. 2003)

cases, and given that Congress intended to overrule *Bildisco*, a Chapter 11 case. Moreover, § 1113 clearly does not apply in Chapter 9 cases because it does not appear in § 901(a) of the Code, which lists all non–Chapter 9 Code provisions applicable to Chapter 9 cases.[33] Although Congress considered adding a provision similar to § 1113 to Chapter 9 in 1991, it never did so.[34] Commentators have since speculated about why Congress did not extend § 1113 to Chapter 9. One view is that the omission of § 1113 was simply an accident.[35] Another view, noted by the district court in the *Vallejo* bankruptcy, is that Congress feared a Tenth Amendment violation, as federal regulation of state and local government CBAs could intrude on state sovereignty.[36] No matter which view is correct, it is clear that § 1113's applicability is limited to Chapter 11 cases.

Bildisco was left as bad law, overruled by Congress, until an unprecedented event occurred in 1994: Orange County, California filed for bankruptcy after badly mismanaging its investments.[37] It was the largest municipal bankruptcy filing in history at that time, and it shocked the nation.[38] Upon filing, the county began to unilaterally modify its CBAs and requested both court approval of the modifications and permission to reject the CBAs.[39]

("Section 1113 does not apply to cases pending under chapter 7 or chapter 9."); Orange Cnty. Emps. Ass'n v. Cnty. of Orange (*In re* Cnty. of Orange), 179 B.R. 177, 183 (Bankr. C.D. Cal. 1995) ("There is no indication in the Congressional record of any discussion about the applicability of § 1113 in Chapter 9.").

33 *See* 11 U.S.C. § 901(a) (2012) (omitting § 1113).

34 *See* Municipal Employee Protection Amendments of 1991, H.R. 3949, 102d Cong. § 2(c) (1991), *available at* http://thomas.loc.gov/cgi-bin/query/z?c102:H.R.3949.IH:, *archived at* http://perma.cc/B793-9TAU (proposing that before a contract rejection, a city must have "fully exhausted State law procedures for the bargaining, implementation, and amendment of a collective bargaining agreement"); *see also Cnty. of Orange*, 179 B.R. at 183 n.15 (examining H.R. 3949 and noting that Congress "contemplated enacting a '§ 1113-like' statute for Chapter 9").

35 *See* Michael W. McConnell and Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 467 (1993) ("Without explanation, and possibly through inadvertence, Congress neglected to make [§ 1113] applicable to Chapter 9.").

36 *See* IBEW, Local 2376 v. City of Vallejo (*In re* City of Vallejo), 432 B.R. 262, 271 (E.D. Cal. 2010) ("[C]ongress may have decided against adding a section 1113 to Chapter 9 out of concern about encroaching on states[']rights under the Tenth Amendment.").

37 *See Cnty. of Orange*, 179 B.R. at 179-80 (recounting the factual background of Orange County's Chapter 9 filing).

38 *See* Cnty. of Orange v. Merrill Lynch & Co., Inc. (*In re* Cnty. of Orange), 241 B.R. 212, 214 (Bankr. C.D. Cal. 1999) (describing the County's 1994 bankruptcy filing as the "largest municipal bankruptcy in history"); *Cnty. of Orange*, 179 B.R. at 179 ("[T]he County and its Investment Pools . . . shocked the nation by filing Chapter 9 petitions in bankruptcy.").

39 *See Cnty. of Orange*, 179 B.R. at 179-80 (noting how, through "Resolutions," the County terminated many employee rights and gave "agency and department heads complete freedom to terminate employees in order to meet certain specified reductions").

The county employees' unions responded by requesting a temporary restraining order (TRO) from the bankruptcy court.[40] The question facing the court was whether to grant the TRO, and so the court did not need to rule on the merits of the county's request. Instead, the question was whether the county was likely to succeed on the merits.[41]

In arguing against the TRO, the county cited *Bildisco*.[42] The county claimed that the TRO should be denied because *Bildisco*'s rejection standard likely applied to a Chapter 9 case and because, under *Bildisco*, the county would prevail on the merits in rejecting its employees' CBA.[43] The court agreed with the county's argument, reasoning that, while 11 U.S.C. § 1113 overruled *Bildisco*, § 1113 was never incorporated into Chapter 9 of the Bankruptcy Code.[44] Therefore, the court held, *Bildisco* controlled in Chapter 9 proceedings.[45]

This holding is problematic, however, for one key reason: it assumes that, in § 1113's absence, *Bildisco*'s rejection standard would apply to a Chapter 9 case. The *Orange County* court failed to notice that *Bildisco*'s language confined itself to labor contracts negotiated under the NLRA and subject to rejection in *Chapter 11* proceedings, and so it never questioned whether *Bildisco* also applied to *Chapter 9*. In the end, however, the *Orange County* court never needed to fully address this question. The parties settled this aspect of the litigation before the court's decision was even released for publication.[46]

In re City of Vallejo was the next case to consider CBA rejection in Chapter 9, and the bankruptcy and district courts followed the same mistaken

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[40] *Id.* at 179.

[41] *Id.* at 181 (citing Ninth Circuit case law for the proposition that injunctive relief like a TRO must be granted only if (1) there is "a probable success on the merits and the possibility of irreparable harm," or (2) serious questions exist about the merits and the balance of hardships significantly favors finding for the moving party); *see also* Douds v. Wine, Liquor & Distillery Workers Union, Local 1, 75 F. Supp. 184, 187 (S.D.N.Y. 1947) ("The Court does not, by the granting of this temporary restraining order, pass upon the ultimate merits of the issues raised by the allegations of the petition . . . .").

[42] *Cnty. of Orange*, 179 B.R. at 181.

[43] *See id.* ("[T]he County contends that . . . *Bildisco* controls and allows it the flexibility to make unilateral changes to the [CBAs].").

[44] *See id.* at 182-83 ("Labor unions were very upset at the Supreme Court's decision in *Bildisco* . . . . In response Congress passed § 1113. It did not, however, change Chapter 9 to make § 1113 applicable." (footnote omitted)).

[45] *Id.* at 183 ("Given this history, I conclude that *Bildisco* applies in Chapter 9 since Congress has had numerous opportunities to limit its effect by incorporating § 1113 into Chapter 9."). The court was correct that § 1113 was never incorporated into Chapter 9. However, this does not mean that *Bildisco* necessarily applies in Chapter 9 cases.

[46] *See id.* at 185 n.21 (revealing that the parties resolved most of their differences through "multiple meet and confer sessions and a settlement conference" and that the court approved a negotiated preliminary injunction in February 1995, a month before the court's opinion was released).

reasoning as the *Orange County* court. Citing the *Orange County* TRO opinion, the *Vallejo* bankruptcy court held that § 1113 "is not incorporated into chapter 9" and thus *Bildisco* provided the standard for rejection.[47] Like the *Orange County* court, the *Vallejo* court did not consider whether *Bildisco* actually applied to Chapter 9 cases.

