RUNNING ON EMPTY: MUNICIPAL INSOLVENCY AND REJECTION OF COLLECTIVE BARGAINING AGREEMENTS IN CHAPTER 9 BANKRUPTCY

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I. INTRODUCTION

The global economic meltdown of late 2008 has, among other things, shined a glaring light on the myriad of financial problems facing the local governments of America. While the banking sector,[1] the automotive industry,[2] and state budget shortfalls[3] have taken turns drawing the ire and attention of panic-stricken observers and policy makers, many municipal governments have been teetering on the brink of insolvency.[4] The National League of Cities reports that municipal governments will ultimately have a total budget shortfall of between fifty-six and eighty-three billion dollars for fiscal years 2010, 2011 and 2012.[5] As a result, everyone from local government officials to municipal bond holders is turning their attention to a rarely used and poorly understood area of federal law: Chapter 9 of the

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1. *See* Mark Deen & David Tweed, *Stiglitz Says Banking Problems are now Bigger than Pre-Lehman*, BLOOMBERG, Sept. 13, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aYdgQkXu9eBg.
2. *See* Chris Woodyard, *As it Asks for Bailout, GM Cuts Extravagance, Office Supplies*, USA TODAY, Nov. 11, 2008, http://www.usatoday.com/money/autos/2008-11-16-gm-cuts-expenses-bailout_N.htm.
3. *See* Elizabeth McNichol, et. al., *States Continue to Feel Recession's Impact*, CTR. ON BUDGET AND POL'Y PRIORITIES, http://www.cbpp.org/cms/index.cfm?fa=view&id=711 (last updated March 9, 2011).
4. *See* Steven Malanga, *The Muni Debt Bomb and how to dismantle it*, WALL ST. J., July 31, 2010, http://online.wsj.com/article/SB10001424052748703999304575399591906297262.html; *see also* Sara Behunek, *Three American Cities on the Brink of Broke*, CNN MONEY (May 28, 2010), http://money.cnn.com/2010/05/28/news/economy/american_cities_broke.fortune/index.htm; Gus Lubin & Leah Goldman, *16 U.S. Cities Facing Bankruptcy if they Don't Make Deep Cuts in 2011*, BUS. INSIDER (Dec. 26, 2010), http://www.businessinsider.com/americas-most-bankrupt-cities-2010-12.
5. Christopher W. Hoene, *City Budget Shortfalls and Responses: Projections for 2010-2012*, NAT'L LEAGUE OF CITIES (Dec. 2009), http://www.elpasotexas.gov/muni_clerk/agenda/01-19-10/01191011A.pdf.

United States Bankruptcy Code, which allows municipal governments to file for bankruptcy protection.[6]

Rising unemployment, declining tax revenue and years of fiscal misfeasance (and in some cases malfeasance[7]) by public officials have left many municipalities on the brink of insolvency.[8] In many cases, labor costs (e.g. salary, benefit and pension obligations) associated with public sector employees are among the most costly items on local balance sheets.[9] These expenses are imposed by collective bargaining agreements negotiated and agreed to by local governments and public sector employee unions. Many municipalities have tried to deal with their budget deficits by laying off public workers and cutting back on public services.[10] As such measures fail to bridge the budget gap, the option of filing for Chapter 9 bankruptcy is becoming increasingly viable.[11]

Historically, municipal bankruptcies are very rare.[12] Only about six hundred state subdivisions have filed for bankruptcy pursuant to Chapter 9 since its enactment in 1937.[13] Fewer than 250 subdivisions have filed in the

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6. 11 U.S.C. §§ 901-46 (2006).
7. *See* Martin Z. Braun, *JPMorgan Sued for Sewer Bond Fraud by Alabama County*, BLOOMBERG, Nov. 13, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aeEzcwih.vEI.
8. *See* Behunek, *supra* note 4.
9. *See* Alan Farnham, *Public Pensions Face Underfunding Crisis*, ABC NEWS (Dec. 13, 2010), http://abcnews.go.com/Business/city-pensions-americas-50-biggest-municipal-pension-shortfalls/story?id=12366160; *see also New York's Exploding Pension Costs*, EMPIRE CENTER FOR N.Y. ST. POL'Y (Dec. 7, 2010), http://www.empirecenter.org/Special-Reports/2010/12/pensionexplosion120710.cfm; Sean P. Murphy, *Runaway Health Costs are Rocking Municipal Budgets*, BOSTON GLOBE, Feb. 28, 2010, http://www.boston.com/news/local/massachusetts/articles/2010/02/28/runaway_health_costs_are_rocking_municipal_budgets/.
10. *See* William Alden, *Newark Police Layoffs Threaten Crime Fighting as Budget Cuts Spark Fears*, HUFFINGTON POST, Feb. 25, 2011, http://www.huffingtonpost.com/2011/02/25/newark-police-layoffs-budget-cuts_n_827993.html; *See also* Devon Lash & Elisabeth Kim, *Stamford Budget Reductions may Mean Municipal Layoffs*, STAMFORD ADVOCATE, Feb. 10, 2010, http://www.stamfordadvocate.com/news/article/Stamford-budget-reductions-may-meanmunicipal-360023.php.
11. *See* Dunston McNichol, *Harrisburg, Pennsylvania, Council Told to Consider Bankruptcy*, BLOOMBERG, April 27, 2010, http://www.bloomberg.com/news/2010-04-27/pennsylvania-s-capital-told-to-consider-chapter-9-bankruptcy-protection.html; *see also* Dan Slater, *Report: Bankruptcy Looms for Jefferson County, Alabama*, WALL ST. J. L. BLOG (Aug. 29, 2008, 12:27 PM), http://blogs.wsj.com/law/2008/08/29/report-bankruptcy-looms-for-jefferson-county-alabama/; Gus Lubin, *New Michigan Governor Says Hundreds of Municipalities Could Go Bankrupt in the Next Four Years*, BUS. INSIDER (Nov. 19, 2010), http://www.businessinsider.com/rick-snyder-hundreds-bankruptcy-2010-11.
12. *See* Kris Turner, *Municipal Bankruptcy Filings Rare*, FLINT J., http://www.mlive.com/news/flint/index.ssf/2011/02/municipal_bankruptcy_filings_r.html (last updated Feb. 16, 2011); *see also* Michelle Park, *Municipalities may for First Time Consider a New Chapter*, CRAIN'S CLEVELAND BUS., Feb. 14, 2011, http://www.crainscleveland.com/article/20110214/FREE/302149964.
13. Monica Davey, *Michigan Town is Left Pleading for Bankruptcy*, N.Y. TIMES, Dec. 27, 2010, http://www.nytimes.com/2010/12/28/us/28city.html?_r=1&pagewanted=1.

last thirty years.[14] Due to the rarity of Chapter 9 cases, municipal bankruptcy case law is uniquely sparse, leaving a number of important questions unanswered. One key question for potential municipal debtors and creditors is if, how and when a municipal debtor can modify or reject a collective bargaining agreement with a public sector union. This issue is key given that once a collective bargaining agreement is rejected by a municipal debtor its terms are no longer enforceable, the union is left only with an unsecured claim against the debtor and such claims rarely recoup anything close to the actual value of the pre-petition interest. This vital question of when modification and/or rejection will be granted has been dealt with in a series of cases beginning with the Supreme Court's decision in *National Labor Relations Board v. Bildisco & Bildisco* (*Bildisco*),[15] followed by a 1995 bankruptcy court decision in *In re County of Orange* (*Orange County*),[16] and, most recently, by the Eastern District of California in the case of *In re City of Vallejo*[17] (*Vallejo*). These decisions and their interpretation of both state and federal law could have enormous implications for local governments and their employees across the nation.

This article will: (i) examine the depth and scope of the municipal debt crisis and assess the role of collective bargaining agreements in that crisis; (ii) provide a brief overview of Chapter 9's history and most relevant provisions vis-à-vis the rejection of collective bargaining agreements; (iii) explain and analyze the *Bildisco*, *Orange County*, *Vallejo* line of cases; and (iv) summarize the potential impact of these decisions at the federal, state and local levels.

II. MUNICIPAL BANKRUPTCY – THE COMING STORM

Local governments are facing unprecedented budget gaps exposed and exacerbated by the ongoing economic turmoil. Many find themselves saddled with collective bargaining obligations they cannot hope to meet in the absence of drastic fiscal reform. In order to fully understand the growing incentive to file for Chapter 9 protection, local government officials must first confront the harsh reality of their own budget deficits.

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14. *Id.*
15. Nat'l Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S. 513 (1984).
16. *In re* Cty. of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995).
17. *In re* City of Vallejo, 432 B.R. 262 (Bankr. E.D. Cal. 2010).

A. The Financial Landscape

One of the most damaging aspects of the current economic recession has been the rise in unemployment and the corresponding decline in sales and income tax revenue for both state and local governments.[18] The housing market crisis has led to a similar decline in property tax revenue.[19] Yet while revenue has declined, municipal expenses have either remained stagnant or increased. In 2009 alone, the average American municipality spent three percent more than the total sum of its general expense fund.[20]

Local governments are unlikely to balance their budgets with spending cuts alone.[21] Harrisburg, Pennsylvania, City Controller Dan Miller was recently asked how the City was planning to balance its budget, and his response captures the sentiment of numerous local officials across the country: "There is no good option."[22] Public sector workers are currently taking the brunt of their employers' attempts to balance their budgets, and the prospects of a reversal in that trend are bleak.[23]

The most common response to budget shortfalls by municipal governments has been workforce reduction through furloughs, hiring freezes and layoffs.[24] One in seven cities has already made cuts to public safety services such as police, fire and emergency, and that number is sure to rise given the current economic outlook and dwindling chances of a local government bailout by the states or the federal government.[25] To make matters worse, the federal aid given to the states as part of President Obama's American Recovery and Reinvestment Act of 2009[26] is slowing to a trickle in 2011, and will expire completely in 2012.[27] Even if the economy should improve dramatically, there is a historical lag between

18. *See* Hoene, *supra* note 5.
19. *See id.*
20. *See id.*
21. *See id.*; *see also* Behunek, *supra* note 4; Nicole Bullock, *US Cities Forced to Consider Bankruptcy*, FIN. TIMES, April 28, 2010, http://www.ft.com/cms/s/0/e29d90ec-52f6-11df-813e-00144feab49a.html#axzz1EbbU0cfB.
22. Bullock, *supra* note 21.
23. *See Jobless Rate: Government Layoffs Could Reverse Trend*, WATERTOWN DAILY TIMES, Feb. 6, 2011, http://www.watertowndailytimes.com/article/20110206/OPINION01/302069962/-1/opinion; *See also* Julie O'Connor, *Thousands of N.J. Teachers get Layoff Notices as School Budget Deadlines Loom*, STAR LEDGER, MAY 14, 2010, http://www.nj.com/news/index.ssf/2010/05/hundreds_of_pink_slips_to_be_s.html; Chris Isidore, *State, City Layoffs 45,000 and Counting*, CNN MONEY, http://money.cnn.com/2008/06/23/news/economy/local_government_layoffs/index.htm (last updated June 23, 2008).
24. Hoene, *supra* note 5.
25. *See* Jon Hilsen & Neil King Jr., *Bernanke Rejects Bailouts*, WALL ST. J., Jan. 8, 2011, http://online.wsj.com/article/SB10001424052748704739504576067602380461160.html.
26. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (codified in scattered sections of 19 U.S.C.).
27. *See* McNichol, et. al., *supra* note 3.

overall economic improvement and increased revenue for local governments.[28]

All of these factors combine to paint a fairly bleak and increasingly volatile picture of the state of local governments. With Chapter 9 bankruptcy becoming an increasingly viable (and in some cases even attractive) option, local governments and their creditors are trying to determine what municipal bankruptcy means for both sides. In many cases, collective bargaining agreements will draw the most focus from debtor and creditor alike.

B. The Role of Collective Bargaining Agreements

Labor costs like salaries, benefits packages and pension obligations can consume upwards of seventy percent of municipal budgets.[29] A modest and steady rise in such costs can prove disastrous when combined with a sharp decline in revenue and can push a local government into bankruptcy in some cases.[30] Moreover, many of these labor costs are often statutorily defined and, in some cases, protected by state constitutions.[31] As a result, public employee labor obligations are exceedingly difficult to adjust under state law.[32] And while local governments and employee unions often have a mutual incentive to work together towards a financially viable plan of compensation,[33] concessions on either side are often very difficult to come by given that negotiations are driven not only by fiscal, but political considerations as well. [34]

For better or worse, the fact remains that many local government officials are either dependent upon union support for re-election or seeking to avoid union opposition.[35] In addition, officials must consider the ramifications of either hiring or firing employees that perform vital civic services (e.g. teachers and policemen).[36] As has been seen recently in both

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28. Hoene, *supra* note 5.
29. Vijay Kapoor, *Public Sector Labor Relations: Why it Should Matter to the Public and Academia*, 5 U. PA. J. LAB. & EMP. L. 401, 406 (2003).
30. *See id.*
31. *See* CAL. CONST. art. I, § 9; *see also* ILL. CONST. art. VIII, § 5.
32. *See* Clyde Summers, *Bargaining in the Government's Business: Principles and Politics*, 18 U. TOL. L. REV. 265 (1987).
33. *See* Kapoor, *supra* note 29, at 406.
34. *See* Summers, *supra* note 32, at 266.
35. *See* Terry M. Moe, *Political Control and the Power of the Agent*, 22 J.L. ECON. & ORG. 1, 5 (2006).
36. *See* Jonathan Lemire & Erin Einhorn, *Mayor Bloomberg Unveils $65.6 Billion City Budget; Fire Dept., Senior Centers, Teachers Face Cuts*, N.Y. DAILY NEWS (Feb. 17, 2011), http://www.nydailynews.com/ny_local/2011/02/17/2011-0217_mayor_bloomberg_unveils_656_billion_city_budget_fire_dept_senior_centers_teacher.html.

