

**United States Government
National Labor Relations Board
OFFICE OF THE GENERAL COUNSEL**

Advice Memorandum

DATE: September 22, 2004

TO : Robert H. Miller, Regional Director
Region 20

FROM : Barry J. Kearney, Associate General Counsel
Division of Advice

SUBJECT: Lyon's Restaurant
Case 20-CA-31814-1

530-4825-6700

This Section 8(a)(1), (3) and (5) case was submitted for advice regarding the liability of a Chapter 11 bankruptcy debtor which, upon resuming the operation of a restaurant that had been run temporarily by a prospective purchaser, refused to recognize and bargain with the incumbent union, threatened employees, and terminated three employees.

We conclude that the debtor must recognize and bargain with the incumbent union and may not unilaterally alter employee working conditions. Its bargaining obligation stems from its initial bargaining relationship with the union, notwithstanding the short hiatus when the prospective purchaser ran the restaurant, and is not based on successorship principles. Thus, the debtor is liable for the unilateral changes it made within the 10(b) period.

FACTS

Lyon's of California, Inc. ("Employer") owns, operates, and franchises restaurants in California. The Employer has been undergoing voluntary Chapter 11 bankruptcy reorganization in the U.S. Bankruptcy Court for the Southern District of California, San Diego, since October 12, 2001.¹ Hotel and Restaurant Employees Local 340 ("Union") has represented employees at the Employer's South San Francisco restaurant since late 2001.²

The parties' most recent collective-bargaining agreement was executed on January 7, 2002 with a term through calendar year 2002. The contract includes, inter

¹ Case No. 01-10624-JM11.

² The South San Francisco restaurant is the only unionized restaurant.

alia, provisions for vacation pay; no-strike/no-lockout; dues check-off; attendance bonuses; grievance-arbitration; and contributions to a health and welfare plan.

In late 2002, the Employer informed the Union that it sought to sell certain of its restaurants, including the South San Francisco location.³ On December 8, 2002, the Employer filed a proposed Second Amended Plan of Reorganization ("Plan") with the bankruptcy court. The Plan lists the South San Francisco restaurant as one of 17 locations the Employer intended to sell as Lyon's franchises in order to fund the Plan, and requires, for each proposed sale, that the Employer enter into asset purchase agreements containing certain provisions with prospective purchasers. The Plan does not require the Employer to enter into interim operating agreements with prospective purchasers, but does require court approval of any interim operating agreements entered into. On February 3, 2003, the bankruptcy court issued an order confirming the Plan.

In late 2003, the Employer entered into an agreement to sell three restaurants, including the South San Francisco restaurant, to Lyon's Imperial of California, Inc. ("Imperial").⁴ In this regard, the Employer and Imperial signed an Asset Purchase Agreement ("APA") and an Interim Operating Agreement ("IOA") on November 14, 2003.

By its terms, the Asset Purchase Agreement provides for a sale not in the ordinary course of business, free and clear of all encumbrances. The APA's effectiveness is conditioned upon the approval of both the bankruptcy court and United States Restaurant Properties ("USRP"), a secured lender. The purchase price for the restaurants was \$1.9 million, to be funded, in part, by a secured promissory note for \$1.45 million that was personally guaranteed by Imperial's owner, Mohammed Sarwar. The APA's "employment" provision requires the Employer to terminate restaurant employees upon Imperial's taking over under the IOA; permits Imperial to elect or decline to hire those

³ On September 13, 2002, the Employer had filed papers with the bankruptcy court to sell the South San Francisco restaurant to Bojo, Inc. The motion to sell the restaurant was taken off the bankruptcy court's calendar on October 24, 2002, and was never completed.

⁴ The other restaurants were the Yuba City location and the Carmichael location. In addition, Imperial was granted a right of first refusal for a fourth restaurant in Sacramento.

employees at its own discretion; and acknowledges that the employees at the South San Francisco location are "union employees." The APA also permits either party to terminate the agreement if the other breaches the agreement. The APA also states that, upon execution of the agreement, the Employer will promptly file the necessary pleadings to request the bankruptcy court's approval.

The Interim Operating Agreement provides that it was to take effect on November 14, 2003, "subject to bankruptcy court approval in due course."⁵ Its stated purpose is to preserve the going concern value of, and avoid disruption to, the restaurants prior to the completion of the sale. The IOA grants Imperial the sole right to operate the restaurants on a day-to-day basis at its own cost, expense, and risk. Imperial is to employ, pay, train, and supervise the restaurant employees, who shall not be or be deemed to be the employees of the Employer for any purpose whatsoever. The IOA states that accounts receivable created before the effective date of the IOA shall be solely the Employer's responsibility, while those created after the effective date shall be solely Imperial's responsibility. The IOA further states that the Employer and Imperial are not a joint venture, partnership, or principal and agent, and that neither party has the authority to create any obligation on behalf of the other. The IOA requires the Employer to promptly file an appropriate ex parte application seeking expedited approval of the IOA from the bankruptcy court. Either party may terminate the IOA for breach.