Perhaps the *Vallejo* court ignored this issue because none of the parties forcefully raised it. In *Vallejo*, the unions' opposition brief used only one sentence to make the argument that *Bildisco* did not apply to Chapter 9 cases.[48] Instead, the unions focused their arguments on § 1113 and state law. They argued that "bankruptcy courts should be guided by Section 1113's requirements, as well as by state collective bargaining law."[49]

The issue of CBA rejection in Chapter 9 was again raised when San Bernardino, California, moved to reject its union contracts after filing for bankruptcy in 2012.[50] During hearings on this issue, the *San Bernardino* court indicated that it would follow the *Vallejo* and *Orange County* precedents and would hold that *Bildisco* controls in a Chapter 9 case, because § 1113 had not been incorporated into Chapter 9.[51] On September 11, 2014, the court issued a preliminary ruling that it would allow rejection of a union contract, pending the resolution of an evidentiary question.[52] The court has not yet made a final decision on this matter.[53]

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[47] *In re* City of Vallejo, 403 B.R. 72, 78 (Bankr. E.D. Cal. 2009), *aff'd*, IBEW, Local 2376 v. City of Vallejo (*In re* City of Vallejo), 432 B.R. 262, 272 (E.D. Cal. 2010) (affirming the bankruptcy court's holding and agreeing with the bankruptcy court's reasoning).

[48] Unions Opposition to Debtor's Motion for Approval of Rejection of Collective Bargaining Agreements at 10, *In re* City of Vallejo, 403 B.R. (No. 08-26813).

[49] *Id.* at 12. This was a sensible argument for the unions to make, given that their goal was to *prevent* rejection (and not to *obtain* rejection under *Bildisco*).

[50] *See* City of San Bernardino, 499 B.R. 776, 780 (Bankr. C.D. Cal. 2013) ("[O]n August 1, 2012, the City filed its petition for chapter 9 . . . ."); Transcript of Oral Argument at 1, *In re* City of San Bernardino, No. 12-28006 (Bankr. C.D. Cal. Apr. 4, 2013) (discussing the city's motion to reject its collective bargaining agreements under 11 U.S.C. § 365).

[51] *See id.* at 8 ("Clearly, the legislature has had the opportunity to eviscerate the Bildisco ruling, as it did in Chapter 11[.] . . . [I]t has not done that in Chapter 9, and therefore, I would . . . find that the measurement of whether or not contracts should be . . . measured by Bildisco.").

[52] Steven Church, *San Bernardino Can End Firefighters' Contract, Judge Says*, BLOOMBERG (Sept. 11, 2014), http://www.bloomberg.com/news/2014-09-11/san-bernardino-can-end-firefighters-contract-judge-says.html, *archived at* http://perma.cc/C9YB-ZHQG (explaining how the bankruptcy judge believed the contract would "burden" the city's recovery).

[53] *But see* Notice of Appeal at 1, *In re* City of San Bernardino, No. 14-2073 (C.D. Cal. Oct. 8, 2014) (notifying the district court, the bankruptcy court, and the city about the firefighters' union's decision to appeal the preliminary order).

The failure of the *Orange County*, *Vallejo*, and *San Bernardino* courts to consider whether *Bildisco* properly applies to Chapter 9 cases is troubling.[54] These courts simply assumed that, unless overruled by § 1113, *Bildisco* controlled the CBA rejection process in Chapter 9 cases. This error has now become "judicial consensus."[55] This position, however, is incorrect. *Bildisco*'s rejection standard should not control in a Chapter 9 case.

II. *BILDISCO*'S THREE-PRONG REJECTION TEST IS NOT MANDATORY AUTHORITY IN A CHAPTER 9 CASE

Bildisco is not binding law in a Chapter 9 case for three reasons: (1) *Bildisco*'s holding was limited to CBAs negotiated under the NLRA, and thus does not apply to CBAs created under state law; (2) *Bildisco*'s holding was limited to Chapter 11 cases; and (3) recent court decisions have rejected the *Bildisco* standard's "balancing" and "burden" prongs as contrary to bankruptcy policy. Because public employee labor contracts are not regulated by the NLRA, because cities do not file for bankruptcy in Chapter 11, and because *Bildisco*'s standard does not serve bankruptcy policy, the case is not binding authority on the question of CBA rejection in Chapter 9.

A. *Public Employee CBAs Are Regulated by State Law, Not the NLRA, and* Bildisco *Is Limited to Labor Contracts Under the NLRA*

Municipal employee CBAs are not negotiated under the NLRA, and so *Bildisco* is not mandatory authority when municipal debtors reject a CBA in Chapter 9.[56] The NLRA covers only private employers, exempting states and

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[54] These are the only courts to have reached this question as of 2014. Another case, *In re City of Stockton*, agreed with *Orange County* and *Vallejo* in dicta, but did not actually reach the question of *Bildisco*'s applicability to Chapter 9 proceedings. 478 B.R. 8, 23 (Bankr. E.D. Cal. 2012). This issue also did not arise in the bankruptcy proceedings of Detroit, Michigan. On August 2, 2013, the city informed the court that because Detroit's CBAs were already set to expire, it did not intend to reject them. Transcript of Hearing at 33, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. Aug. 2, 2013).

[55] *In re City of Stockton*, 478 B.R. at 23 ("The judicial consensus is that *Bildisco* controls rejection of collective bargaining agreements in chapter 9 cases.").

[56] Commentators elsewhere have noted that *Bildisco* may not apply to CBAs in Chapter 9 cases because *Bildisco*'s reach is limited to CBAs under the NLRA. *See* Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, and a Reconsideration of Chapter 9*, 85 AM. BANKR. L.J. 363, 381-82 (2011) (noting the *Vallejo* court "ignor[ed] the full holding and rationale of *Bildisco*" with respect to the NLRA, and arguing that 11 U.S.C. § 903 requires application of only state law as part of § 365(a)'s rejection standard); Winograd, *supra* note 7, at 290-93 (asserting that "*Bildisco*'s applicability to the public sector is questionable" and arguing that state collective bargaining laws should be allowed to operate in Chapter 9 bankruptcy cases despite § 365(a)).

their political subdivisions.[57] As political subdivisions of states, cities are not subject to the NLRA and are thus not required by federal law to negotiate collective bargaining agreements with their employees.[58] This point is uncontroversial and is "routinely addressed by summary orders" of lower courts.[59]

States and their political subdivisions instead have their own laws governing labor contracts in the public sector.[60] Public labor law is distinct from private sector labor law. Public employers are part of the government, and instead of focusing on profit, they must consider government-specific concerns during negotiation with employees: the budget, the tax base, and politics.[61] This makes public labor law for states and cities unique.[62] Traditionally, public employees had no right at common law either to bargain collectively with public employers or to strike.[63] Moreover, public employees have no

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57 *See* 29 U.S.C. § 152(2) (2012) ("The term 'employer' . . . shall not include . . . any State or political subdivision thereof . . . .").