New Jersey[37] and Wisconsin,[38] finding a balance between all of these competing interests can prove to be quite explosive.

Municipal compensation, benefit and pension obligations are a product of collective bargaining: "Negotiations between an employer and the representatives of organized employees to determine the conditions of employment, such as wages, hours, discipline and fringe benefits."[39] An individual (typically the union leader) is selected by the employees to conduct the negotiations with the employer and may be the exclusive or sole bargaining representative.[40] Once created, the agreement may be enforced by the union as a whole or by any individual employee, even if no other member of the union wishes or intends to do likewise.[41] Any individual employee's invocation of rights pursuant to the agreement in question is presumed to be "concerted activity" on behalf of the union as a whole.[42]

Government officials and public sector employees negotiate for salary increases, pension and health care benefits and new hires.[43] The agreements they reach can vary in length and detail, but the common characteristic is their insulation from the overall economic climate.[44] As an economy improves, the terms of the collective bargaining agreements remain unchanged.[45] The same is true when the economy deteriorates, unless the collective bargaining agreement is renegotiated.[46]

The collective bargaining agreements between municipalities and public sector workers are not sustainable under the current fiscal framework.[47] The nation's largest municipal pension plans are underfunded

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37. *See* Bob Jordan & Jason Method, *Emotions Run High as N.J. Unions Gather to Protest Christie Tactics in Trenton*, COURIER POST, Feb. 26, 2011, http://www.courierpostonline.com/article/20110226/NEWS01/102260354/Emotions-run-high-as-N-J-unions-gather-to-protest-Christie-tactics-in-Trenton; *see also* Terrence T. McDonald, *N.J. Parents, Teachers and Public Officials Rally to Defend All-Day Pre-Kindergarten Education*, JERSEY J., http://www.nj.com/hudson/index.ssf/2011/02/jersey_city_parents_teachers_a.html (last updated Feb. 17, 2011).
38. *See* Lisa Holew, *Wisconsin Protests Divide Neighbors, Friends, Families*, AOL NEWS (Feb. 25, 2011), http://www.aolnews.com/2011/02/25/wisconsin-protests-set-neighbor-against-neighbor/; *See also* Brian Montopoli, *Rhetoric over Wisconsin Fight Turns Violent*, CBS NEWS (Feb. 24, 2011), http://www.cbsnews.com/8301-503544_162-20035921-503544.html.
39. BLACK'S LAW DICTIONARY 299 (9th ed. 1969).
40. *See* 48 Am. Jur. 2d *Labor and Labor Relations* § 818 (2010).
41. *See id.* at § 1320.
42. *See id.*
43. *See* Moe, *supra* note 35, at 5.
44. *See* Ryan Preston Dahl, *Collective Bargaining Agreements and Chapter 9 Bankruptcy*, 81 AM. BANKR. L.J. 295, 304 (2007).
45. *See id.*
46. *See id.*
47. *See* Scott Martindale, *Experts: California not Wisconsin, but Benefits Unsustainable*, ORANGE CNTY. REGISTER, Feb. 25, 2011, http://www.ocregister.com/news/percent-289949-teachers-benefits.html; *See also* Alan Farnham, *Public Pensions Face Underfunding Crisis*, ABC NEWS

by $574 billion, or $14,000 per household in each respective town or city.[48] Public employee health care benefits face a similar problem.[49] As Joshua Rauh, business professor at Northwestern University and the author of the leading study on the municipal pension shortfall put it, "[t]he ability of local governments, particularly cities, to provide levels of service they do now is threatened by this liability."[50] The difficulties facing Hamtramck, Michigan, and Framingham, Massachusetts, illustrate the scope of the problem and may provide a glimpse into the bleak futures of other municipalities.

The government of Hamtramck has responded to its fiscal crisis, like many other municipalities, by laying off public sector employees and attempting to renegotiate the salaries and benefits of those that remain.[51] The city faces an $18 million deficit for fiscal year 2011 and spends 60% of its total general operating budget to pay for the salaries of police and firefighters.[52] An entry-level police officer costs the city roughly $75,000 per year in salary and benefits, and repeated efforts to renegotiate contracts have yielded no results.[53]

While City officials seek concessions in compensation and health care costs, employees question the validity of the City's budget numbers.[54] As the City Manager put it in rather appropriate terms for a City whose economy waxes and wanes with the fortunes of the automotive industry: "They [public employees] have the Cadillac [health care] plan and we'd kind of like the Chevy."[55] In defending his members' current compensation and benefits packages, the incoming president of the Hamtramck Police Union managed to distill the sentiment of many public workers: "Nobody likes the police until you need them."[56] The City's population has shrunk from fifty thousand to less than half that, and the City government is pleading with the State to allow it to declare bankruptcy[57] so that it might be able to start over with its labor contracts.[58]

(Dec. 13, 2010), http://abcnews.go.com/Business/city-pensions-americas-50-biggest-municipal-pension-shortfalls/story?id=12366160; Michael A. Fletcher, *Report Warns of Coming Wave of Municipal Shortfalls*, WASH. POST, Oct. 12, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/10/12/AR2010101200044.html.

48. Fletcher, *supra* note 47.
49. *See* Renee Loth, *Going Postal on Public Workers*, BOSTON GLOBE, Feb. 19, 2011, http://www.boston.com/bostonglobe/editorial_opinion/oped/articles/2011/02/19/going_postal_on_public_workers/.
50. Fletcher, *supra* note 47.
51. *See* Davey, *supra* note 13.
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. *See infra* Section III(B)(ii) for further discussion of the state authorization issue.
58. *See* Davey, *supra* note 13.

The City of Framingham, Massachusetts, faces a similar array of problems. Health care costs for public workers have jumped more than $20 million in the past ten years alone.[59] Under the current labor agreement, the City is responsible for 87% of premiums for over 3,700 employees and retirees.[60] In all, it spends $16,400 for each employee with a family health care package and $6,275 for each individual, while the employee pays $2,400 and $925 respectively.[61] On average, 14% of every town budget in Massachusetts is spent on health care costs for public sector employees.[62] Attempts by Framingham officials to renegotiate its health care obligations have been stymied by a state law that gives public sector unions veto power over any such proposals.[63]

The problems facing Hamtramck and Framingham are highly representative of those facing hundreds of other municipalities across the country. To put it simply, towns and cities cannot afford to operate under the current revenue structure. While some argue for higher taxes and others argue for reducing the pay and benefits of public employees, the numbers do not lie. Local governments are being forced to confront this reality and Chapter 9 could ultimately provide a viable solution to budget gaps nationwide.

III. AN OVERVIEW OF CHAPTER 9

Chapter 9 of the Federal Bankruptcy Code is reserved for debtors that satisfy the requirements outlined in Section (C)(1), *infra*. How courts interpret the relatively obscure provisions of Chapter 9 will ultimately determine the strength of debtors' incentives to seek its protection. The general framework and underlying goals of Chapter 9 play a large role in judicial analysis of its sections due to the paucity of prior case law. Therefore, understanding this framework is a necessary precursor to analyzing *Bildisco* and its progeny.

A. The Purpose of Chapter 9

Chapter 9 of the Federal Bankruptcy Code is designed to provide floundering municipalities with bankruptcy protection and consists of a "patchwork of federal laws that borrows concepts and particular sections

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59. Sean P. Murphy, *Town's Heath Care Bill Triggers Pain*, BOSTON GLOBE, May 6, 2010, http://www.boston.com/news/local/massachusetts/articles/2010/05/06/towns_health_care_bill_triggers_pain/.
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*

from other chapters of the Bankruptcy Code . . . to allow a municipality to deal with its problems outside the confines of applicable state law."[64] Chapter 9 is designed to provide a means of adjusting the debtor's obligations, but without altering the debtor's structure.[65] Whereas a private debtor will almost always emerge from bankruptcy with a radically altered organizational structure, the municipal debtor will emerge with new debt obligations and the same form.[66] This distinction is a product of the federalism concerns implicated by allowing a federal court to play a role in the financial affairs of a state subdivision. Such concerns lurk just beneath the surface throughout Chapter 9 and must be kept in mind while interpreting its provisions.

B. The History of Chapter 9

Congress, in the midst of the Great Depression, made its first attempt to provide a forum for municipal bankruptcies in 1933 with the Municipal Bankruptcy Act.[67] Until that time, a federal provision for municipal bankruptcy was thought to be clearly unconstitutional. This was confirmed when, in 1936, the Supreme Court struck down the original Municipal Bankruptcy Act, finding it unconstitutional.[68] However, Congress made a second attempt to produce a municipal bankruptcy law that would withstand constitutional scrutiny, and it succeeded with an amended version of the Municipal Bankruptcy Act, the legislative predecessor to modern-day Chapter 9.[69] In the 1938 case of *U.S. v. Bekins* (*Bekins*), the Supreme Court found the second incarnation of the Municipal Bankruptcy Act constitutional.[70] In distinguishing the previously unconstitutional version, the Court emphasized the extreme importance of making any municipal bankruptcy filing contingent on state authorization.[71] The states' right to determine when and if its subdivisions should be able to file for bankruptcy in federal court was the "essence of sovereignty" reserved to the states by

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64. *An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments*, JONES DAY, LLP (Aug. 2010), http://www.jonesday.com/an-overview-of-chapter-9-of-the-bankruptcy-code-municipal-debt-adjustments-08-15-2010/.
65. *See* Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 427 (1993).
66. *See id.*
67. Municipal Bankruptcy Act, Pub. L. No. 251, 48 Stat. 798 (1934).
68. *See* Ashton v. Cameron Cty. Water Improvement Dist. No. One, 298 U.S. 513 (1936) (holding that the federal courts have no jurisdiction over any bankruptcy action involving a political subdivision of a state).
69. Municipal Bankruptcy Act, Pub. L. No. 302, 50 Stat. 652 (1937).
70. U.S. v. Bekins, 304 U.S. 27 (1938) (holding that the Municipal Bankruptcy Act was constitutional in light of the state authorization provisions).
71. *See id.* at 52.

the Tenth Amendment.[72] The 1937 Act was originally set to expire in 1940, but was extended several times thereafter.[73] The first major alterations of the Act were made in 1976 and set the foundation for modern-day Chapter 9.

C. Eligibility to File

Before filing for Chapter 9 protection, a potential Chapter 9 debtor must first satisfy five statutory requirements created by the Bankruptcy Code. Failure to satisfy any one of these five requirements disqualifies the potential debtor for Chapter 9. Many of these requirements appear clear, but have proven to be quite nuanced in practice. Moreover, to date, Chapter 9 cases have proven relatively rare and, as such, the case law in this area is limited. The absence of clear authority with respect to the following questions creates space for future conflict.

1. Qualifying as a "Municipality"

Chapter 9 is limited to debtors that qualify as a "municipality."[74] "Municipality" is defined by the Bankruptcy Code as "a political subdivision or public agency or public instrumentality of a State."[75] The definition was intended to be construed broadly and clearly includes such entities as towns, villages, counties and cities. Also included are less obvious cases like school districts,[76] hospitals[77] and irrigation districts.[78] As a recent example of the elasticity of the term "municipality," the publicly owned New York City Off-Track Betting Corp. (OTB) filed for Chapter 9 protection in December of 2009 after being unable to meet its statutorily required payments to state and local governments as well as the horse racing industry.[79]

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72. *See id.*
73. McConnel & Picker, *supra* note 65, at 428.
74. 11 U.S.C. § 109(c) (2006).
75. 11 U.S.C. § 101(40).
76. *See Ailing School District Files for Bankruptcy*, N.Y. TIMES, April 20, 1991, http://www.nytimes.com/1991/04/20/us/ailing-school-district-files-for-bankruptcy.html.
77. *See* Chris Bagley, *Hospitals File for Chapter 9 Bankruptcy*, N. CTY TIMES, Dec. 14, 2007, http://www.nctimes.com/news/local/article_74e56c77-8202-57c1-9fc5-7907c24ee82b.html.
78. In fact, the debtor that commenced the municipal bankruptcy that ultimately culminated in the Supreme Court decision in *Bekins* was an irrigation district. *See U.S. v. Bekins*, 304 U.S. 27.
79. *See* Alison Gendar, *OTB Files for Bankruptcy, Needs Time to Get House in Order*, N.Y DAILY NEWS (Dec. 4, 2009), http://www.nydailynews.com/money/2009/12/04/2009-12-04_neigh_it_aint_so_otb_is_bankrupt.html; *see also In re* N.Y. Cty Off-Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010).