For most of 2003, the Employer and the Union had extended the collective-bargaining agreement on a month-to-month basis. In a letter dated December 1, 2003, the Employer informed the Union that it would no longer extend the expired collective-bargaining agreement, and that as of November 24, 2003, Imperial had taken over operations of the South San Francisco restaurant. The Employer sent another letter to the Union, dated December 8, 2003, providing the Union with Imperial's contact information.

Imperial operated the three restaurants from November 24, 2003 until late March 2004. According to Sarwar, he was solely in charge during this period. Imperial retained all of the Employer's employees at the South San Francisco restaurant, although it fired two managers - Fern King and Oscar Leyva - in January 2004, allegedly due to poor sales.

⁵ IOA, Section 13.

The Union first requested to meet and bargain with Imperial in a letter dated December 17, 2003, which also included a copy of the expired collective-bargaining agreement. Imperial had two telephone conversations with the Union, but they never met. Nonetheless, Imperial deducted Union dues, transmitted them to the Union, and apparently honored most of the other contractual terms while it operated the South San Francisco restaurant. Imperial did not, however, make contractual health and welfare payments, and it is unclear whether it paid contractual holiday pay.⁶ The Union again formally requested bargaining with Imperial in a letter dated March 18, 2004.⁷

On March 25, 2004, Fern King and Harold Gaubert, an independent consultant for the Employer, entered the South San Francisco restaurant and announced to the employees that the Employer was taking over the restaurant, and that "we're no longer union, whoever wants a union can go look for another job." The lock on the front door was changed and a security guard was posted at the front door, presumably to impede the entry of anyone associated with Imperial.⁸ The Employer has claimed that it assumed control over the restaurants from Imperial because Imperial was not making payments required under the APA or paying the suppliers. Imperial disputes these contentions.⁹

⁶ The Union presented evidence that the Employer had not made some contractual health and welfare payments in 2003, prior to transferring operations of the South San Francisco restaurant to Imperial. The Region's view is that this was a result of clerical or accounting mistakes, as some eligible employees did not receive the health & welfare contributions while some ineligible employees did receive the contributions.

⁷ The Union has not filed any Board charges against Imperial.

⁸ The Employer also took over the other two restaurants that Imperial had operated.

⁹ To date, Imperial has not filed a lawsuit which would have provided an opportunity, through discovery, to determine in more detail the reasons for the Employer's action in assuming control of the restaurant. During the early stages of the investigation, Imperial's counsel stated that such a lawsuit was being considered, however settlement discussions are ensuing.

Notwithstanding the language in the Plan, the APA, and the IOA, which requires the Employer to attempt to gain bankruptcy court approval for the above transactions with Imperial, our review of the bankruptcy court's docket report indicates that no filings have been made and no court orders have been issued with respect to the proposed sale to Imperial, Imperial's interim operation, or the Employer's resumption of control.

When it resumed control in March, the Employer gave employees of the South San Francisco location an application packet to fill out, which included a document requiring the applicant to agree to be a non-union employee and that the store will not be a union store. Three employees were terminated on March 25 and 26, one manager was fired, and Fern King subsequently threatened employees with termination if they spoke to or about any of the terminated employees. In a letter dated March 29, 2004, the Union advised the Employer of its understanding that the terms and conditions established under the expired collective-bargaining agreement would continue, and requested to meet and bargain. On March 30, the Union sent the Employer a letter requesting bargaining over the three discharged employees. The Employer did not answer the Union's letters, and has not deducted Union dues since assuming control from Imperial. The Union also claims that the Employer unilaterally cut senior employees' shifts and hours; hired new employees; and on April 7, 2004, granted all employees a 10-cent-an-hour wage increase. The Employer has not provided a written position statement.

ACTION

We conclude that the Employer must recognize and bargain with the Union and is not privileged to set initial terms and conditions of employment unilaterally. The Employer's bargaining obligation stems from its initial bargaining relationship with the Union, notwithstanding the five-month hiatus when Imperial ran the restaurant, and is not based on successorship principles. Thus, the Employer is liable for the unilateral changes it made within the 10(b) period.¹⁰

The Employer's 8(a)(5) liability for (1) its refusal to recognize the Union when it resumed operations in March 2004, and (2) its unilateral changes in working conditions

¹⁰ The Region has determined that the Employer's threats and discharges when it resumed operations violated Section 8(a)(1) and (3). Those conclusions are not affected by the issues discussed here.

when it resumed operations, depends on the Employer's status after resuming operations. Under one approach, Imperial was the Employer's successor when it operated the restaurant, and the Employer, in turn, became Imperial's successor when it reasserted control over the restaurant. Alternatively, successorship principles do not apply, and instead the Employer's bargaining obligation is based on its pre-Imperial relationship with the Union, notwithstanding the five-month hiatus when Imperial ran the restaurant.