58 *See generally* Police Dep't of Chicago v. Mosley, 408 U.S. 92, 102 n.9 (1972) (noting that the city of Chicago was not an "employer" under the NLRA, because it was a political subdivision of the state of Illinois and thus exempt from 29 U.S.C. § 152); Richardson v. City of Niagara Falls, No. 09-0824, 2012 WL 75771, at *7 (W.D.N.Y. Jan. 10, 2012) (holding that the federal court lacked subject matter jurisdiction because, as a political subdivision of the state of New York, the city of Niagara Falls was exempt from the NLRA); *see also* McElrath v. City of Dayton, No. 11-0378, 2012 WL 5471840, at *1 (S.D. Ohio Nov. 9, 2012) (holding that the city of Dayton was a political subdivision of the state of Ohio and thus the federal court did not have subject matter jurisdiction to hear a claim under the Labor Management Relations Act); Harris v. City of Chicago, 665 F. Supp. 2d 935, 959 (N.D. Ill. 2009) (holding that the city of Chicago was a political subdivision of Illinois and thus exempt under the LMRA); Dahl, *supra* note 6, at 303 ("[T]he NLRA does not apply to states and their sub-units as employers.").

59 Ford v. D.C. 37 Union Local 1549, 579 F.3d 187, 188 (2d Cir. 2009) (holding that the New York City Department of Health and Mental Hygiene is a political subdivision of New York and thus "exempt under § 152(2)").

60 *See* Dahl, *supra* note 6, at 303 ("Each of the fifty states has been free to independently define the rights and duties of public employers and their employees."); Winograd, *supra* note 7, at 290 ("[D]irect application of private sector labor law is inappropriate because Congress expressly excluded from the NLRA definition of employer 'any State or political subdivision thereof.'").

61 *See* Clyde W. Summers, *Public Sector Bargaining: Problems of Governmental Decisionmaking*, 44 U. CIN. L. REV. 669, 672-73 (1975) (discussing the political nature of public employers' decisions when bargaining with their employees).

62 *See id.* at 670 (emphasizing how "[t]he uniqueness of public employment . . . is in the special character of the employer).

63 *See* Local 2238 of AFL-CIO v. Stratton, 796 P.2d 76, 80 (N.M. 1989) (observing that, in 1989, the "well-settled" rule "among a majority of jurisdictions throughout the United States" was "that *absent express statutory authority, public officials or state agencies do not have the authority to enter into collective bargaining agreements with public employees*"); *see also* Cnty. Sanitation Dist. No. 2 v. L.A. Cnty. Emps. Ass'n, Local 660, 699 P.2d 835, 841 (Cal. 1985) (describing the traditional "common law prohibition" against public employee strikes).

constitutional right to bargain with their employers.[64] To the extent public employees have these rights at all, the rights come from state statutes.[65] Not all states have such statutes, however, and many actually prohibit collective bargaining by public employees.[66]

Because municipal labor contracts are governed by state law only, the rejection of these contracts in Chapter 9 cases does not implicate the NLRA. Furthermore, any conflict between § 365(a) of the Bankruptcy Code (which allows rejection of executory contracts) and state labor law (which may prohibit such rejection) would be a conflict between state and federal law that must be resolved in favor of federal law. Federal law preempts state law under the Supremacy Clause of the U.S. Constitution,[67] so any state laws that conflict with the Bankruptcy Code are preempted.[68]

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64 *See* Smith v. Ark. State Highway Emps., Local 1315, 441 U.S. 463, 465 (1979) ("The public employee surely can associate and speak freely and petition openly . . . [b]ut the First Amendment does not impose any affirmative obligation on the government to listen, respond or, in this context, to recognize the association and bargain with it."); Laborers Local 236 v. Walker, 749 F.3d 628, 640 (7th Cir. 2014) (holding that a Wisconsin law that limited public employees' ability to bargain collectively "does not violate the First or Fourteenth Amendments to the United States Constitution").

65 *See Stratton*, 796 P.2d at 80 (listing jurisdictions that require express statutory authorization before public employees may bargain collectively).

66 *See, e.g.*, Peters v. Health & Hosps. Governing Comm'n, 430 N.E.2d 1128, 1130 (Ill. 1981) (finding "no authority in [Illinois] statutory or case law which supports the position that a public body can be ordered to negotiate [a collective bargaining] agreement"); Jefferson Cnty Bd. of Educ. v. Jefferson Cnty. Educ. Ass'n, 393 S.E.2d 653, 659 (W. Va. 1990) ("[I]t is clear that a public employer is not required to recognize or bargain with a public employee association or union in the absence of a statutory requirement.") (citation and internal quotation marks omitted); *see also* Martin H. Malin, *The Legislative Upheaval in Public-Sector Labor Law: A Search for Common Elements*, 27 A.B.A. J. LAB. & EMP. L. 149, 150 & n.12 (2012) (explaining that some states prohibit collective bargaining by public employees, and citing North Carolina, Texas, and Virginia statutes to support this proposition).

67 *See* U.S. CONST. art. VI, cl. 2 (establishing that federal law is the "supreme Law of the Land" notwithstanding contrary state laws); Perez v. Campbell, 402 U.S. 637, 652 (1971) ("[T]he controlling principle [is] that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause.").

68 *See, e.g.*, *Perez*, 402 U.S. at 656 (holding that an Arizona discharge statute conflicted with, and thus was preempted by, federal bankruptcy law); Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005) (discussing how the Bankruptcy Code preempts contrary state laws); *In re* City of Vallejo, 403 B.R. 72, 77 (Bankr. E.D. Cal. 2009) (citing *Sherwood Partners* for the proposition that state laws must yield to federal bankruptcy policy), *aff'd*, IBEW, Local 2376 v. City of Vallejo (*In re* City of Vallejo), 432 B.R. 262 (E.D. Cal. 2010); *see also* Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929) ("States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations."). It is important to note that all contract rejections under § 365(a) involve conflicts of law between state contract law and 11 U.S.C. § 365(a). Contracts are traditionally state law matters, and § 365 directly conflicts with state contract law by explicitly allowing breaches of contract. However, in typical bankruptcy cases (i.e., cases filed under Chapters 7, 11, or 13), it is undisputed that § 365(a) controls.

In fact, outside of Chapter 9's public labor contract context, it is uncontroversial that debtors in bankruptcy may reject their state law contracts under 11 U.S.C. § 365(a).[69] The *Bildisco* decision, in contrast, was predicated on resolving a conflict between two federal laws: § 365(a) and the NLRA.[70] Because the conflict between state labor law and federal bankruptcy law presented by Chapter 9 CBA rejections does not require any such compromise, *Bildisco*'s holding is inapposite in the Chapter 9 context. Accordingly, *Bildisco*'s standard for rejecting labor contracts is not binding authority in a Chapter 9 case.

B. Bildisco*'s Rejection Standard Was Limited to Chapter 11 Cases, and So It Is Not Binding Authority in Chapter 9 Cases*

The *Bildisco* rejection standard's applicability was also limited to Chapter 11 cases, so it is not binding in other chapters of the Bankruptcy Code. The Supreme Court held that when applying the rejection standard, "rejection should not be permitted" unless a court finds "the policy of Chapter 11" would be served by rejection.[71] Examining Chapter 11's policies, the Court concluded that "the authority to reject an executory contract is vital to the basic purpose to a Chapter 11 reorganization."[72] Given *Bildisco*'s explicit language, its rejection standard was tied to the Chapter 11 context alone.[73] Accordingly, it should not be applied to a Chapter 9 case.