Issues over what qualifies as a "municipality" can arise, however, despite the broadly worded definition. For example, in the case of *In re Las Vegas Monorail Co.*, United States Bankruptcy Judge Bruce A. Markell held that a debtor created as a private, non-profit corporation to create a monorail in Las Vegas and funded by state issued bonds was not a "municipality" within the meaning of section 101(40) and thus ineligible for Chapter 9.[80] In so holding, Judge Markell distilled the qualities of a "municipality" under Chapter 9 and set out the factors to be weighed in determining whether a would-be debtor qualified: (a) does the debtor have "any of the powers typically associated with sovereignty, such as eminent domain, the taxing power or sovereign immunity;" (b) if not, does it have a "public purpose" and, if so, what level of control does the state exercise in pursuing that purpose; (c) finally, in deference to the state, how does it designate and treat the debtor?[81] Judge Markell ultimately determined that while the State of Nevada had a significant amount of control over the debtor, the State was insulated from any losses as a result of the debtor's business because the bonds sold to finance its creation were non-recourse and because the debtor lacked any of the powers traditionally associated with government.[82] Judge Markell conducted a totality of the circumstances-type analysis of the three elements, with no one factor necessary or sufficient.

2. State Authorization

Any debtor that wishes to file for Chapter 9 protection must also have specific authorization from the state.[83] State authorization may be unconditional,[84] restricted[85] or non-existent.[86] In some cases, Chapter 9

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80. *See In re* Las Vegas Monorail Co., 429 B.R. 770 (Bankr. D. Nev. 2010).
81. *Id.* at 788-89.
82. *Id.* at 795.
83. 11 U.S.C. § 109(c)(2) (2006).
84. *See* ALA. CODE 1975 § 11-81-3 (2008); *see also* ARIZ. REV. STAT. ANN. § 35-603 (1995); ARK. CODE ANN. § 14-74-103 (2011); CAL. GOV'T CODE § 53760 (Deering 2011); COLO. REV. STAT. § 32-1-1402 (2002); FLA. STAT. ANN. § 218.01 (West 2005); IDAHO CODE ANN. § 67-3903 (2006); KY. REV. STAT ANN. § 66.400 (LexisNexis 2004); MINN. STAT. ANN. § 471.831 (West 2008); MO. ANN. STAT. § 427.100 (West 2010); MONT. CODE ANN. § 7-7-132 (Supp. 2002); NEB. REV. ST. § 13-402 (2007); OKLA. STAT. ANN. tit. 62, §§ 281, 283 (West 2010); S.C. CODE ANN. § 6-1-10 (2004); TEX. LOC. GOV'T CODE § 140.001 (West 2008); WASH REV. CODE § 39.64.040 (2000). Some of the aforementioned statutes refer to a "taxing district" as "[a] district constituting the whole state, a county, a city, or other smaller unit-throughout which a particular tax or assessment is ratably apportioned and levied on the district's inhabitants." BLACK'S LAW DICTIONARY, *supra* note 39, at 545.
85. *See* CONN. GEN. STAT. Ann. § 7-566 (West 2008); *see also* LA. REV. STAT. ANN. § 39-619 (2005); MICH. COMP. LAWS § 141.1222 (2005); N.J. STAT. ANN. § 52:27-40 (West 2010); N.C.

filing by a municipality is outright prohibited.[87] Some states that do not authorize a Chapter 9 filing are considering legislation that would allow their municipalities to do so.[88] Recall that this state authorization provision of the Municipal Bankruptcy Act was the dispositive factor for the Supreme Court's holding that a federal forum for municipal bankruptcy did not violate state sovereignty and was thereby constitutional.[89]

However, the issue of state authorization is not always clear cut. Chapter 9 was amended in 1994.[90] One of the amendments altered the state authorization requirement from "general" to "specific".[91] This shift in language was designed to prevent would-be Chapter 9 debtors from siphoning off Chapter 9 authorization from a one-size-fits-all grant of authority (e.g. "to do all acts necessary, proper or convenient").[92] As a result, an air of doubt was cast over any state authorization passed or issued prior to 1994. At present, only sixteen states have specific authorization statutes.[93] As municipal bankruptcies become more common, the issue of which type of state authorization satisfies Section 109(c)(2) will become more prominent.

The issue arose recently in the aforementioned OTB bankruptcy case.[94] Following OTB's Chapter 9 petition, three OTB creditors objected to the filing, arguing that there was no specific authorization for municipal bankruptcy under New York law and that an executive order signed by then-Governor David Patterson was insufficient.[95] Judge Martin Glenn of the Bankruptcy Court for the Southern District of New York held that the order was sufficient as it "[followed] Congress' instructions precisely" and was valid under New York state law, thereby satisfying the requirements of section 109(c)(2).[96] Again, this particular issue will become increasingly relevant as more state entities consider filing for Chapter 9 protection.

GEN. STAT. § 23-48 (2009); OHIO REV. CODE ANN. § 133.36 (LexisNexis 2002); 53 PA. CONS. STAT. ANN. § 11701.261-11701.263 (West 2011).

86. Alaska and Alabama are among the states that do not authorize Chapter 9 filings by their subdivisions.

87. *See* O.C.G.A. 36-80-5 (2011); *see also* IOWA CODE ANN. 76.16 (2011).

88. *See* Caitlin Devitt, *Indiana may Allow Chapter 9*, BOND BUYER (Dec. 30, 2010), http://www.bondbuyer.com/issues/119_498/indiana-chapter-9-1021621-1.html.

89. *See* U.S. v. Bekins, 304 U.S. 27 (1938).

90. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4107 (1994).

91. *See* 6 COLLIER ON BANKR. § 900.02 (2010).

92. *See In re* Slocum Lake Drainage Dist. of Lake County, 336 B.R. 387, 390 (Bankr. N.D. Ill. 2006) (stating that general grant of authority will not satisfy § 109(c)); *see also In re* Timberon Water and Sanitation Dist., No: 9-07-12142 ML, 2008 Bankr. LEXIS 3345, at *2 (D.N.M. 2008) (stating that the authorization language must be "exact, plain, and direct with well defined limit . . . .").

93. *See supra* note 84.

94. *See In re* N.Y. City Off-Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010).

95. *See id.*

96. *See id.* at 267-69.

3. Insolvency

A municipal debtor must also be insolvent.[97] This is not a purely mathematical determination.[98] The 1994 Amendments refined the definition of insolvency. A municipality is considered insolvent when it is: (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due.[99] Because the assets of a municipal debtor are not easy to valuate, the "balance sheet test" for determining solvency is not usually applied to municipal debtors.[100] Rather, courts will apply a cash-flow analysis to determine whether it is feasible for a municipal debtor to meet its obligations with its current sources of revenue.[101] A municipal debtor is generally not required to increase taxes or take other measures to avoid insolvency.[102] This is consistent with the overall minimization of federal interference with issues of municipal governance that is so critical to Chapter 9's constitutional viability.

4. Desire a Plan to Adjust Debts

A municipal debtor must "desire a plan to adjust its debts."[103] Simply stated, a municipal debtor must file for Chapter 9 in good faith. For example, a municipal debtor may not file for Chapter 9 as a means of evading its current financial obligations or to buy itself more time.[104] However, a municipal debtor need not have a preliminary plan in place at the time of filing in order to satisfy this requirement.[105]

5. The Conditions of Section 109(c)(5)

The debtor must also satisfy one of the following four conditions: (a) it has obtained the consent of at least a majority of impaired claimholders under the proposed plan; (b) it has negotiated in good faith but has failed to

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97. 11 U.S.C. § 101(32)(C) (2006).
98. *See* FRANK J. FABOZZI, THE HANDBOOK OF MUNICIPAL BONDS 159 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 1st ed. 2008) (noting that in the case of *In re* Sullivan Cty. Regional Refuse Disposal Dist., 165 B.R. 65 (Bankr. D. N.H. 1994), the Bankruptcy Court rejected an argument that the debtor failed to qualify as insolvent because it did not conduct a special assessment of its finances).
99. 11 U.S.C. § 101(32)(C)(i)-(ii).
100. *See An Overview of Chapter 9 of the Bankruptcy Code*, *supra* note 64.
101. *See In re* City of Bridgeport, 129 B.R. 332 (Bankr. D. Conn. 1991).
102. *See id.*
103. 11 U.S.C. § 109(c)(3)-(4).
104. *See An Overview of Chapter 9 of the Bankruptcy Code*, *supra* note 64.
105. *See id.*

reach any agreement with a majority of the impaired claimholders under the proposed plan; (c) negotiation with such claimholders is impractical; or (d) it has a reasonable belief that a creditor may attempt to obtain preference.[106] A debtor need only establish one of the preceding elements to satisfy this requirement.

6. Summarizing Eligibility

A debtor is eligible to file for Chapter 9 protection if it: (i) qualifies as a "municipality"; (ii) has specific state authorization; (iii) is insolvent; (iv) desires a plan to adjust its debts; and (v) it satisfies one of the four conditions imposed by Section 109(c)(5). After filing, the debtor will enter Chapter 9 reorganization and encounter a myriad of issues beyond the scope of this article. It is, however, worth mentioning that just because a debtor is eligible and chooses to file for Chapter 9 bankruptcy, that does not mean it is guaranteed to reach a plan to adjust its debts.

A Chapter 9 petition may be dismissed if the court learns that the debtor has not filed in good faith and/or cannot reach a confirmable plan of reorganization.[107] Liquidation of a municipal debtor's assets is not permitted under Chapter 9. Dismissal is truly a worst-case scenario, and it is in the interest of all parties to avoid such an outcome at all costs. However, it does occur.[108] For almost any municipal debtor to avoid dismissal and reach a confirmable plan of reorganization, there must be a renegotiation of collective bargaining agreements with public sector employees. The modification and/or rejection of such agreements is a key component to this renegotiation and the subject of the *Bildisco*, *Orange County*, *Vallejo* line of decisions.

D. The Mechanics of Rejection in Chapter 9

In addition to the provisions that make up Chapter 9 of the Bankruptcy Code, Section 901 incorporates a variety of sections from other chapters and renders them applicable in municipal bankruptcy proceedings.[109] One of the sections incorporated into Chapter 9 by Section 901 is Section 365.[110] Subsection (a) of Section 365 allows the debtor to "assume or reject any executory contract or unexpired lease of the debtor."[111] It is Section 365

106. 11 U.S.C. § 109(c)(5).
107. 11 U.S.C. § 921(c).
108. *See* Tiffany Kary, *NYC Off-Track Betting Bankruptcy Case Dismissed*, BLOOMBERG, Jan. 25, 2011, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUmdzj4TVE9U.
109. *See* 11 U.S.C. § 901(a).
110. 11 U.S.C. § 365.
111. *Id.*

that empowers a municipal debtor to reject collective bargaining agreements in bankruptcy under certain circumstances. Section 365 was also the source of rejection power for Chapter 11 debtors until 1994 when Congress created section 1113,[112] which overruled the Supreme Court's decision in *Bildisco*[113] and became the exclusive vehicle for rejection of collective bargaining agreements by Chapter 11 debtors. However, Section 901(a) was never amended to incorporate Section 1113 into Chapter 9.

In effect, the passage of Section 1113, combined with the failure to amend Section 901(a) created a legislative no-man's-land with respect to the rejection of collective bargaining agreements by municipal debtors. As a result, the courts have been forced to step into the breach and fill this gap. How they chose to do so in *Vallejo* and its predecessor, *Orange County*,[114] is the subject of Sections IV(B) and (C) of this article. The judicial construction of the aforementioned sections of the Bankruptcy Code and the manner in which they are interpreted will ultimately determine the fate of both municipal debtors and the public workers they employ. It is in light of this reality that the implications of the decisions in *Bildisco, Orange County* and *Vallejo* and their impact on a potentially growing number of municipal debtors must be understood.

IV. THE *BILDISCO, ORANGE COUNTY, VALLEJO* LINE OF CASES

The following cases create the analytical framework for the modification and/or rejection of collective bargaining agreements in Chapter 9. Despite similar sets of facts, the courts addressing the issue reach different results, creating a series of inconsistencies that will ultimately have to be addressed in future Chapter 9 cases. The primary benefit of filing for Chapter 9 is the ability to adjust or eliminate collective bargaining obligations and the following cases determine if and when such relief is permissible.

A. *National Labor Relations Board v. Bildisco & Bildisco*

The decision by the Supreme Court in *Bildisco* is the jurisprudential ancestor of the more recent Chapter 9 bankruptcy decisions in *Orange County* and *Vallejo*. However, *Bildisco* was a Chapter 11, not a Chapter 9 case. Yet its application in the Chapter 9 context has enormous consequences for both municipal debtors and public sector employees.

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112. 11 U.S.C. § 1113.
113. *See* discussion *infra* Section IV(B)(iii).
114. *In re* Cty. of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995).