A. The Employer is obligated, at a minimum, to recognize and bargain with the Union under either of the above theories of liability.

Whichever of the above theories is ultimately accepted, at a minimum, the Employer owes the Union a duty to recognize and bargain.¹¹ An employer is a Burns successor, required to recognize the representative of the predecessor employees, if it retains essentially the same workforce as its predecessor and there is substantial continuity in the employing enterprise.¹² The Employer clearly meets the technical requirements to be a Burns successor to Imperial. Thus, when Imperial took over the restaurant from the Employer, and when the Employer subsequently retook control from Imperial, they retained essentially the same work force and maintained substantial continuity in the employing enterprise. Therefore, at the very least, the Employer violated 8(a)(5) by refusing to recognize and bargain with the Union with respect to ongoing wages, hours, and other terms and conditions of employment. However, a Burns successor may generally reject its predecessor's collective-bargaining agreement and set initial terms and conditions of employment unilaterally.¹³ This Burns privilege is based on policies of supporting freedom of contract¹⁴ and promoting and

¹¹ Cf. Transmontaigne, Inc., 337 NLRB 262, 262-263 (2001) (where issue is merely whether employer must recognize and bargain with union, Board need not determine whether case is better suited to "stock transfer" or successorship principles).

¹² NLRB v. Burns Int'l Security Services, Inc., 406 U.S. 272 (1972); Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 43 (1987).

¹³ NLRB v. Burns Int'l Security Services, Inc., 406 U.S. at 281-82, 291, 294 (1972).

¹⁴ Id. at 281-83 ("It does not follow...from Burns' duty to bargain that it was bound to observe the substantive terms

protecting the free flow of capital.¹⁵ Thus, under a successorship theory, the Employer would not be liable for unilaterally setting terms and conditions of employment when it retook the restaurant.

B. The Employer was not privileged to unilaterally set terms and conditions of employment, because the Employer's bargaining obligation is not limited by successorship principles.

The Burns decision's emphasis on protecting and promoting the transfer of capital and freedom of contract indicates that the successorship doctrine is meant to apply where a business is transferred to a new employer, i.e. an employer that has not recently dealt with the union and employees involved.¹⁶ This concept is well illustrated in Board decisions where an employer has recaptured and resumed performing subcontracted work. Where such an employer is truly new to the union and employees involved, the Board has applied successorship principles to determine its bargaining obligation.¹⁷ On the other hand, where such an employer has recently dealt with the union and employees at issue, and therefore cannot be considered a truly new employer, the Board has found successorship principles inapplicable.¹⁸ A more detailed description of these cases follows.

of the collective-bargaining contract the union had negotiated with Wackenhut and to which Burns had in no way agreed").

¹⁵ Id. at 287-88 (A "potential employer may be willing to take over a moribund business only if he can make changes," such that "[s]addling...an employer with the terms and conditions of employment contained in the old collective-bargaining contract may...discourage and inhibit the transfer of capital.").

¹⁶ Similarly, in Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. at 39, the Supreme Court recognized that a true successor employer has no "formal and established bargaining relationship" with the union.

¹⁷ Cablevision Systems Development Co., 251 NLRB 1319 (1980), enfd. in pertinent part 671 F.2d 737 (2d Cir. 1982), cert. denied 459 U.S. 906 (1982); Saks Fifth Avenue, 247 NLRB 1047 (1980), enfd. 634 F.2d 681 (2d Cir. 1980).

¹⁸ F & A Food Sales, 325 NLRB 513 (1998), enfd. 202 F.3d 1258 (10th Cir. 2000).