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[69] *See, e.g.*, *In re* Am. Suzuki Motor Corp., 494 B.R. 466, 475 (Bankr. C.D. Cal. 2013) ("A significant body of federal case law exists supporting the view that state laws are preempted when they seek to impair a bankruptcy trustee or debtor from assuming or rejecting executory contracts.").

[70] *See In re* Shannon, 100 B.R. 913, 919 (S.D. Ohio 1989) ("*Bildisco* interprets section 365 of the Bankruptcy Code and its relation to the NLRA . . . ."); *In re* Jenkins, 58 B.R. 702, 705 (Bankr. W.D. Mich. 1986) (observing that *Bildisco* considered a conflict of law between the federal NLRA and the federal Bankruptcy Code).

[71] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984), *superseded by statute*, 11 U.S.C. § 1113 (2012).

[72] *Id.* at 528.

[73] *But see* Fitzgerel v. IBEW, Local Union No. 124 (*In re* Fitzgerel), 44 B.R. 628, 630-31 (Bankr. W.D. Mo. 1984) (applying *Bildisco* to the rejection of a federally protected CBA in a Chapter 13 proceeding). An exhaustive search of the federal reporters revealed no decisions applying *Bildisco* outside of the Chapter 11 context, with the exception of *Orange County* and *Vallejo*. The *Fitzgerel* court assumed, without examination, that *Bildisco* applied in Chapter 13 proceedings. Because of the court's failure to discuss whether *Bildisco*'s standard applies in Chapter 13 proceedings for Chapter 13–related reasons, the *Fitzgerel* opinion is erroneous.

C. *The* Bildisco *Three-Part Rejection Standard Is Unsound as a Policy Proposition with Respect to the Bankruptcy Code Generally*

The *Bildisco* rejection standard applies the "burden" and "balancing" tests, which have been abandoned by modern courts because they are contrary to bankruptcy policy[74] and practice.[75]

Bildisco's use of these antiquated tests is further reason not to extend the decision to Chapter 9 cases. The "burden" test was a common standard for contract rejection through the 1970s. Under this test, a court would approve rejection only if the bankruptcy estate would suffer an "actual loss" from continued performance of the contract, "as distinguished from the obtaining of a more profitable rental [or other business opportunity]."[76] Some courts were still using this test when the *Bildisco* was decided, and the Supreme Court incorporated it into *Bildisco*'s "burden" prong.[77] However, courts since the 1980s have soundly rejected this test on the ground that it is too rigid to effectuate the bankruptcy policy of rehabilitating debtors.[78] One bankruptcy court even commented that "virtually all recent Bankruptcy Court decisions" reject the burden test and instead apply the business judgment test.[79]

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[74] *See, e.g.*, *In re* Thinking Machs. Corp., 182 B.R. 365, 368 (D. Mass. 1995) (holding that the business judgment test is the proper standard for contract rejection and noting how "sound bankruptcy policy" supports this decision), *rev'd on other grounds*, Thinking Machs. Corp. v. Mellon Fin. Servs. Corp. #1 (*In re* Thinking Machs. Corp.), 67 F.3d 1021 (1st Cir. 1995); *In re* Trans World Airlines, Inc., 261 B.R. 103, 123 (Bankr. D. Del. 2001) (rejecting the "balancing" test); *In re* A.J. Lane & Co., 107 B.R. 435, 439-40 (Bankr. D. Mass. 1989) (declining to apply both the "burden" standard and the "balancing" standard); Summit Land Co. v. Allen (*In re* Summit Land Co.), 13 B.R. 310, 315-16 (Bankr. D. Utah 1981) (finding that a policy-driven interpretation of § 365(a) supports a business judgment standard, and declining to apply the "burden" standard).

[75] *See* Agarwal v. Pomona Valley Med. Grp., Inc. (*In re* Pomona Valley Med. Grp., Inc.), 476 F.3d 665, 670-71 (9th Cir. 2007) (holding that the business judgment standard is the correct test for rejection under § 365(a)); *In re* Nickels Midway Pier, LLC, 332 B.R. 262, 270-71 (Bankr. D.N.J. 2005) (applying the business judgment rule and rejecting consideration of "the burden or hardship which rejection would impose on other parties" (internal quotation marks omitted)); *In re* A.J. Lane & Co., 107 B.R. at 439 (citing Grp. of Institutional Investors v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523, 550 (1943)) (noting that the business judgment standard was the dominant standard under the pre-1978 Bankruptcy Code).

[76] Am. Brake Shoe & Foundry Co. v. N.Y. Rys. Co., 278 F. 842, 844 (S.D.N.Y. 1922).

[77] *See supra* notes 21-25 and accompanying text.

[78] *See In re* Thinking Machs. Corp., 182 B.R. at 368-69 (citing numerous policies underlying the business judgment test); *Summit Land Co.*, 13 B.R. at 315 & n.6 (explaining why the bankruptcy policy of rehabilitating debtors forecloses the use of the "burden" test).

[79] *In re* Stable Mews Assocs., Inc., 41 B.R. 594, 596 (Bankr. S.D.N.Y. 1984), *cited with approval by In re* Delta Air Lines, Inc., 359 B.R. 468, 476 (Bankr. S.D.N.Y 2006); *see, e.g.*, *In re* Thinking Machs. Corp., 182 B.R. at 368 (holding that the correct test for contract rejection in bankruptcy is the business judgment test).

Bankruptcy courts have discarded the "balancing" test used in *Bildisco* for similar reasons.[80] Courts addressing the issue have noted that contract rejection is intended to benefit the debtor,[81] and thus effects on other parties are not relevant.[82] In fact, initial use of the "balancing test" was based on a misinterpretation of *In re Chi-Feng Huang*, a Ninth Circuit opinion from 1982, which implied that courts could balance the interests of the debtor against those of the contract counterparty when deciding a § 365(a) motion.[83] The Ninth Circuit itself has since distinguished that opinion and explained that the correct test is the business judgment test.[84] Because *Bildisco* applies both the "burden" and "balancing" tests, the *Bildisco* rejection standard is unsound as a matter of bankruptcy policy and should be ignored.

III. IGNORING *BILDISCO*, THE BUSINESS JUDGMENT RULE SHOULD CONTROL CBA REJECTION IN CHAPTER 9 CASES

Having concluded that *Bildisco*'s rejection standard does not bind a Chapter 9 court, the analysis of CBA rejection in municipal bankruptcy becomes simple: the business judgment rule controls. Two arguments support this conclusion. First, the statutory scheme and § 365(a)'s policy call for a business judgment standard. Second, Chapter 9's legislative history supports a deferential standard of approval.

A. *Statutory Analysis Of § 365(a) Leads to the Business Judgment Standard, and There Is No Reason to Carve Out Public Labor Contracts from This Reading*

Although the plain language of § 365(a) does not explicitly establish any standard of approval for contract rejection,[85] courts have consistently held

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[80] *See generally In re* A.J. Lane & Co., 107 B.R. at 440 (Bankr. D. Mass. 1989) (explaining how the "balancing" approach incorrectly "crept into the case law" because of a misreading of Ninth Circuit precedent).

[81] *See In re* Trans World Airlines, Inc., 261 B.R. 103, 123 (Bankr. D. Del. 2001) (rejecting the "balancing" test as contrary to § 365(a)'s focus on benefiting the debtor).