1. The Facts and Procedural History

In *Bildisco*, a New Jersey building supply company filed a voluntary petition for Chapter 11 Bankruptcy.[115] At the time of the filing, roughly 40% to 45% of Bildisco's labor force was represented by private sector unions and employed under the terms of a three-year collective bargaining agreement.[116] The agreement provided that it was to be binding upon both parties even in the event of bankruptcy.[117]

In January of 1980, Bildisco began defaulting on some of its obligations under the collective bargaining agreement and in May of that same year it refused to increase employee wages, as required by the agreement.[118] Bildisco filed for Chapter 11 protection in April of 1980 and eight months later requested permission from the Bankruptcy Court to reject the collective bargaining agreement pursuant to Section 365(a) of the Bankruptcy Code.[119]

Prior to the Bankruptcy Court ruling on the issue of rejection, the union brought a claim pursuant to the National Labor Relations Act (NLRA),[120] alleging that Bildisco had unlawfully and unilaterally altered the terms of the collective bargaining agreement.[121] The National Labor Relations Board (NLRB) found in the union's favor and held that Bildisco had violated the NLRA[122] by unilaterally altering the terms of the agreement.[123]

At the subsequent rejection hearing, Bildisco presented the testimony of just one witness, one of its partners, to support its motion for rejection.[124] The partner stated that rejection of the collective bargaining agreement would save Bildisco $100,000 in 1981.[125] The union presented no evidence and no witnesses to rebut Bildisco's assertion and the Bankruptcy Court granted Bildisco's motion while allowing the union 30 days in which to file a claim for damages.[126] The District Court upheld the Bankruptcy Court order.[127]

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115. Nat'l Labor Relations Bd. v. Bildisco, 465 U.S. 513, 517 (1984).
116. *Id.* at 517-18.
117. *Id.* at 518.
118. *Id.*
119. *Id.*
120. 29 U.S.C. §§ 151-69 (2011) (2006).
121. *See Bildisco*, 465 U.S. at 518.
122. The NLRB held that Bildisco had violated sections 158(a)(5) and 158(a)(1) of the NLRA. *Id.*
123. *See Bildisco*, 465 U.S. at 519.
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*

The Third Circuit Court of Appeals consolidated the union's claim and Bildisco's petition for enforcement of the Bankruptcy Court order, refused to enforce the order of the NLRB and remanded the case to the Bankruptcy Court. [128] The Third Circuit reasoned that the debtor in bankruptcy was a "new entity," and thus no longer bound by the collective bargaining agreement.[129] The Supreme Court granted certiorari to resolve the split between the Third Circuit's decision in *Bildisco* and the Second Circuit opinion in *Airline and Steamship Clerks v. REA Express, Inc.* (*REA Express*).[130] The two issues on appeal were: (i) if and by what standard a Bankruptcy Court can grant rejection of a collective bargaining agreement by a Chapter 11 debtor; and (ii) if a debtor can be found guilty of unfair labor practices for either unilaterally modifying an agreement prior to rejection or by rejecting the agreement outright.[131]

2. The Opinion

In first addressing the issue of if and when rejection would be permitted, the Court acknowledged that Section 365(a), by its terms, allowed for the rejection of "any executory contract" with the exception of those specifically exempted.[132] "Executory contract" is not defined by the Bankruptcy Code; however, the Court relied upon the definition provided by the legislative history to Section 365. "The legislative history of [Section] 365(a) indicates that Congress intended the term to mean a contract 'on which performance remains due to some extent on both sides.'"[133] The Court went on to hold that a collective bargaining agreement fell within the ambit of this definition, despite its differences from an ordinary contract, because it imposed reciprocal obligations on both parties.[134]

In rejecting the union's argument that collective bargaining agreements were exempted from the scope of Section 365(a) by the NLRA, the Court put forth two separate but related rationales: First, Section 365(a) contained no limitation of the debtor's power of rejection with respect to collective bargaining agreements.[135] Second, Section 1167 of the

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128. *Id.* at 522.
129. *See id.* at 519.
130. Airline and Steamship Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017 (1975).
131. *See Bildisco*, 465 U.S. at 519.
132. Section 365(a) states that any executory contract may be rejected "except as provided in sections 765-766 and subsections (b), (c), and (d)." 11 U.S.C. § 365(a) (2006).
133. *See Bildisco*, 465 U.S. at 523 (citing H.R. REP. NO. 95-595, at 347 (1977)).
134. *See id.*
135. *See id.* at 522.

Bankruptcy Code exempted collective bargaining agreements governed by the Railway Labor Act (RLA)[136] from rejection by a debtor, and thus Congress contemplated exempting certain agreements from rejection and chose only to exempt those governed by the RLA.[137] Justice Rhenquist put it bluntly: "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 Section 365(a) apply to all collective bargaining agreements covered by the NLRA."[138] On this point, the Court was unanimous, holding that, in the absence of an exception in either the text of Section 365(a) or another section of the Bankruptcy Code, collective bargaining agreements were subject to rejection.

With this threshold issue settled, the Court turned to articulating a substantive standard to govern the circumstances in which rejection should be allowed. In doing so, the Court backtracked a bit on its primary rationale for branding collective bargaining agreements as executory contracts by distinguishing them from other types of executory contracts. Rejection of such contracts was traditionally restricted by only the business judgment standard,[139] which is to say rejection was not truly restricted in any significant way.[140] Despite the absence of any indication in the text of Section 365 that collective bargaining agreements were to be judged by a different standard than all other executory contracts, the Court, in relying on the unanimity of Circuit Courts of Appeal on this issue, held that a higher standard was required.[141] "[B]ecause of the special nature of a collective-bargaining contract, and the consequent 'law of the shop' which it creates [internal citations omitted], a somewhat stricter standard should govern the decision of the Bankruptcy Court to allow rejection of a collective bargaining agreement." [142]

The Court rejected the union's proposed standard that required denial of a motion for rejection unless rejection was necessary to an effective reorganization.[143] The union drew its standard from the Second Circuit

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136. 45 U.S.C. §§ 151-158 (2006).
137. "The subject of railway labor is too delicate . . . for this code to upset established relationships." H.R. REP. NO. 95-595, at 423 (1977).
138. *Bildisco*, 465 U.S. at 522-23.
139. "The presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in honest belief that their actions are in the corporation's best interest." BLACK'S LAW DICTIONARY, *supra* note 40, at 523.
140. *See Bildisco*, 465 U.S. at 523.
141. *See id.*
142. *Id.* at 524.
143. *See id.*

opinion in *REA Express*,[144] which was decided prior to the Congressional amendments to the Bankruptcy Code in 1978 and pursuant to then Section 82 of the Bankruptcy Act, a municipal bankruptcy provision.[145] The union argued that Congress, in passing Section 365(a) three years later, intended to codify the rigid rejection standard from *REA Express*.[146] The Court ultimately rejected this argument and the standard it sought to impose.[147] The Court reasoned that a different standard was created by the Second Circuit in the case of *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*,[148] and thus Congress could not be presumed to have selected one over the other without some affirmative indication.[149]

Having cleared the interpretive underbrush, the Court went about fashioning its own rejection standard under Section 365(a). In rejecting the *REA Express* standard, the Court reasoned that the high bar for rejection it created was inconsistent with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code.[150] And while it acknowledged the important interests of employee unions in the enforcement of collective bargaining agreements, the Court ultimately sought to strike a balance between such interests and those of the debtor. "We agree with the Court of Appeals below, and with the Court of Appeals for the Eleventh Circuit in a related case, *In re Brada Miller Freight System, Inc.*,[151] that the Bankruptcy Court should permit rejection of a collective-bargaining agreement under Section 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."[152] Also, "the Bankruptcy Court should be persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution."[153] However, under *Bildisco*, the Bankruptcy Court should allow for extensive negotiations between the parties, consistent with the NLRA's goal of

144. Airline and Steamship Clerks v. REA Express, Inc., 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017 (1975).
145. *See Bildisco*, 465 U.S. at 524.
146. *See id.*
147. Though the fact that the Second Circuit created the *REA Express* standard in the context of a municipal bankruptcy proceeding could support an argument that Section 365(a) imposes a harsher burden on municipal debtors seeking to reject collective bargaining agreements than their Chapter 11 counter-parts. While nothing in the text of Section 365(a) supports this distinction, the same could be said for the Court's distinguishing collective bargaining agreements from other executory contracts as a means of avoiding the business judgment standard for rejection.
148. Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698, 707 (2d Cir. 1975).
149. *See Bildisco*, 465 U.S. at 525.
150. *See id.*
151. *In re* Brada Miller Freight System, Inc., 702 F.2d 890 (11th Cir. 1983).
152. *See Bildisco*, 465 U.S. at 525-26.
153. *Id.* at 526.

encouraging collective bargaining.[154] The Bankruptcy Court should not involve itself in the negotiations until intervention is necessary to facilitating the reorganization process.[155] The Bankruptcy Court must also consider the burdens imposed on each party by either allowance or denial of rejection, the consequences of liquidation and the reduced value of creditor claims.[156]

In addressing the issue of whether an unfair labor practice claim premised on the modification and/or rejection of a collective bargaining agreement could be maintained, the Court held that it could not, and rejected the Third Circuit's "new entity" rationale for not enforcing the NLRB order.[157] Instead, the Court held that the debtor in bankruptcy was still the same entity as the one that entered into the collective bargaining agreement, but was empowered by the Bankruptcy Code to escape its obligations under certain circumstances.[158] The Court held that the fundamental purpose of reorganization was to avoid liquidation and that an infusion of capital was sometimes required in order to reorganize successfully.[159] "[R]ecapitalization," the Court wrote, "could be jeopardized if the [debtor] [was] saddled with . . . prior collective-bargaining agreement[s] . . . Thus, the authority to reject . . . is vital to the basic purpose of a Chapter 11 reorganization."[160]

Moreover, the Court held that, once rejected, a collective bargaining agreement was "no longer immediately enforceable, and may never be enforceable again."[161] As a result, the union in *Bildisco* no longer had a viable claim pursuant to the NLRB because the collective bargaining agreement was no longer enforceable, hence the debtor could not be found liable for failing to satisfy the obligations it imposed.[162] To make matters worse from the union's perspective, the Court not only rendered any NLRA claim against a debtor for rejection null and void, but did the same for any claim based on unilateral modification *prior to* court ordered rejection.[163] In short, the Court reasoned that allowing a labor claim against a debtor for rejection or unilateral modification of the agreement prior to rejection negated the debtor's rights under Section 365(a). The Court went on to

154. *See id.*
155. *See id.*
156. *See id.* at 527.
157. *See id.* at 528.
158. *See id.*
159. *See id.*
160. *See id.*
161. *Id.* at 532.
162. *See id.*
163. *See id.* at 529.

state that upon rejection, any claims for breach of the collective bargaining agreement must be brought in bankruptcy and treated as unsecured.[164]

3. Summarizing National Labor Relations Board v. Bildisco & Bildisco

To summarize, the Court in *Bildisco* rendered a debtor-friendly decision that compromised the integrity of all collective bargaining agreements between private labor unions and Chapter 11 debtors. The *Bildisco* decision allows for unilateral modification of a collective bargaining agreement by a debtor and subsequent rejection if the debtor can show that: (1) the collective bargaining agreement burdens the estate; (2) the balance of equities favors rejection; and (3) the debtor negotiated reasonably with the union prior to rejection.[165] In conducting their analysis, Bankruptcy Courts should consider the burdens imposed on both parties.[166] Furthermore, the union cannot maintain an unfair labor practice claim against the debtor for either modification or rejection because the collective bargaining agreement is no longer enforceable.[167] Thus, a debtor could modify a collective bargaining agreement prior to rejection, subsequently reject the modified agreement, and a union could not maintain an unfair labor claim for either action. While the union argued that allowing unilateral modification prior to rejection was in direct violation of the NLRA, the Court held that the modification was not unilateral, but rather by operation of law. [168] Unfortunately for the union in *Bildisco*, this may have ultimately turned out to be a distinction without much of a difference.

Justice Brennan, joined by Justices White, Marshall and Blackmun, concurred in the Court's holding with respect to the right of a debtor to reject collective bargaining agreements and the standard by which to do so. [169] However, they dissented on the NLRA issue, arguing that the union should be able to maintain an NLRA claim for unfair labor practices for unilateral modification prior to court authorized rejection.[170] In writing for the dissenters, Justice Brennan emphasized the important policy concerns embodied by the NLRA and sought to strike what he believed to be a more appropriate balance between similarly compelling, but facially incompatible interests of Section 365 and the NLRA.[171]

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164. *See id.* at 531.
165. *See id.* at 526.
166. *See id.* at 527.
167. *See id.* at 532.
168. *See id.* at 533.
169. *See id.* at 535 (J. White, dissenting).
170. *See id.*
171. *See id.*

The difficulty in striking such a balance is a product of the compelling but conflicting interests of a bankruptcy debtor and the labor rights of its employees. In *Bildisco*, the majority came down on the side of the debtor. But its decision was not taken lightly and it was not long before Congress was moving to alter the legislative scheme in order to better preserve the aforementioned interests of labor in bankruptcy.

4. The Fallout from National Labor Relations Board v. Bildisco & Bildisco

The *Bildisco* decision provoked the ire of organized labor, which lobbied Congress to overturn the Court's decision.[172] In 1994 Congress enacted Section 1113, which overturned *Bildisco's* standard for rejection, expressly prohibited unilateral modification unless certain procedures were met and instituted more rigorous standards for rejection.[173]

Under Section 1113(b), a debtor must "make a proposal to the authorized representative of the employees covered by [the collective bargaining agreement], based on the most complete and reliable information available . . . " and provide the representative with the proposed modifications *necessary* to the reorganization.[174] The debtor must then also provide the representative with the necessary information "to evaluate the proposal" and meet with the representative "to reach mutually satisfactory modifications."[175] Such procedural requirements stand in stark contrast to the *Bildisco* decision, which allowed for unilateral modification by the debtor without subjecting it to any such procedural requirements.[176]

With respect to actual rejection of the collective bargaining agreement, Section 1113 altered the substantive standard by which rejection may be granted. Under Section 1113(c), a court may only grant a debtor's motion for rejection of a collective bargaining agreement if: (1) the trustee makes a proposal to the authorized representative in accordance with subsection (b)(1), which requires that rejection be *necessary* for effective reorganization; (2) the authorized representative refuses to accept such proposals without good cause; and (3) the balance of equities *clearly* favors rejection.[177] This too, marks a sharp change from *Bildisco*: (i) Under *Bildisco*, the debtor need only show that the collective bargaining agreement burdens the estate, whereas under Section 1113, the debtor must show that rejection is necessary to reorganization; (ii) Under *Bildisco,* the

172. *See* ROBERT E. GINSBERG, ET. AL., GINSBERG AND MARTIN ON BANKRUPTCY 7-52 (Susan V. Kelly, 4th ed. 2007).
173. *See* 11 U.S.C. § 1113 (2006).
174. *See id*. at § 1113(b)(1)(A).
175. *See id*. at § 1113(b)(1)-(2).
176. *See Bildisco*, 465 U.S. at 534.
177. *See* 11 U.S.C. § 1113(c) (2006).

equities need only favor rejection, while under Section 1113 the equities must *clearly* favor rejection; and (iii) *Bildisco* requires a debtor to make only reasonable efforts to negotiate with a union, while Section 1113 requires a debtor to satisfy the more rigorous procedural and substantive requirements of subsection (b)(1).

Given the difference in burden imposed by *Bildisco* and Section 1113 in the area of modification and rejection, the interplay between *Bildisco*, Section 365(a), Section 1113 and Section 901(a) is of the utmost importance. On its face, the *Bildisco* standard is a far more lenient one for the debtor and far more hospitable to both modification and rejection. This much is clear from the outcome in *Bildisco* itself, where the debtor was able to modify and then reject an agreement merely by presenting the testimony of one of its partners and no other evidence supporting its motion for rejection.[178] Thus, how a court interprets and applies this area of bankruptcy law has a direct and tangible effect on the fate of both debtor and creditor alike. It dictates not only the outcome in bankruptcy, but the incentives to file and the probability of municipal debtors pursuing bankruptcy as a viable solution to their fiscal woes.

B. *In re County of Orange*

Orange County marked the first meticulous analysis of the Supreme Court's decision in *Bildisco* in the Chapter 9 context. In conducting this analysis, the effect of *Bildisco* on municipal debtors and public sector unions became apparent and, thus, may have played a part in the Bankruptcy Court's careful handling of *Bildisco* and the apparently inconsistent outcome of its decision.

1. The Facts and Procedural History

The 1994 bankruptcy filing by Orange County, California, was the largest municipal bankruptcy in United States history and remains so to this day.[179] The County filed for Chapter 9 protection on December 6, 1994, after a complex series of investments led by former County Treasurer Robert Citron went sour.[180] In an effort to increase municipal revenue,

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178. *See Bildisco*, 465 U.S. at 518.

179. *See* Maura Dolan, *Vallejo Proposes Defaulting on some Debts*, L.A. TIMES, Jan. 21, 2011, http://articles.sfgate.com/2011-01-21/bay-area/27041159_1_creditors-municipal-bankruptcy-debts.

180. Citron pled guilty to six felony charges stemming from the Orange County investment debacle and was sentenced to six years in prison in 1996. *See Orange County Jail Term Set*, N.Y. TIMES, Nov. 20, 1996, http://www.nytimes.com/1996/11/20/business/orange-county-jail-term-set.html?ref=robertlcitron. Citron was released less than one year later for good behavior and

Citron, in conjunction with several large Wall Street investment banks, created an investment pool comprised of $7.5 billion of the County's money and $14 billion of debt.[181] The pool invested in securitized interest rate-based derivatives and assumed large amounts of leverage.[182] In essence, the County borrowed large sums of money from a variety of eager Wall Street lenders and made enormous bets on the stability of national interest rates.[183]

In order for this type of investment strategy to work, interest rates had to either remain stable or decline.[184] But when the Federal Reserve began raising interest rates in February of 1994, the derivatives that formed the basis of the Orange County investment fund declined sharply in value.[185] The County was also forced to borrow additional funds at a higher interest rate in order to meet its prior debt obligations and ended up paying more to borrow than it was making on its investments.[186] What followed was a quick and painful inevitability. As the County defaulted on a payment to one of its lenders, creditors began seizing collateral and, after the Securities and Exchange Commission refused to stop the seizure, the County was forced to file for Chapter 9 protection.[187]

In all, the tale of Orange County's descent into economic oblivion was, in hindsight, an ominous and accurate preview of the sort of securitized derivatives that led to the current economic crisis.[188] Much like Lehman Brothers and Bear Stearns, the County made a series of risky bets on securitized derivatives and took on an enormous amount of leverage in order to do so. When those bets failed to pan out as the County had hoped, it was forced to file for bankruptcy.[189] Despite the similarities between the

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making payments in accordance with court-ordered restitution. *See Ex Treasurer Freed in California County*, N.Y. TIMES, Oct. 25, 1997, http://www.nytimes.com/1997/10/25/business/ex-treasurer-freed-in-california-county.html?ref=robertlcitron.

181. *See Today, Orange County*, BUSINESS WEEK (Dec. 19, 1994), http://www.businessweek.com/archives/1994/b340434.arc.htm.

182. *See id.*

183. *See Orange County Case Study*, SUNGARD AMBIT ERISK (June 2001), http://www.erisk.com/learning/casestudies/orangecounty.asp.

184. *See Today, Orange County*, *supra* note 181.

185. *See Orange County Case Study*, *supra* note 183.

186. *See Today, Orange County*, *supra* note 181.

187. *See id.*

188. Orange County drew the attention of federal regulators at the time and there were inquiries into what type of regulation could prevent such disastrous outcomes in the future. *See* Floyd Norris, *Orange County's Bankruptcy: The Overview*, N.Y. TIMES, Dec. 8, 1994, http://www.nytimes.com/1994/12/08/business/orange-county-s-bankruptcy-the-overview-orange-county-crisis-jolts-bond-market.html. Then Federal Reserve Chairman Alan Greenspan stated that: "The trouble with legislation is that it is very likely in this type of market to become rapidly obsolete, and could very readily become counterproductive to the required flexibility that we need to address the types of problems that we are addressing." *Id.*

189. The County emerged from bankruptcy in 1996 following the confirmation of a plan that left creditors and the County itself in far better financial condition than originally thought. As part of

Orange County collapse and the current economic crisis, most individual municipalities face a different set of challenges than those confronted by Orange County.[190] Whereas Orange County was rendered insolvent by a series of bad investments that culminated in one colossal financial blow, cities like Hamtramck, Michigan, and Framingham, Massachusetts, face structural operating deficits caused by years of rising costs and a recent decline in revenue.[191] Yet, the issue of what to do with expensive collective bargaining agreement obligations remains a key issue for any municipal debtor.

Prior to its bankruptcy filing, Orange County had entered into a series of Memoranda of Understandings with County employees outlining the terms of their employment (i.e. wages, hours, etc.).[192] The County Board of Supervisors adopted the Memoranda and they became binding on the County as a result.[193] Following the collapse of its investment pool, the County was faced with a projected shortfall of $172 million for 1995 and an even greater deficit for 1996.[194] In the wake of its budget shortfall, the County Board of Supervisors adopted a resolution unilaterally suspending certain provisions of the Memoranda and began laying off a number of County workers.[195] The coalitions representing these employees filed suit, seeking a temporary restraining order (TRO) against the County in an attempt to prevent it from implementing the layoffs and otherwise altering the terms of the Memoranda.[196] The Bankruptcy Court for the Central District of California granted the TRO and ordered the parties to meet and

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its plan, the County sold $800 in new bonds to help pay its debts and, as a result, was able to pay vendors and other creditors one hundred cents on the dollar. *See* Shelby Grad, *Creditors Apparently Buying Recovery Plan*, L.A. TIMES, May 4, 1996, http://articles.latimes.com/1996-05-04/local/me-490_1_recovery-plan. Two years after filing, Orange County was able to regain access to capital markets and seven years after its bonds enjoyed a AA credit rating. *See* Dustan McNichol, *Orange County Tells Harrisburg Bankruptcy has Positive Side*, BUSINESS WEEK (May 17, 2010), http://www.businessweek.com/news/2010-05-17/orange-county-tells-harrisburg-bankruptcy-has-positive-side.html.

190. One notable exception is Jefferson County, Alabama, which faces a pending fiscal crisis much like the one that drove Orange County into Chapter 9. *See* Braun, *supra* note 7. On the advice of Wall Street investors, Jefferson County refinanced over $3 billion in outstanding debt and turned it from fixed to variable interest rates. *See id.* The County then bought credit default swaps designed to hedge against a rise in interest rates. *See id.* As with Orange County, the investments declined in value, interest rates rose and the government official in charge (in this case County Commission President Larry Langford) went to jail. *See Timeline On Debt Crisis in Alabama's Jefferson County*, REUTERS, April 9, 2010, http://www.reuters.com/article/2010/04/09/us-usa-alabama-jeffersoncounty-factbox-idUSTRE6384O020100409.

191. *See* Davey, *supra* note 13; *see also* Murphy, *supra* note 59.

192. *See In re* Cty. of Orange, 179 B.R. 177, 179 (Bankr. C.D. Cal. 1995).

193. *See id.*

194. *See id.* at 180.

195. *See id.* at 179.

196. *See id.*

negotiate.[197] When negotiations stalled, the Bankruptcy Court was forced to decide whether the County had authority, under *Bildisco*, to unilaterally modify the terms of the memoranda prior to rejection.[198]

2. The Opinion

The Bankruptcy Court in *Orange County* was forced to confront the conceptual gap created by *Bildisco*, Section 1113 and Section 901(a) of the Bankruptcy Code. *Bildisco* had allowed for the unilateral modification of collective bargaining agreements prior to rejection and created a standard governing the circumstances of rejection.[199] By passing Section 1113, Congress rejected both of these holdings *in the Chapter 11 context*.[200] But it had also failed to amend Section 901, the provision responsible for incorporating selected portions of the Bankruptcy Code into Chapter 9.[201] Section 1113 was conspicuous in its absence from Section 901(a) and, thus, the ghost of *Bildisco* endured. The Bankruptcy Court in *Orange County* was forced to address the conceptual gap created by both the Supreme Court and Congress with respect to modification of a collective bargaining agreement by a municipal debtor prior to actual rejection.

In order to determine whether or not to grant the TRO, the Bankruptcy Court in *Orange County* had to address: (1) the likelihood of the coalition's success on the merits; and (2) the existence of questions going to the merits and a balance of hardships on either party.[202] In order to do so, the Bankruptcy Court had to determine what standard the County's modification of the Memoranda would be assessed by, which required a determination of whether *Bildisco* applied in the Chapter 9 context despite the enactment of Section 1113.[203] The Bankruptcy Court's answer amounted to a "yes, but . . . ," as Bankruptcy Judge John E. Ryan held that while *Bildisco* did apply in the Chapter 9 context, it did not empower municipal debtors to unilaterally alter the terms of a collective bargaining agreement.[204] In attempting to reconcile these two apparently contradictory propositions, the Bankruptcy Court relied on equitable principals and the apparent intention of Congress to allow some aspects of state law to govern in the Chapter 9 context.

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197. *See id.* at 180.
198. *See id.*
199. Nat'l Labor Relations Bd. v. Bildisco, 465 U.S. 513 (1984).
200. 11 U.S.C. § 1113 (2006).
201. 11 U.S.C. § 901(a).
202. *See In re* Cty. of Orange, 179 B.R. 177, 181 (Bankr. C.D. Cal. 1995).
203. *See id.*
204. *See id.* at 183.