[82] *See In re* Nickels Midway Pier, LLC, 332 B.R. 262, 271 (Bankr. D.N.J. 2005) (explaining that hardships imposed on other parties are not relevant when determining whether rejection is in the best interest of the debtor).

[83] *See supra* note 80 and accompanying text.

[84] *See* Agarwal v. Pomona Valley Med. Grp., Inc. (*In re* Pomona Valley Med. Grp., Inc.), 476 F.3d 665, 670-71 (9th Cir. 2007) (holding that the business judgment standard, rather than the "balancing" standard and corresponding "weighing of equitable concerns," is the correct test for rejection under § 365(a)).

[85] *See* 11 U.S.C. § 365(a) (2012) ("Except as provided [in other parts of this section and in other sections in this title], the trustee, subject to the court's approval, may assume or reject any

that the bankruptcy policies of efficient case administration and debtor rehabilitation call for deference to a bankrupt's decision to assume or reject a contract.[86] Circuit courts interpreting § 365(a) have thus held that a bankruptcy judge should approve a debtor's decision to reject a contract if doing so benefits the debtor's bankruptcy, unless the debtor's decision is the product of bad faith, whim, or caprice.[87] This rule is the business judgment standard of approval.[88]

As discussed above, courts have rejected all other standards of approval—namely, the "burden" and "balancing" standards.[89] Although in 1985 one Chapter 9 commentator suggested that courts should review CBA rejection

executory contract or unexpired lease of the debtor."); *In re* Lafayette Radio Elecs. Corp., 8 B.R. 528, 533 (Bankr. E.D.N.Y. 1981) (noting that the Bankruptcy Code does not codify a standard of approval).

[86] *See* Hassett v. Revlon, Inc. (*In re* O.P.M. Leasing Servs., Inc.), 23 B.R. 104, 118 (Bankr. S.D.N.Y. 1982) (construing § 365(a) in line with bankruptcy policy); Summit Land Co. v. Allen (*In re* Summit Land Co.), 13 B.R. 310, 315 (Bankr. D. Utah 1981) (same).

[87] *Agarwal*, 476 F.3d at 670 (holding that courts should approve rejection unless the debtor's decision was based on "bad faith or on whim or caprice"); *see, e.g.*, ReGen Capital I, Inc. v. Halperin (*In re* U.S. Wireless Data, Inc.), 547 F.3d 484, 488 (2d Cir. 2008) (applying the business judgment test to a motion filed under § 365(a)); Delightful Music Ltd. v. Taylor (*In re* Taylor), 913 F.2d 102, 107 (3d Cir. 1990) (holding that the business judgment test is the correct standard for approval of contract rejection under § 365(a)); Byrd v. Gardinier, Inc. (*In re* Gardinier, Inc.), 831 F.2d 974, 975 n.2 (11th Cir. 1987) ("[C]ourts review a trustee's decision to assume or reject a contract under a traditional 'business judgment' standard . . . ."); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1047 (4th Cir. 1985) (holding that under the business judgment test, the debtor's decision to reject a contract must be "accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion"), *superseded by statute on other grounds*, 11 U.S.C. § 365(n); Eagle Ins. Co. v. BankVest Capital Corp. (*In re* BankVest Capital Corp.), 290 B.R. 443, 447 (B.A.P. 1st Cir. 2003) ("Under a motion to assume or reject an executory contract, the only issue properly before a court is whether the assumption or rejection of the subject contract is based upon a debtor's business judgment."); *In re* Pilgrim's Pride Corp., 403 B.R. 413, 422 (Bankr. N.D. Tex. 2009) ("The general rule is that the decision to reject a given contract should be left to the trustee's (or debtor in possession's) sound business judgment."); *Summit Land Co.*, 13 B.R. at 315 ("In any event, court approval under Section 365(a), if required, except in extraordinary situations, should be granted as a matter of course.").

[88] *See generally* cases cited *supra* note 87. The "business judgment rule" is a misnomer because it applies even if the debtor is not a business. *See, e.g.*, Bregman v. Meehan (*In re* Meehan), 59 B.R. 380, 385 (E.D.N.Y. 1986) (applying the business judgment test to an individual's Chapter 13 bankruptcy).

[89] *See, e.g.*, *In re* Riodizio, Inc., 204 B.R. 417, 425 n.9 (Bankr. S.D.N.Y. 1997) ("Section 365 does not require any balancing of the equities."); Wheeling-Pittsburgh Steel Corp. v. West Penn Power Co. (*In re* Wheeling-Pittsburgh Steel Corp.), 72 B.R. 845, 848 (Bankr. W.D. Pa. 1987) ("[W]e are not free to deviate from a traditional business judgment analysis and weigh the effect of rejection on [other parties]."); *see also In re* Old Carco LLC, 406 B.R. 180, 192-93 (Bankr. S.D.N.Y. 2009) (finding that in cases in which courts applied a balancing test to disallow contract rejection, "these cases involve circumstances under which the business judgment standard either failed to be met or failed to be properly applied by the bankruptcy court"). *See generally supra* Section II.C.

in Chapter 9 under a balancing standard that weighs the "broad social interests" associated with contract rejection,[90] today the courts would flatly reject such an argument as inconsistent with § 365(a)'s policy design.[91] Only one modern case, *Mirant Corp.*, has held that social interests may be considered.[92] However, as discussed below, this statement was written in dicta, and all courts considering *Mirant Corp.* as a whole have distinguished and criticized its assertion.[93]

Courts have also noted that Congress is aware of the business judgment standard, and that this standard must apply unless Congress says otherwise.[94] This argument accords with the canon of statutory construction that statutes should be interpreted as part of a broader statutory scheme, and therefore, if Congress drafts an exception in one area, a court may not imply other exceptions.[95]

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[90] Winograd, *supra* note 7, at 327.

[91] *See In re* Stable Mews Assocs., Inc., 41 B.R. 594, 596 (Bankr. S.D.N.Y. 1984) ("The great weight of modern authority applies the business judgment test. Indeed, virtually all recent Bankruptcy Court decisions apply this test." (citations omitted)), *cited with approval by In re* Delta Air Lines, Inc., 359 B.R. 468, 476 (Bankr. S.D.N.Y 2006).

[92] Mirant Corp. v. Potomac Elec. Power Co (*In re* Mirant Corp.), 378 F.3d 511, 525 (5th Cir. 2004) ("Use of the business judgment standard would be inappropriate in this case because it would not account for the public interest inherent in the transmission and sale of electricity.").

[93] *See infra* text accompanying notes 106-08.

[94] *See In re* Old Carco LLC, 406 B.R. 180, 193 (Bankr. S.D.N.Y. 2009) (finding that, "absent Congressional authority . . . , the court is not free to deviate from the business judgment standard); *Wheeling-Pittsburgh Steel Corp.*, 72 B.R. at 847-848 ("Congress has plainly provided for the rejection of executory contracts, notwithstanding the obvious adverse consequences for contracting parties thereby made inevitable." (quoting Lubrizol Enters. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1048 (4th Cir. 1985), *superseded by statute on other grounds*, 11 U.S.C. § 365(n) (2012))); *see also* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522-23 (1984) ("Obviously, Congress knew how to draft an exclusion for collective-bargaining agreements when it wanted to; its failure to do so in this instance indicates that Congress intended that § 365(a) apply to all collective-bargaining agreements covered by the NLRA.").