The Bankruptcy Court began its discussion with a meticulous analysis of Section 1113 and its legislative history.[205] "Section 1113 reflects Congressional displeasure with *Bildisco's* holding that prior to rejection, a Chapter 11 debtor-in-possession can unilaterally modify a collective bargaining agreement."[206] The Bankruptcy Court noted that "there is no clear explanation as to why Congress excluded [Section] 1113 from Chapter 9, [but] many believe that Congress was concerned about encroaching on state rights under the Tenth Amendment . . . ."[207] In further hypothesizing on why Congress chose not to include Section 1113 in the enumerated sections of Section 901(a) (thereby making it applicable in Chapter 9 cases), the Bankruptcy Court stated that "Congress contemplated enacting a '[Section] 1113-like' statute for Chapter 9."[208] The proposed section would have forced a Chapter 9 debtor to comply with its collective bargaining obligation, but never made it into the 1994 Bankruptcy Code amendments passed into law.[209] Based on this Congressional inaction, the Bankruptcy Court inferred that *Bildisco* did in fact control the modification and/or rejection of collective bargaining agreements in Chapter 9 cases, but in a modified manner. In doing so, the Bankruptcy Court broke new ground as, by Judge Ryan's own admission, "no other court [had] addressed the implications of *Bildisco* in Chapter 9."[210]

Despite *Bildisco's* clear holding that unilateral modification by a Chapter 11 debtor is permitted, the Bankruptcy Court in *Orange County* held that such modification was not permitted in the Chapter 9 context unless the debtor satisfied the applicable requirements of state law.[211] In arriving at this conclusion, the Bankruptcy Court noted the "painstaking efforts [by Congress] to harmonize its legislation with state sovereignty,"[212] and concluded that a debtor must comply with State law requirements for modification.[213] In reaching this surprising conclusion, the Bankruptcy Court placed a great deal of emphasis on Section 903 and its generalized "[r]eservation of State power to control municipalities."[214] According to the Bankruptcy Court, the preservation of state sovereignty embodied by Section 903, combined with the inequity of allowing for unilateral modification in Chapter 9, required that the *Bildisco* allowance for

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205. *See id.* at 181-84.
206. *Id.* at 181.
207. *Id.*
208. *Id.* at 183.
209. *See id.*
210. *Id.* at 185.
211. *See id.* at 184.
212. *See id.* at 183.
213. *See id.* at 184.
214. 11 U.S.C. § 903 (2006).

unilateral modification of collective bargaining agreements prior to rejection be negated in the Chapter 9 context.[215]

In distinguishing *Bildisco* with respect to its allowance for unilateral modification, the Bankruptcy Court emphasized the unique nature of Chapter 9.[216] As a result, the County was required to satisfy a four-part test created by California law[217] prior to unilaterally modifying the Memoranda governing its labor obligations.[218] Under the facts of the Orange County bankruptcy, the Bankruptcy Court concluded that the County would likely be unable to satisfy this standard and therefore granted the TRO against modifying the Memoranda.[219] Perhaps sensing the tension between the decision and the holding in *Bildisco*, Judge Ryan stated, "I do not believe this result conflicts in principle with *Bildisco*."[220]

3. Summarizing In re County of Orange

The *Orange County* decision departs from one pillar of the *Bildisco* decision by not allowing a Chapter 9 debtor to unilaterally modify a collective bargaining agreement prior to court-ordered rejection. In claiming that *Bildisco* applied in the Chapter 9 context but qualifying it in this manner, the Bankruptcy Court took an inconsistent position, further complicating the Chapter 9 collective bargaining issue. According to the Bankruptcy Court in *Orange County*, *Bildisco* lives, albeit in a somewhat altered form, in Chapter 9. Because of the case's procedural posture, the Bankruptcy Court did not address whether actual rejection by Orange County would have been warranted under the *Bildisco* standard. This set the table for the *Vallejo* decision that addressed both the modification and rejection issues and departed from *Orange County* in several key respects.

C. *In re City of Vallejo*

The Bankruptcy and District Court opinions in *Vallejo* erode the rationale of the Bankruptcy Court in *Orange County* and mark a shift back toward the application of the Bankruptcy Code as interpreted in *Bildisco*. The effect of this shift is apparent when comparing the disparate results and incongruous rationales of *Orange County* and *Vallejo*. In departing from

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215. *See In re* Cty. of Orange, 179 B.R. at 184.
216. *See id.*
217. For an in-depth discussion of the California standard for unilateral modification of state contractual obligations by way of legislation, *see* Sonoma Cty. Org. of Pub. Emp. v. Cty. of Sonoma, 23 Cal. 3d 296 (1979).
218. *See In re Cty. of Orange*, 179 B.R. at 184.
219. *See id.*
220. *See id.* at 185.

Orange County, the District Court in *Vallejo* realigns Chapter 9 jurisprudence with the Supreme Court's interpretation of Sections 1113 and 365, leaving *Orange County* as the outlier with respect to the issue of rejection.

1. The Facts and Procedural History

The events leading up to the Chapter 9 filing by Vallejo, California, are far more representative of the types of problems facing many municipalities today than those preceding the Orange County bankruptcy 14 years earlier. Faced with growing unemployment and high rates of home foreclosure, the City could no longer meet its financial obligations.[221] At the time of bankruptcy, the City had one thousand to five thousand creditors, estimated assets of between $500 million and $1 billion and liabilities of approximately $100 million to $500 million.[222] The City estimated that had it not filed for Chapter 9 protection, its general fund would have been depleted within a month.[223] Upwards of three quarters of the City's obligations were for public safety employee wages, benefits and pensions.[224] The City's largest unsecured creditor was the U.S. pension fund known as Calpers, which held a claim for $135.4 million in retiree health benefits and another for $83.0 million in unfunded pension plan benefits.[225]

The City filed for bankruptcy on May 23, 2008, by a unanimous vote of the City Counsel.[226] When asked to explain the decision, Council-Woman Joanne Schivley gave what may soon be an increasingly common answer among local government officers:

> We finally realized there are no other options. We were going to run out of cash come the end of June. It's not a decision that any of us took pleasure in, but there are a lot of other cities that are probably [going to] be in the same boat shortly.[227]

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221. *See* Adam Tanner, *San Francisco Suburb Vallejo Files for Bankruptcy*, REUTERS, May 23, 2008, http://www.reuters.com/article/2008/05/23/us-bankruptcy-california-city-idUSN2352179020080523.
222. *See id.*
223. *See id.*
224. *See id.*
225. *See id.*
226. *See* Jesse McKinley, *City Council in Bay Area Declares Bankruptcy*, N.Y. TIMES, May 8, 2008, http://www.nytimes.com/2008/05/08/us/08bankrupt.html.
227. *See id.*

And in a candid statement that may foreshadow future actions by other local government officers across the country, Council-Woman Schivley admitted that one thing the City hoped to accomplish by filing for Chapter 9 was to increase its leverage in the ongoing negotiations to adjust the City's obligations with public employee unions.[228]

On June 17, 2008, the City filed its motion for rejection of four collective bargaining agreements with four public sector unions: The International Association of Firefighters (IAFF), The Vallejo Police Officers Association (VPOA), the Confidential Administrative Managerial and Professional Employees of Vallejo (CAMP), and the International Brotherhood of Electrical Workers (IBEW).[229] Days later, Vallejo unilaterally modified the terms of those same four collective bargaining agreements.[230] Three of the four unions challenged the City's Chapter 9 eligibility and the Bankruptcy Court held that Vallejo was eligible to file for Chapter 9 because it was insolvent and had established the other necessary elements for eligibility.[231] The Appellate Panel for the Ninth Circuit affirmed.[232] With eligibility established, the unions were forced to challenge both the unilateral modification and potential rejection of the collective bargaining agreements on the merits.

Prior to the hearings on both issues, two of the original four unions (VPOA and CAMP) agreed to modifications in their collective bargaining agreements and were voluntarily dismissed from the City's case, leaving only the IAFF and IBEW.[233] The IAFF challenged the City's modification, and both unions challenged the City's motion for rejection. On March 2, 2009, the Bankruptcy Court issued an opinion on the issue of modification of the collective bargaining agreements by the City after filing its motion for rejection.[234] On March 13, the Bankruptcy Court issued another opinion deciding the rejection issue itself.[235]

In challenging the City's unilateral modifications, the IAFF requested relief from the automatic stay imposed by Section 362(a)(3)[236] in order to file a grievance against the city in a non-bankruptcy forum.[237] The goal of the potential grievance proceeding was to compel the City to meet certain

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228. *See* Tanner, *supra* note 221.
229. *See id.*
230. *See In re* City of Vallejo, 432 B.R. 262, 265 (Bankr. E.D. Cal. 2010).
231. *See id.*
232. *See In re* City of Vallejo, 408 B.R. 280 (B.A.P 9th Cir. 2009).
233. *See id.*
234. *See In re* City of Vallejo, No: 08-26813-A-9, 2009 Bankr. LEXIS 970 (E.D. Cal. Mar. 2, 2009).
235. *See In re* City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009).
236. An automatic stay precludes the assertion of any cause of action and the enforcement of any judgment against the debtor outside of bankruptcy. *See* 11 U.S.C. § 362(a)(3) (2006). (protecting a debtor from "any act . . . to exercise control over property of the estate.").
237. *See In re* City of Vallejo, 2009 Bankr. LEXIS, at *1.

staffing requirements, thereby forcing it to expend resources in the process.[238] On March 2, 2009, the Bankruptcy Court denied the IAFF's request for relief, concluding that enforcement of the City's collective bargaining obligations would allow the IAFF to "exercise control over property of the estate" in direct violation of Section 362(a).[239] In arguing for relief from the automatic stay, the IAFF relied heavily on *Orange County*, and with good reason. In addressing this precise issue of whether a Chapter 9 debtor may unilaterally modify a collective bargaining agreement, the *Orange County* Bankruptcy Court held that the debtor was required to satisfy the stringent requirements of California state labor law in order to do so.[240]

In distinguishing *Orange County*, the *Vallejo* Bankruptcy Court relied on the fact that the City modified its agreements *after* filing its request for rejection of those same agreements, as opposed to Orange County, which modified its agreements prior to moving for rejection.[241] The Bankruptcy Court failed to extrapolate on this distinction and never explained why it required the application of federal bankruptcy standards, as opposed to the state labor law applied in *Orange County*. Instead, the Bankruptcy Court went on to hold that, under federal bankruptcy law, relief from the automatic stay was not warranted in this case.[242] The Bankruptcy Court also deferred any decision on the rejection issue but provided a preview of how that issue would be decided by stating that "[m]odifying the automatic stay . . . makes little sense" because if "*Bildisco* fully appl[ied] . . . the CBA would not be enforceable unless and until the City accept[ed] it."[243]

On March 13, 2009, the Bankruptcy Court held that Section 365 as interpreted by the Supreme Court in *Bildisco* controlled rejection, relying primarily on the supremacy of federal law, the need for uniformity in bankruptcy and the state's broad authority to restrict municipal eligibility for Chapter 9.[244] The Bankruptcy Court noted the importance of balancing the equally compelling interests of federal supremacy and state sovereignty, as required by Section 903.[245] In striking this balance, the Bankruptcy Court noted that while the ultimate determination of whether or not a state's municipalities were able to file for Chapter 9 was left to the state itself,

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238. *See id.*
239. 11 U.S.C. § 362(a)(3).
240. *See In re* Cty. of Orange, 179 B.R. 177, 184 (Bankr. C.D. Cal. 1995).
241. *See In re City of Vallejo*, 2009 Bankr. LEXIS, at *7.
242. *See id.* at *9.
243. *See id.* at *9-10.
244. *See In re* City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009).
245. *See* 11 U.S.C. § 903 (2006) ("This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality….").

Section 903 provided no basis for restricting the application of Chapter 9 provisions once filing was authorized by state law.[246] As a result, so long as Chapter 9 filings were authorized by state law, federal bankruptcy law governed all issues that arose therein.[247] As the Bankruptcy Court put it, "by authorizing the use of Chapter 9 by its municipalities, California must accept Chapter 9 in its totality; it cannot cherry pick what it likes while disregarding the rest."[248]

In supporting its decision, the Bankruptcy Court cited to a decision by Judge John E. Ryan from the Orange County bankruptcy.[249] However, it was not the decision that dealt with the modification of collective bargaining agreements.[250] Rather, the Bankruptcy Court cited to a subsequent decision by Judge Ryan that did not deal with collective bargaining at all.[251] The *Orange County* decision cited in *Vallejo* in support of its argument that Section 365(a) trumped state labor law in the rejection context addressed the validity of a subsequent suit by Orange County against Merril Lynch for its role in the forming of the County's disastrous investment pool.[252] The "cherry picking" language cited in *Vallejo* was put forth by Judge Ryan to address an issue of conflict between California law and Chapter 9 with respect to creditor priority.[253] This decision had absolutely nothing to do with the rejection of collective bargaining agreements pursuant to Section 365(a). Moreover, the decision of the *Vallejo* Bankruptcy Court all but ignored and appears to be in conflict with *Orange County*, the decision by Judge Ryan that actually did address collective bargaining agreements.[254]

Orange County (which addressed the issue of unilateral modification of collective bargaining agreements and is discussed *supra* Section IV(B)(ii)), held that state labor law did govern certain issues pertaining to collective bargaining agreements in Chapter 9.[255] While *Orange County* addressed the specific issue of unilateral modification prior to rejection and *Vallejo* addressed the standards for actual rejection, both dealt with the overarching issue of applying state labor law in the Chapter 9 context. Yet, the *Vallejo* Bankruptcy Court made only a passing reference to *Orange*

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246. *See In re City of Vallejo*, 403 B.R. at 75.
247. *See id.* at 76.
248. *See id.* (quoting *In re* Cty. of Orange, 191 B.R. 1005, 1021 (Bankr. C.D. Cal. 1996)).
249. *See id.*
250. *See In re* Cty. of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995) (holding that a municipal debtor may not unilaterally modify its obligations under a collective bargaining agreement unless it satisfies the requirements of California law).
251. *See In re City of Vallejo*, 403 B.R. at 72.
252. *See id.*
253. *See In re* Cty. of Orange, 191 B.R. 1005, 1021 (Bankr. C.D. Cal. 1996).
254. *See In re* Cty. of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995).
255. *See id.*

County,[256] cited a largely irrelevant decision for its primary support and issued an opinion that conflicted with prior case law.[257]

After determining that *Bildisco* governed the rejection of collective bargaining agreements, the *Vallejo* Bankruptcy Court postponed a ruling on whether the standard was met and ordered IBEW and the IAFF to engage in judicially supervised mediation with the City.[258] In August 2009, the IAFF agreed to rejection of its agreement and the Bankruptcy Court granted the City's motion for rejection of the one remaining collective bargaining agreement with IBEW.[259] IBEW then appealed the Bankruptcy Court ruling to the Eastern District of California, which had to decide: (1) whether Section 365(a) authorized the City to reject the collective bargaining agreement with IBEW; (2) whether California or federal law provided the standard by which the City may unilaterally modify and reject the collective bargaining agreement in Chapter 9; (3) whether *Bildisco* provided the appropriate standard to reject should federal law apply; and (4) whether the City appropriately modified the collective bargaining agreement prior to rejection.

2. The Opinion

In addressing the authorization issue, the Eastern District adopted a very similar position to that taken by the Bankruptcy Court below. The Eastern District noted that Section 365 is incorporated into Chapter 9 by Section 901(a) and, as a result, provided a viable means of rejection by a municipal debtor so long as that debtor is authorized to file for Chapter 9 bankruptcy by the State of California.[260] While a state may impose certain pre-conditions to a municipality's ability to file, California created no such conditions in passing California Government Code Section 53760 which, according to the Eastern District, "[was intended] to provide the broadest possible state authorization for municipal bankruptcy proceedings and thus provides the specific state law authorization for municipal bankruptcy filing required under federal law."[261] While Section 53760 does qualify its authorization by instituting several specific exceptions, compliance with California labor law is not one of them.[262] Therefore, the Eastern District

256. *See In re City of Vallejo*, 403 B.R. at 76.
257. The incongruence of the two *Orange County* decisions is also significant. Why does California labor law govern the issue of modification in bankruptcy, but not the issue of priority? This conflict merits further discussion but is beyond the scope of this article.
258. *See In re* City of Vallejo, 432 B.R. 262, 266 (Bankr. E.D. Cal. 2010).
259. *See id.*
260. *See id.* at 268.
261. *See id.*
262. *See id.*

concluded, both Chapter 9 and the California authorization statute supported the claim that the City of Vallejo was empowered to reject collective bargaining agreements in some circumstances.[263]

Having acknowledged the authority to reject, the Eastern District went on to determine that federal law, pursuant to the Supremacy Clause, [264] pre-empted state labor law and thus determined the standard by which a motion for rejection should be judged.[265] In expanding on its position, the Eastern District again argued that if California had intended to apply state labor law in the bankruptcy context, it would have made compliance with state labor law a pre-requisite for state authorization under Section 53760.[266] According to the Eastern District, Congress, in an attempt to ensure Chapter 9's constitutional viability, delegated to the states the ultimate authority to determine if, when and under which circumstances a municipality would be allowed to file for bankruptcy.[267] The Eastern District noted again that if the state of California had intended for state labor law to restrict a municipal debtor's ability to reject collective bargaining agreements, it would have said so in its authorization statute.[268] Its failure to do so led the Eastern District to conclude that federal bankruptcy law pre-empted existing state labor law in the Chapter 9 context and thus Section 365(a) governed the standards of rejection.[269]

In adopting a standard for rejection, the Eastern District in *Vallejo* was faced with the same legislative gap confronted by the Bankruptcy Court in *Orange County* fourteen years earlier. Following the overruling of *Bildisco* by Section 1113 in the Chapter 11 context, a question remained as to whether the *Bildisco* standard still governs rejection in Chapter 9 bankruptcies. The Eastern District, in adopting the same rationale as the Bankruptcy Court in *Orange County*, answered in the affirmative.[270] The Eastern District argued that because Section 1113 was not integrated into Chapter 9 by Section 901(a) at the time of its enactment or when it was later amended (perhaps out of concern for encroaching on states' Tenth Amendment rights) that Congress never intended it to apply in Chapter 9 cases.[271] As a result, *Bildisco* still governed the rejection of collective bargaining agreements by Chapter 9 debtors.[272] The Eastern District

263. *See id.*
264. *See* U.S. CONST. art. IV, cl. 2.
265. *See In re City of Vallejo*, 432 B.R. at 270.
266. *See id.*
267. *See* 11 U.S.C. § 109(c)(2) (2006).
268. *See In re City of Vallejo*, 432 B.R. at 270.
269. *See id.*
270. *See id.* at 271.
271. *See id.*
272. *See id.*

outlined the *Bildisco* framework: (1) did the IBEW collective bargaining agreement constitute a burden on the City; (2) did the balance of equities favor rejection; and (3) had the city negotiated reasonably with IBEW prior to rejection?[273] The standard of review of the Bankruptcy Court's determination that the *Bildisco* factors were met and rejection was warranted was clearly erroneous.[274] By this standard, the Eastern District affirmed the Bankruptcy Court's granting of the City's motion for rejection.[275]

In finding that the IBEW collective bargaining agreement did burden the City's ability to reorganize, the Eastern District held that it was proper for the Bankruptcy Court to inquire into the burden on the City's general fund, as opposed to the burden on the City's finances overall.[276] The Eastern District found that because the City was unable to divert revenue from sources other than the general fund to meet its collective bargaining obligations to IBEW, it was unnecessary to inquire as to the effect of the IBEW agreement on such other sources.[277] Despite an erroneous interpretation of a provision in the IBEW collective bargaining agreement dealing with longevity pay by the Bankruptcy Court, the Eastern District affirmed the Bankruptcy Court's ruling on this first prong of *Bildisco*.[278] In doing so, the Eastern District acknowledged the existence of countervailing evidence, but relied principally on the clearly erroneous standard of review and held that it could not overturn the Bankruptcy Court determination on the evidence before it.[279]

In affirming the Bankruptcy Court on the equities prong of *Bildisco*, the Eastern District acknowledged evidence of plunging municipal revenue, increasing labor expenses and the equal treatment of IBEW relative to other municipal constituencies considered by the Bankruptcy Court and affirmed its decision with respect to the second prong of *Bildisco*.[280] "[T]here was little, if anything left for the City to cut apart from its labor expenses . . . further reductions in the funding of services threatened the City's ability to provide for the basic health and safety of its residents . . . ."[281]

Finally, in just one paragraph of its opinion, the Eastern District found that the City had reasonably negotiated with IBEW by entering into court

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273. *See id.* at 272.
274. *See id.*
275. *See id.*
276. *See id.* at 274.
277. *See id.*
278. *See id.*
279. *See id.*
280. *See id.* at 275.
281. *See id.*

ordered mediation.[282] It affirmed the Bankruptcy Court ruling that the City had satisfied the third and final prong of *Bildisco*.[283]

Despite identifying Vallejo's unilateral modification of the IBEW collective bargaining agreement as an issue on appeal, the Eastern District summarily refused to address it, finding that it was waived by the unions without further explanation.[284]

3. Summarizing In re City of Vallejo

As a result of its Chapter 9 filing and subsequent motion for rejection, the City of Vallejo obtained the leverage over the public sector employees Council-Woman Joan Schivley hoped it would.[285] Three of the four unions representing the employees agreed to either modification of the collective bargaining agreements (VPOA and CAMP) or outright rejection (IAFF). IBEW, the one union that maintained its opposition throughout, had its collective bargaining agreement rejected as well, albeit involuntarily. In the end, all four unions were forced to accept some modification of their rights under the collective bargaining agreement and this was a direct result of the City's decision to file for Chapter 9 and the interpretation of both state and federal law by the Bankruptcy and Eastern District Courts.[286]

One cannot read both *Orange County* and *Vallejo* without noticing the conceptual inconsistency between them. An argument could be made that the two cases presented different questions of law. *Orange County* dealt with the propriety of unilateral modification by a municipal debtor prior to moving to reject,[287] and *Vallejo* dealt with modification after moving to reject as well as the proper law and standards governing actual rejection.[288] This is, however, a rather weak distinction. Both cases presented issues pertaining to modification and/or rejection of collective bargaining agreements by a municipal debtor in bankruptcy. The opinions in both cases struggled with the issue of whether to apply state labor law or federal bankruptcy law and, in the end, how this issue was decided determined the outcome.

The Bankruptcy Court in *Orange County* applied state labor law standards to Orange County's attempt to modify the collective bargaining agreement unilaterally, and the union succeeded in enjoining such

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282. *See id.*
283. *See id.*
284. *See id.* at 270.
285. *See* Tanner, *supra* note 221.
286. *See In re* City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009); *see also In re* City of Vallejo, No: 08-26813-A-9, 2009 Bankr. LEXIS 970 (E.D. Cal. Mar. 2, 2009).
287. *See In re* Cty. of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995).
288. *See In re* City of Vallejo, 432 B.R. at 270; *see also In re* City of Vallejo, 403 B.R. 72.

modifications.[289] In contrast, the Bankruptcy Court and Eastern District in *Vallejo* applied federal bankruptcy law as interpreted in *Bildisco* and, as a result, the City was able to reject or renegotiate all four of its collective bargaining agreements.[290] All three *Vallejo* decisions struggled to avoid confronting the inconsistency of these two outcomes. The Bankruptcy Court made a passing and ultimately misleading reference to the *Orange County* decision that actually dealt with collective bargaining,[291] and ultimately relied on another, far less relevant, *Orange County* decision.[292] For its part, the Eastern District acknowledged the issue of unilateral modification by the City (the exact issue decided by the Bankruptcy Court in *Orange County*[293]) at the start of its opinion but never actually addressed it.[294]

All of these cases combine to create a cloud of uncertainty over the issues of modification and rejection of collective bargaining agreements in Chapter 9. The Eastern District in *Vallejo* opened the door to states making compliance with their own labor law a pre-condition for granting municipalities the authority to file for Chapter 9 protection.[295] However, none of the states with statutes specifically authorizing their municipalities to file for Chapter 9 have included such a condition.[296] As a result, Bankruptcy Courts around the country may be forced to confront the inconsistencies in the *Bildisco*, *Orange County* and *Vallejo* decisions.

In applying the law as interpreted in these cases, a court would have to: (i) allow for rejection of collective bargaining agreements pursuant to Section 365(a) and not Section 1113 (in accordance with *Bildisco* and *Orange County*); (ii) apply the federal standard as articulated in *Bildisco* to the issue of whether or not rejection is warranted (in accordance with *Vallejo*); (iii) apply federal law to the modification of collective bargaining agreements made after the motion for rejection (in accordance with *Vallejo*); (iv) but apply state labor law standards to any modification made prior to the motion for rejection (in accordance with *Orange County*); (v)

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289. *See In re Cty. of Orange*, 179 B.R. 177.

290. *See In re City of Vallejo*, 432 B.R. at 270; *see also In re City of Vallejo*, 403 B.R. 72.

291. The Bankruptcy Court's citation to the problematic *Orange County* decision addressing the issue of unilateral modification bears the dubious citation signal "*cf.*" *See In re City of Vallejo*, 403 B.R. at 76. The Blue Book defines *"cf."* as "[c]ited authority supports a proposition different from the main proposition but sufficiently analogous to lend support." *See* THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION, R. 1.2, at 55 (Columbia Law Review Ass'n et. al. eds. 19th ed. 2010).

292. *In re* Cty. of Orange, 191 B.R. 1005, 1021 (Bankr. C.D. Cal. 1996) (addressing issues of priority between creditors in bankruptcy).

293. *See In re Cty. of Orange*, 179 B.R. 177.

294. *See In re City of Vallejo*, 432 B.R. 262.

295. *See id.* at 270.

296. *Supra* note 84.

and also deny any federal labor claims against the debtor on the basis of such modification (in accordance with *Bildisco*). If a municipal debtor can secure a judgment allowing rejection, its labor costs can be reduced dramatically and the employee unions would be left with only an unsecured claim for damages.[297] In all, as of the Eastern District's most recent opinion in *Vallejo*, the law in this area of modification and rejection is still debtor-friendly and creates an incentive for municipalities to seriously consider Chapter 9 as a solution to their budget short-falls.

V. THE IMPACT OF THE COLLECTIVE BARGAINING DECISIONS

All of the inconsistencies in the collective bargaining decisions are a product of the courts attempting to walk the tightrope between state sovereignty and effective reorganization that Chapter 9 itself attempts to walk. Difficult cases make bad law and there may be no more difficult issue in all of Chapter 9 than deciding when, how and pursuant to what law a municipal debtor is allowed to modify and/or reject collective bargaining agreements with public sector employees. Moreover, this struggle is no longer limited to the courts. The issue of how to deal with the municipal debt crisis looms large in the current national policy debate. The role of collective bargaining agreements and public sector unions has been thrust to the forefront of that debate by the recent events in Wisconsin.[298]

Understanding the mechanics and application of both federal and state law in the Chapter 9 context has become far more important. The interpretation and application of law created by Chapter 9, *Bildisco*, *Orange County* and *Vallejo* could have an impact on the national debate and could factor into policy decisions at the federal, state and local levels.

A. The Impact of the Collective Bargaining Decisions at the Federal Level

Recent government intervention in the private sector has generated an enormous amount of debate and controversy both in Washington D.C. and elsewhere. The series of so called bailouts of the banking sector and automotive industry have made the debate over such intervention

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297. *See* Collier on Bankruptcy, *supra* note 91, at ¶901.04.