[95] *See* Law v. Siegel, 134 S. Ct. 1188, 1196 (2014) ("The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions."); Hillman v. Maretta, 133 S. Ct. 1943, 1953 (2013) ("[W]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.") (citation and internal quotation marks omitted); TRW Inc. v. Andrews, 534 U.S. 19, 28 (2001) (same); FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.") (citation and internal quotation marks omitted); *Lubrizol Enters.*, 756 F.2d at 1048 ("Awareness by Congress of [potential] consequences [for contract counterparties] is indeed specifically reflected in the special

Congress has at times enacted bankruptcy statutes that establish special rejection standards for certain contracts. For example, 11 U.S.C. § 365(n) creates special rejection standards for intellectual property licenses.[96] Congress enacted § 365(n) in response to the Fourth Circuit's *Lubrizol* decision, which allowed the rejection of an intellectual property license under the business judgment standard.[97] Because Congress did not want such licenses to be rejected under the business judgment rule, it enacted § 365(n).[98] Other examples of special contract rejection standards include 11 U.S.C. § 1113, which sets special standards for the rejection of private labor contracts,[99] and 11 U.S.C. § 365(h), which governs the rejection of unexpired real property leases.[100] Because Congress has enacted special rejection standards for these contracts and not others, the courts may not depart from the business judgment standard absent an explicit statutory directive.[101] Courts have thus applied the business judgment rule even when faced with arguments for more stringent standards in cases involving franchise contracts and public utility contracts, as no statute sets special standards for the rejection of these types of contracts.[102]

Applying this canon of construction to CBA rejection in Chapter 9 cases, it is clear that Congress has enacted no special provision in the Bankruptcy

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treatment accorded to [private sector] union members under collective bargaining contracts . . . . But no comparable special treatment is provided for [the contracts at issue here].").

96 11 U.S.C. § 365(n) (2012).

97 *See Lubrizol Enters.*, 756 F.2d at 1046 (applying the business judgment standard).

98 *See* Micron Tech. v. Qimonda AG (*In re* Qimonda AG Bankr. Litig.), 433 B.R. 547, 567 (E.D. Va. 2010) (explaining how Congress enacted § 365(n) to overrule *Lubrizol* and correct the "precarious position" that *Lubrizol* had created for licensees (citation and internal quotation marks omitted)).

99 11 U.S.C. § 1113 (detailing specific standards for rejection of collective bargaining agreements in Chapter 11 cases).

100 11 U.S.C. § 365(h); *see also In re* Stable Mews Assocs., Inc., 41 B.R. 594, 597 (Bankr. S.D.N.Y. 1984) (finding that Congress enacted special rejection procedures regarding leases, including those allowing trustees to reject undesirable leases and those allowing tenants to treat the rejected lease as terminated and to then make claims against the estate).

101 *See In re* Old Carco LLC, 406 B.R. 180, 193 (Bankr. S.D.N.Y. 2009) (finding that "the court is not free to deviate from the business judgment standard" unless directed by statute); Wheeling-Pittsburgh Steel Corp. v. West Penn Power Co. (*In re* Wheeling-Pittsburgh Steel Corp.), 72 B.R. 845, 847-848 (Bankr. W.D. Pa. 1987) (holding that because Congress has excepted certain contracts from the business judgment standard by statute, the court must apply the business judgment standard absent such a statute); *In re Stable Mews*, 41 B.R. at 596-98 (citing § 365's statutory structure when declining to apply a test other than the business judgment standard); *see also* Law v. Siegel, 134 S. Ct. 1188, 1196 (2014) (holding that the Bankruptcy Code's many "meticulous" exemptions and exceptions precludes courts from creating additional exceptions).

102 *See In re Old Carco*, 406 B.R. at 192-93 (applying the business judgment rule to the rejection of car dealership franchise contracts); *Wheeling-Pittsburgh*, 72 B.R. at 848 (applying the business judgment rule to the rejection of a utility contract).

Code for public labor contracts.[103] In particular, that Congress enacted 11 U.S.C. § 1113 to protect CBAs in Chapter 11 of the Bankruptcy Code,[104] and not in any other chapter of the Code, further shows that CBAs in Chapter 9 cases should not receive special treatment.

Legislative history also bears out this point. In a 1991 draft amendment to the Bankruptcy Code, Congress considered adding special terms for CBAs in Chapter 9 proceedings, but the proposal was never enacted.[105] Because the Bankruptcy Code does not create special standards for CBA rejection in Chapter 9 proceedings, courts addressing this issue must apply the default business judgment standard.

One other argument complicates this analysis: the Fifth Circuit's discussion (in dicta) of a public interest standard. In *Mirant Corp. v. Potomac Electric Power Co.*, the Fifth Circuit wrote that a debtor's decision to reject a federally regulated power contract could be approved only under a standard similar to the *Bildisco* standard.[106] According to the *Mirant* court, if § 365(a) conflicts with another federal statute or if rejection is contrary to some other national public interest, then a heightened "public interest" standard should govern.[107] The few courts that have considered this opinion have

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103 *See* 11 U.S.C. § 901 (failing to incorporate any special provision for public labor contracts).

104 *See, e.g.*, Carpenters Health & Welfare Trust Funds for Cal. v. Robertson (*In re* Rufener Constr., Inc.), 53 F.3d 1064, 1068 (9th Cir. 1995) ("Reading the language of § 1113 in its entirety, we conclude that it is applicable only to bankruptcies filed under Chapter 11.").

105 *See* Orange Cnty. Emps. Ass'n v. Cnty. of Orange (*In re* Cnty. of Orange), 179 B.R. 177, 183 n.15 (Bankr. C.D. Cal. 1994) (noting that H.R. 3949, a "'§ 1113-like' statute for Chapter 9," was never enacted by Congress); Municipal Employee Protection Amendments of 1991, H.R. 3949, 102d Cong. § 2(c)(3) (1991), *available at* http://thomas.loc.gov/cgi-bin/query/z?c102:H.R.3949.IH:, *archived at* http://perma.cc/B793-9TAU (proposing to add special terms for CBA rejection to title 11 of the Code).

106 *See* Mirant Corp. v. Potomac Elec. Power Co. (*In re* Mirant Corp.), 378 F.3d 511, 525 (5th Cir. 2004) (stating in dicta that a more stringent standard than the business judgment standard might be applied to rejection of a utility contract regulated by the Federal Energy Regulatory Commission). The Fifth Circuit may be backing away from this position. On remand, the district court said that it would apply the public interest standard recommended by the circuit court. *In re* Mirant Corp., 318 B.R. 100, 107-08 (N.D. Tex. 2004). But when the parties appealed the district court's ruling, the Fifth Circuit did not mention the public interest standard and decided the issue on other grounds, instead holding that the policies of Chapter 11 bankruptcy should guide any finding on the appropriate standard of approval for contract rejection. *See* Potomac Elec. Power Co. v. Mirant Corp. (*In re* Mirant Corp.), No. 05-10038, 2006 WL 2034612, at *293 (5th Cir. July 19, 2006) (per curiam) (holding that "determination of the applicable standard a debtor must meet for rejection is unnecessary," but recognizing that "the purpose of § 365 rejection is to free the debtor from agreements that would hinder or disable reorganization").