298. Enormous protests have erupted in Madison over a recent law that stripped certain public sector unions of their collective bargaining rights. *See* James Kelleher, *Wisconsin Enacts Union Curbs, Rescinds Layoffs*, CHICAGO TRIBUNE, Mar. 11, 2011, http://www.chicagotribune.com/news/sns-rt-usreport-us-wisconsitre729094-20110310,0,1465895.story. The Wisconsin debate over the roll of collective bargaining and the roll of public sector workers in the creation of and solution to the current budget crisis have spread across the country. *See* Matt Wettendall, *Wisconsin Protests Gain National Attention*, IOWA ST. DAILY NEWS (Feb. 25, 2011), http://www.iowastatedaily.com/news/article_820e9a58-3e34-11e0-a06f-001cc4c002e0.html.

contentious and turned the issue of similar intervention in other industries into a political third rail.[299] The issue has surfaced again recently, this time in the context of the state debt crisis.[300] A number of lawmakers have rallied against even the possibility of a federal bailout for the states.[301] In the course of this debate, expanding Chapter 9 to allow states to file for bankruptcy has been put forth as an alternative to the highly controversial bailout option.[302]

A potential state bankruptcy bill has a number of high-profile supporters including former Speaker of the House and potential 2012 Republican presidential candidate, Newt Gingrich and former Florida Governor Jeb Bush.[303] Such a bill is also being seriously considered by some legislators on Capitol Hill.[304] While such a bill could present a series of constitutional issues similar to those raised by the Supreme Court in *Bekins*,[305] some commentators believe that they could be avoided if the law were properly crafted.[306] Adjustment of state obligations in bankruptcy could potentially violate the Takings Clause of the Fifth Amendment[307] or principles of state sovereignty embodied in the Tenth Amendment.[308] However, University of Pennsylvania Professor of Law David Skeel argues

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299. *See* John Harwood, *Battle Over Bailouts Shifts Oversight Debate*, CAUCUS (May 2, 2010, 10:10 PM), http://thecaucus.blogs.nytimes.com/2010/05/02/battle-over-bailouts-shifts-oversight-debate/; *see also* David E. Sanger, *The Great Bailout Debate*, N.Y. TIMES, Nov. 18, 2008, http://www.nytimes.com/2008/11/18/us/politics/18web-sanger.html.

300. *See* Betty Liu & Martin Z. Braun, *Whitney Says U.S. States may Need Federal Bailout*, BLOOMBERG, Sept. 30, 2010, http://www.bloomberg.com/news/2010-09-30/whitney-says-states-may-need-federal-bailout-in-next-12-months.html.

301. *See* Alan Fram, *Lawmakers Oppose Federal Bailout for States*, YAHOO NEWS (Feb. 9, 2011), http://news.yahoo.com/s/ap/20110209/ap_on_re_us/us_states_federal_aid; *see also* Rep. Patrick McHenry, *No Bailout for States' Looming Crises*, POLITICO (Feb. 9, 2011), http://www.politico.com/news/stories/0211/49141.html; Governors Rick Perry & Mark Sanford, *Governors Against State Bailouts*, WALL ST. J., Dec. 2, 2008, http://online.wsj.com/article/SB122818170073571049.html.

302. *See* Mary Williams Walsh, *A Path is Sought for States to Escape their Debt Burdens*, N.Y. TIMES, Jan. 20, 2011, http://www.nytimes.com/2011/01/21/business/economy/21bankruptcy.html.

303. *See* Lisa Lambert, *State Bankruptcy Bill Imminent, Gingrich Says*, REUTERS, Jan. 21, 2011, http://www.reuters.com/article/2011/01/21/us-usa-states-bankruptcy-idUSTRE70K6PI20110121; *see also* Michael O'Brien, *Gingrich, Bush Support Bankruptcy for States*, HILL (Jan. 27, 2011, 11:02 AM), http://thehill.com/blogs/blog-briefing-room/news/140655-rift-between-republicans-on-bailout-for-states; John Keefe, *Enabling State Bankruptcy Gathers Support*, CBS MONEY WATCH (Jan. 21, 2011), http://moneywatch.bnet.com/economic-news/blog/macro-view/enabling-state-bankruptcy-gathers-support/3017/.

304. *See* Andy Sullivan & Lisa Lambert, REUTERS, Jan. 25, 2011, http://www.reuters.com/article/2011/01/25/us-usa-states-bankruptcy-senate-idUSTRE70O66220110125.

305. U.S. v. Bekins, 304 U.S. 27 (1938).

306. *See* David Skeel, *A Bankruptcy Law-Not Bailouts-for the States*, WALL ST. J., Jan. 18, 2011, http://online.wsj.com/article/SB10001424052748703779704576073522930513118.html.

307. U.S. CONST. amend. V.

308. U.S. CONST. amend. X.

that a Takings Clause violation is unlikely because the obligations terminated would be unlikely to be interpreted as property rights and a Tenth Amendment violation can be avoided by leaving ultimate authority to the states in deciding whether or not to file.[309]

Whatever the likelihood or constitutional viability of a state bankruptcy bill, the mere fact that one is being debated has been enough to provoke staunch opposition from labor leaders.[310] The primary reason for such opposition is the prospect of wide-spread modification and/or rejection of collective bargaining agreements on a far greater scale than is currently possible under Chapter 9. A state bankruptcy bill would be likely to include or incorporate most if not all of the current Chapter 9 provisions including Section 365(a) and, by extension, all of the case law that comes with it (i.e. *Bildisco*, *Orange County* and *Vallejo*). In fact, the potential ability of states to renegotiate their collective bargaining obligations with public sector unions free from the constraints of union-friendly state labor law seems to be one of the primary factors driving the arguments of state bankruptcy supporters.[311] Professor Skeel himself argues that "state bankruptcy could even permit a restructuring of the Cadillac pension benefits that states have promised to public employees . . . [that are] often vested under state law and . . . protected by the state constitution."[312]

This line of argument rests on the supposition that federal bankruptcy law actually governs the modification and rejection of collective bargaining agreements, the primary issue in *Bildisco*, *Orange County* and *Vallejo*. A state bankruptcy bill could significantly augment the impact of these decisions. With more collective bargaining agreements subject to modification and in the crosshairs of Section 365(a)'s rejection power, the mechanics of applying that law become even more important. When, how and pursuant to what law collective bargaining agreements could be modified or rejected by states would be a critical issue in the application of a state bankruptcy bill and in the path to solvency for a number of state governments.

B. The Impact of the Collective Bargaining Decisions at the State Level

One of the primary reasons the *Bildisco*, *Orange County*, *Vallejo* line of cases is so important is that it imposes a more debtor-friendly set of

309. *See* Skeel, *supra* note 306.

310. *See* Sean Higgins, *GOP Planning Ahead to Avoid State Pension Bailouts*, INVESTOR BUSINESS DAILY, Jan. 21, 2011, http://www.investors.com/NewsAndAnalysis/Article/560607/201101211903/GOP-Plans-Ahead-To-Prevent-Bailout-Of-States-Pensions.aspx.

311. *See* Skeel, *supra* note 306.

312. *Id.*

federal laws and eschew more union-friendly state laws. However, the landscape of state and local labor law may be undergoing a series of dramatic changes. While national attention has been focused on the debate in Wisconsin over the stripping of collective bargaining rights for some public sector unions,[313] as many as seventeen other states have begun considering similar bills.[314]

Bills like the one passed in Wisconsin and being considered in other states across the country may be the beginning of a broader movement to nullify existing collective bargaining agreements with public sector workers. If mitigating the influence of unions and the effect of collective bargaining agreements becomes the new imperative for state governments, the notion of authorizing municipal bankruptcy in accordance with Section 109(c)(2) (a once politically untenable position) may be the next logical step. More states could join those that already have specific authorization statutes.[315] Indiana, for example, is already considering just such a bill that already has the support of Governor Mitch Daniels.[316]

Should more states follow Indiana's lead and authorize municipal bankruptcy, the application of Section 365(a) in the rejection of collective bargaining agreements would become even more significant and the decisions in *Bildisco*, *Orange County* and *Vallejo* would become even more influential.

C. The Impact of the Collective Bargaining Decisions at the Municipal Level

The events in Wisconsin have politicized the debate over the pending (and in some cases ongoing) municipal debt crisis. Politicization has lead to polarization with pro-labor (largely Democratic) forces lining up in support of collective bargaining agreements and pro-business (largely Republican) forces moving to support bills like the one passed in

313. The bill was signed into law on March 11, 2011, by Governor Scott Walker. *See Wis. Governor Officially Cuts Collective Bargaining*, MSNBC NEWS, http://www.msnbc.msn.com/id/41996994/ns/politics-more_politics/ (last updated Mar. 11, 2011).

314. *See Map: States with Union-Stripping Measures*, MADDOW BLOG, http://maddowblog.msnbc.msn.com/_news/2011/03/10/6237836-map-states-with-union-stripping-measures; *see also* Neil King Jr., et. al., *Political Fight Over Unions Escalates*, WALL ST. J., Feb. 22, 2011, http://online.wsj.com/article/SB10001424052748703800204576158851079665840.html.

315. *See supra* note 84.

316. *See* Karen Pierog, *Indiana Bill Would Allow Municipal Bankruptcy*, WESTLAW NEWS & INSIGHT (Dec. 29, 2010), http://newsandinsight.thomsonreuters.com/Bankruptcy/News/2010/12_-_December/Indiana_bill_would_allow_municipal_bankruptcy/.

Wisconsin.[317] While this debate rages, municipalities are still in the process of confronting enormous budget deficits, and many will be forced to deal with them, long before the dust settles on the national debate.

Many local governments across the country are suffering from the same simple, but devastating problem: growing costs and declining revenue.[318] Structural operating deficits like the one that forced the City of Vallejo into Chapter 9 bankruptcy are forcing municipal governments across the country to make unimaginably difficult choices in a desperate attempt to avoid the same fate. However, the severity of this problem does vary. Some municipalities, like Framingham, have serious budgetary problems to deal with, but are taking steps toward avoiding an all-out collapse of local government. [319] Others, like Hamtramck, have already been forced to discontinue several key public services and are forced to rely on state financial and logistical support to avoid leaving their citizens without the most basic services like public safety and sanitation. [320] The City of Newark, New Jersey, falls somewhere along this continuum.

Faced with a $100 million budget deficit, Newark was forced to make the kinds of difficult choices facing many municipalities across the country.[321] The scope of Newark's budgetary problems and the drastic measures taken by Mayor Cory Booker and the City Council to avoid financial collapse were chronicled in the documentary television series *Brick City*.[322] In the Season Two finale, Mayor Booker is shown striking items from the city budget, line by line, in an attempt to avoid widespread layoffs of public employees.[323] In acknowledging the severity of the deficit, Mayor Booker at one point states candidly that if cuts are not made, municipal bankruptcy is the only option.[324] In the end, the City was forced to lay off hundreds of public employees.[325] Mayor Booker, like countless other local representatives, has received no shortage of grief from his constituents for making these types of hard choices.[326]

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317. *See* A.G. Sulzenberger, *Union Bill is Law, but Debate is Far from Over*, N.Y. TIMES, Mar. 11, 2011, http://www.nytimes.com/2011/03/12/us/12wisconsin.html.
318. *See* Hoene, *supra* note 5.
319. *See* Murphy, *supra* note 59.
320. *See* Davey, *supra* note 14.
321. *See* David Giambusso, *Newark $100M Budget Deficit Forces Doubling of Employee Furloughs*, STAR-LEDGER, June 3, 2010, http://www.nj.com/news/index.ssf/2010/06/newark_employees_furlough_mayo.html.
322. *Brick City: Judgment Day* (The Sundance Channel broadcast Mar. 13, 2011).
323. *Id.*
324. *Id.*
325. *See* David Diambusso, *After Hundreds of Layoffs, Former Newark Public Employees are Left to Ponder Future*, STAR-LEDGER, Dec. 4, 2010, http://www.nj.com/news/index.ssf/2010/12/400_newark_city_employees_look.html.
326. *See News 12* New Jersey Television Interview with Cory Booker, Mayor of Newark, N.J. (Mar. 20, 2011); *see also* David Giambusso, *Protestors Block Newark Traffic, Criticize Mayor Booker's*

If the financial conditions of local governments do not improve, there will be more hard choices like those made by Mayor Booker facing a growing number of local government officials. Faced with a plethora of unpalatable choices, Chapter 9 bankruptcy could prove to be the most appealing of the bunch. Moving forward, local governments, like the one in Newark, may decide that filing for Chapter 9 in an attempt to adjust collective bargaining obligations and mitigate the potential for public-worker layoffs is the best decision for their budgets and their constituents. If they do, the decisions in *Bildisco*, *Orange County* and *Vallejo* will loom large.

VI. CONCLUSION

From Hamtramck, to Framingham, to Newark, the option of filing for municipal bankruptcy is more likely than ever before. The City of Vallejo may end up being remembered as the first domino to fall, instead of a historical outlier. The prospect of modifying and/or rejecting collective bargaining agreements to reduce salary, benefit and pension commitments to public sector workers is a powerful incentive for municipalities to file for Chapter 9. The current interpretation of Sections 901, 365(a) and 1113 by the courts in *Bildisco*, *Orange County* and *Vallejo* make unilateral modification possible, and lower the bar for outright municipal rejection of collective bargaining agreements. If the approach taken in *Vallejo* is widely adopted by other Bankruptcy Courts, the scope of impact for this interpretation will broaden and more local governments may ultimately decide to take the opportunity to modify and/or reject collective bargaining agreements with public sector employees.

Plan to Lay off 230 Sanitation Workers, STAR-LEDGER, Aug. 11, 2010, http://www.nj.com/news/index.ssf/2010/08/protestors_block_traffic_criti.html.