107 *See In re* Pilgrim's Pride Corp., 403 B.R. 413, 424-25 (Bankr. N.D. Tex. 2009) (citing *Mirant*'s heightened public interest standard, but finding no qualifying public interest issues at stake in the *Pilgrim's Pride* case).

distinguished it from subsequent cases, and, declining to apply a "public interest" standard, they have held that the business judgment rule governs instead.[108]

But even if the public interest standard is valid, it would not apply to a Chapter 9 case for two reasons. First, CBA rejection in Chapter 9 does not create a conflict between two federal laws.[109] Second, even if a generalized public interest regarding CBAs is reason to apply a "public interest" standard, a strong counterargument exists: Chapter 9 is itself designed for the public interest.[110] A failed municipal reorganization could result in a loss of essential services like garbage collection, police protection, street lighting, or fire protection.[111] Chapter 9 bankruptcy is designed to protect these interests and ensure public health and safety, and so a public interest rejection standard would be awkward to apply in a Chapter 9 case. *Mirant* is thus no obstacle to the argument that the business judgment standard governs CBA rejection in Chapter 9 proceedings.

B. *Chapter 9's Legislative History and Congress's Constitutional Concerns Call for Deference to a Municipal Debtor's Rejection Decisions*

A Chapter 9 debtor has the power to reject contracts under Bankruptcy Code § 901, which incorporates § 365. Given this context, Chapter 9's legislative history should be considered when interpreting § 365(a). The legislative history indicates that Congress may have actually intended a

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[108] *See, e.g.*, *id.* at 424 (holding that business judgment remains the correct standard for contract rejection, absent a critical "national policy" at stake); *see also* Cal. Dep't of Water Res. v Calpine Corp. (*In re* Calpine Corp.), 337 B.R. 27, 36-39 (S.D.N.Y. 2006) (holding, contrary to *Mirant*, that the court lacked jurisdiction to adjudicate rejection of certain power agreements when doing so would interfere with the jurisdiction of the Federal Energy Regulatory Commission).

[109] *See generally In re* Caribbean Petroleum Corp., 444 B.R. 263, 269 (Bankr. D. Del. 2010) (declining to apply the "public interest" standard to reject a contract regulated by the Petroleum Marketing Practices Act (PMPA), given that the PMPA "was not a Congressional effort to protect the national public interest"); *In re* Old Carco, LLC, 406 B.R. 180, 191, 199 (Bankr. S.D.N.Y. 2009) (holding that "local laws designed to protect public health and safety, without imminent harm present, do not give rise to application of a heightened standard for contract rejection," even if § 365 conflicts with them, because federal law trumps state law); *see also In re* Am. Suzuki Motor Corp., 494 B.R. 466, 477 (Bankr. C.D. Cal. 2013) (holding that § 365(a) preempts Florida car dealership statutes protecting franchise contracts).

[110] *See, e.g.*, Pope v. Ala. Power Co. (*In re* Ala. State Fair Auth.), 214 B.R. 929, 935-36 n.10 (Bankr. N.D. Ala. 1997) (noting the "public policy considerations" that support the continued operation of Chapter 9 debtors).

[111] *In re* Addison Cmty. Hosp. Auth., 175 B.R. 646, 648 (Bankr. E.D. Mich. 1994) ("Because the purpose of municipalities (i.e. police protection, fire protection, sewage, garbage removal, schools, hospitals) is to provide essential services to residents, it is crucial that chapter 9 relief allow these entities enough flexibility to remain viable.").

deferential standard of approval, given its concern that the Tenth Amendment may require city autonomy in municipal bankruptcy.

Chapter 9 was crafted in the context of New York City's 1970s fiscal crisis.[112] New York was badly in debt, and President Gerald Ford wanted to avoid a federal bailout of the city.[113] President Ford thus proposed legislation to amend the then-existing municipal bankruptcy statute to prepare for the possibility of New York filing for bankruptcy.[114] Senator Quentin Burdick introduced the President's bill and quickly scheduled committee hearings.[115]

Although a municipal bankruptcy statute had existed since the 1930s, the Ford administration did not see it as a viable option for cities like New York.[116] The pre-1970s municipal bankruptcy statute was designed for small municipal corporations, like water districts or county hospitals.[117] According to the bill's drafters, large cities like New York or Detroit would need more expansive powers to successfully reorganize in bankruptcy.[118]

One of President Ford's proposed amendments was to give municipalities the power to reject contracts.[119] The pre-1970s municipal bankruptcy code did not permit contract rejection, but the new bill granted Chapter 9 debtors contract rejection powers.[120] The House Report explained that

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112 *See The Bankruptcy Reform Act Revision of the Salary Fixing Procedure for Bankruptcy Judges: Adjustment of Debts of Political Subdivisions and Public Agencies and Instrumentalities: Hearing on S. 235, S. 236, S. 582, and S. 2597 Before the Subcomm. on Improvements in Judicial Machinery of the S. Committee on the Judiciary*, 94th Cong. 197 (1975) [hereinafter *Hearings*] (statement of Sen. Roman L. Hruska) ("President Ford proposed the addition of a new Chapter XVI to the bankruptcy laws to provide a remedy for New York City's fiscal problems.").

113 Gerald R. Ford, *695—The President's News Conference, November 26, 1975*, THE AM. PRESIDENCY PROJECT, http://www.presidency.ucsb.edu/ws/?pid=5399 (last visited Oct. 23, 2014), *archived at* http://perma.cc/6JJQ-TG63 ("I again ask the Congress promptly to amend the Federal bankruptcy laws so that if the New York plan fails, there will be an orderly procedure available.").

114 *See supra* note 112.

115 *See Hearings*, *supra* note 112, at 197 (statement of Sen. Roman L. Hruska) (commending the timeliness with which Senator Burdick scheduled the hearings).

116 *See id.* at 197-98 (statement of Assistant Att'y Gen. Antonin Scalia, Office of Legal Counsel) (explaining that, under the then-existing statute, finding a majority of a large city's creditors within a short period of time would be an "impossible" task).

117 *See id.* at 212 (remarking that the Supreme Court would be more likely to uphold "a bill that handles major municipalities the size of New York, Chicago, and so forth, than . . . a bill that could handle a very small water district").

118 *See id.* at 209 (proposing that, because large cities are similar to—though still not as complicated as—major corporations, they should have more flexibility under bankruptcy law).

119 *See* H.R. REP. NO. 94-686, at 17 (1975) ("Subsection (b) grants the court powers . . . to permit the rejection of executory contracts . . . .").

120 *See id.* at 8 ("The bill grants the court two powers which a bankruptcy court has under Chapters X and XI . . . , but which had not previously been granted under Chapter IX. The first is the power to permit the petitioner to reject executory contracts.").

"rejection of executory contracts" was "necessary to the continued functioning and subsequent rehabilitation of the [municipal] petitioner."[121] This provision was crucial, given that labor agreements can be among municipalities' largest expenditures.[122] The House Report, however, was ambiguous about what standards to apply to contract rejection.[123] The report simply noted that prior case law surrounding bankruptcy contract rejection statutes should be incorporated into Chapter 9, and it did not identify any particular rejection standard.[124]

Congress was also sensitive to state sovereignty and local control. The Tenth Amendment forbids federal violations of state sovereignty,[125] and municipalities operate as expressions of that sovereignty.[126] For this reason, in 1936 the Supreme Court in *Ashton v. Cameron County* struck down Congress's first attempt at writing a municipal bankruptcy law.[127] Although the Court subsequently upheld a nearly identical municipal bankruptcy

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121 *Id.* at 17. President Ford had also highlighted public employee labor contracts as one source of New York City's fiscal troubles. *See Hearings*, *supra* note 112, at 192 (remarks by President Gerald R. Ford) (noting the large discrepancy between the New York City public employees' pay and benefits and the lower amounts paid to public employees in other American cities).

122 *See generally supra* note 3.

123 *See* H.R. REP. NO. 94-686, at 17 (stating merely that the statute "is broad in scope").

124 *See id.* ("The abundant case law surrounding [other Bankruptcy Code provisions permitting executory contracts' rejection] is meant to be incorporated into Chapter IX. For example, the court may permit the rejection only after hearing on notice and only for reasons that have been established by case law under Chapters X and XI." (citation omitted)).

125 *See* U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."); Printz v. United States, 521 U.S. 898, 920-21 (1997) (holding that the Tenth Amendment protects state sovereignty, and asserting that the "local or municipal authorities form distinct and independent portions of the supremacy, no more subject, within their respective spheres, to the general authority than the general authority is subject to them, within its own sphere" (citation and internal quotation marks omitted)).

126 *See generally* Ashton v. Cameron Cnty. Water Improvement Dist. No. One, 298 U.S. 513, 529-30 (1936) ("A municipal corporation like the city of Baltimore is a representative not only of the State, but is a portion of its governmental power."); *In re* Addison Cmty. Hosp. Auth., 175 B.R. 646, 649 (Bankr. E.D. Mich. 1994) (holding that "[o]ne of the powers reserved to states" by the Constitution "is the power to create and govern municipalities," and noting that 11 U.S.C. § 904 codifies this limitation).

127 *See Ashton*, 298 U.S. at 530-32 ("Like any sovereignty, a State may voluntarily consent to be sued . . . . But nothing in this tends to support the view that the Federal Government, acting under the bankruptcy clause, may impose its will and impair state powers . . . ."). *Cf.* United States v. Bekins, 304 U.S. 27, 51-52 (1938) (upholding under the Tenth Amendment Congress's second attempt at drafting a municipal bankruptcy statute, because the new law properly limited the power of bankruptcy courts in municipal cases); *In re* Pierce Cnty. Hous. Auth., 414 B.R. 702, 715 (Bankr. W.D. Wash. 2009) (explaining that federal court power in Chapter 9 cases is limited, given the Supreme Court's decision "requiring that a municipality be left in control of its governmental affairs during a Chapter 9 case").

statute in 1938,[128] Congress in the 1970s remained concerned about interfering with local governmental affairs in a way that might lead the Supreme Court to find a Tenth Amendment violation.[129] This concern extended to debates over contract rejection procedures.[130] During hearings on President Ford's bill, the Ford Administration sent one of its young attorneys to explain the Administration's proposal to Congress: Antonin Scalia. Then-Assistant Attorney General Scalia answered questions about the Ford Administration's proposed bill and its constitutionality. In the context of these questions, Assistant Attorney General Scalia's answers implied a standard for the rejection of labor contracts under the bill that would give deference to bankrupt municipalities:

> SENATOR BURDICK. Do you believe that the court should have the power to cancel labor contracts or person [sic] plans where it determines that they are too burdensome for the State?
>
> MR. SCALIA. Well; no, sir. It is never a question of the power of the court to cancel them. The court under this proposal does not run the city and does not direct anything to be done.
>
> The city can offer to renegotiate contracts, to do whatever it thinks is necessary and reasonable to put its house in order. It would be a voluntary action by the city presented to the court, and the court could approve that action if it considered it reasonable.[131]

This colloquy with the Judiciary Committee shows that the drafters of the Chapter 9 amendments may have intended for bankruptcy courts to approve labor contract rejections under a deferential standard of approval. A deferential standard would prevent a federal bankruptcy judge from "run[ing] the city" and thus intruding on a bankrupt city's autonomy.

The general rule for considering legislative history in statutory interpretation holds that "no significance should be accorded statements made by interested *witnesses* at congressional hearings."[132] However, courts have held that statements made at hearings by the *drafters* of legislation may be

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128 *See supra* note 127.

129 *See Hearings*, *supra* note 112, at 223-24 (statements of Sen. Roman L. Hruska and Assistant Att'y Gen. Antonin Scalia, Office of Legal Counsel) (discussing the bill's constitutionality).

130 *See id.* at 221 (statements of Sen. Quentin Burdick and Assistant Att'y Gen. Antonin Scalia, Office of Legal Counsel) (discussing bankruptcy courts' power to cancel labor contracts under the proposed bill).

131 *See id.* at 221.

132 Occidental Chem. Corp. v. Power Auth. of N.Y., 786 F. Supp. 316, 329 (W.D.N.Y. 1992).

considered, as drafters are "uniquely qualified to provide guidance on the meaning" of the legislation.[133] Thus Scalia's statements as a representative of the Ford Administration, which initially drafted the Chapter 9 amendments, may provide insight into the legislators' views. In essence, his statements show that the drafters' intentions may be consistent with a deferential business judgment standard. Thus, the traditional business judgment test, as compared to the *Bildisco* standard, the "burden" standard, or the "balancing" standard, may better give effect to Congress's intent.

CONCLUSION

Courts should recognize that *Bildisco*'s rejection standard does not apply to the rejection of public employee CBAs in Chapter 9, and that the *Orange County* and *Vallejo* holdings are incorrect. *Bildisco*'s standard was predicated on a conflict of law between the NLRA and the Bankruptcy Code. Because municipal employee labor agreements are not governed by the NLRA, *Bildisco* is not binding authority in a Chapter 9 case. Moreover, *Bildisco* was expressly limited to Chapter 11 cases. Instead of the *Bildisco* standard, the appropriate standard of approval for CBA rejection in Chapter 9 cases should be the business judgment standard. Given the statutory scheme of the Bankruptcy Code, bankruptcy policy, legislative history, and controlling bankruptcy case law, this approach is the soundest interpretation of 11 U.S.C. § 365(a).

Preferred Citation: Evan Sherwood, Case Note, *Distinguishing* Bildisco *in Municipal Bankruptcy: Why the Business Judgment Standard Should Apply to CBA Rejection in Chapter 9*, 163 U. PA. L. REV. ONLINE 123 (2014), http://www.pennlawreview.com/online/163-U-Pa-L-Rev-Online-123.pdf.

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133 United States v. Doe, 730 F.2d 1529, 1532 n.7 (D.C. Cir. 1984) (internal quotation marks omitted).