In Cablevision Systems Development, an employer (Sterling) whose employees had been represented by a union (Local 3) subcontracted installation and service technician work to Broadway, an independent company, whose employees were represented by another union (Local 25). About three years later, Sterling's successor corporation, Cablevision, decided to terminate the subcontract and perform the installation and service technician work in-house, and hired the vast majority of the employees who had performed the work for Broadway.¹⁹ Local 25 had initially established its bargaining relationship with the subcontractor (Broadway) rather than with Cablevision. Thus, Cablevision had not dealt with Local 25 prior to the subcontract. The Board found that Cablevision was the successor to the subcontractor, Broadway, and therefore owed a bargaining obligation to Local 25.²⁰

On the other hand, in F & A Food Sales, supra, the Board found successorship principles inapplicable where an employer resumed performing work that had been subcontracted for a relatively shorter time period and where the employer had previously dealt with the union regarding the employees' terms and conditions of employment. The employer (F & A) had closed its transportation department and subcontracted the work of its drivers and helpers, with the union's acquiescence, during the term of a collective-bargaining agreement that specifically included drivers and helpers, among others, in the unit description.²¹ About 18 months later, still during the term of the collective-bargaining agreement, the subcontractor cancelled its relationship with F & A. F & A then reinstated its transportation department and hired the drivers and helpers that had been employed by the

¹⁹ Local 3 disclaimed representation of the installation employees and service technicians upon their employment with Cablevision.

²⁰ Cablevision Systems Development Co., 251 NLRB at 1325-26. See also Saks Fifth Avenue, 247 NLRB at 1050-51. There, an employer that ended a long-term subcontract of alterations work and then began performing its own alterations work using most of the contractor's alterations employees was treated as a successor. The employer had subcontracted the work for an unspecified period, perhaps as many as 25 years, and it is unclear whether Saks itself had ever previously performed that work.

²¹ During the subcontract, the employer continued to recognize the union and apply the collective-bargaining agreement to the remainder of the bargaining unit.

subcontractor.²² Under these circumstances, F & A clearly was not "new" to the union or employees involved. Accordingly, the ALJ declined to apply successorship principles to F & A, distinguishing Cablevision and noting the "existence of the unit certification" and "contract coverage during the course of events in this case."²³ The Board adopted the ALJ's decision, finding that F & A was obligated to recognize the union, apply the existing contract, and make employees whole for loss of pay and benefits, where both the subcontracting and recapture of the driver and helper work occurred during the effective period of a single collective-bargaining agreement.²⁴ On enforcement, the 10th Circuit found that F & A simply "returned to its status as original employer after a short hiatus, agreed to by the Union, with no substantial changes in the original employment relationship."²⁵ F & A's bargaining obligation with respect to the drivers and helpers essentially reverted to its pre-subcontract status.²⁶

We conclude that successorship principles should not limit the Employer's bargaining obligation because the Employer is not truly a "new employer," and that its bargaining obligation should instead revert to its pre-Imperial status with the Union. In this respect, the instant case is distinguishable from Cablevision and Saks Fifth Avenue, and is more analogous to F & A Food Sales. Thus, unlike Cablevision and Saks, the Union and Employer had a collective-bargaining relationship before the Employer transferred operations to Imperial. When the

²² Only three of about twenty drivers and helpers hired by the employer after the subcontract ended had been employed by F & A before the subcontract.

²³ F & A Food Sales, 325 NLRB at 520.

²⁴ Id. at 513.

²⁵ 202 F.3d at 1262.

²⁶ We also note that the Board has found a new company to be the alter ego of an old company, and required it to apply the terms of the old company's contract, notwithstanding that the new company purchased the assets from an intervening assignee for the benefit of creditors. Cf. Marquis Printing Corp., 213 NLRB 394, 401 (1974). This supports the proposition that an intervening third party does not necessarily extinguish the original party's full bargaining obligations when it reassumes control of the business.

Employer decided to retake the restaurant a mere five months later, the Employer was re-establishing a connection with the facility, the Union, the employees, and the employees' terms and conditions of employment, which it had negotiated. The Employer was not, as envisioned in Burns, "new" to the Union, the employees, or the restaurant. As in F & A Food Sales, the Employer's bargaining obligation should be based on the Employer's status vis a vis the Union before Imperial began running the restaurant.²⁷

Our conclusion that the Employer's bargaining obligation should be based on its initial bargaining relationship with the Union, rather than on a successorship theory, is underscored by the fact that the IOA appears to have been legally ineffective. Both the Second Amended Plan of Reorganization and the Interim Operating Agreement condition the IOA's effectiveness upon bankruptcy court approval.²⁸ However, there is no evidence that the Employer even sought bankruptcy court approval of the IOA, much less obtained it. Therefore, as a legal matter, it appears that the IOA never became operative, notwithstanding that Imperial in fact ran the restaurant for five months before the Employer retook the restaurant against Imperial's will. All of the significant events in this case - the transfer of control to Imperial, the apparent failure to seek bankruptcy court approval, the resumption of control by the Employer, the repudiation of the Union - occurred completely within the Employer's discretion and control.

²⁷ We recognize that this case differs factually from F & A Food Sales in some respects. Significantly, F & A continued to deal with the union throughout the entire subcontract term with respect to the unit employees whose positions were not subcontracted. In other respects, however, the "pre-existing connection" principle is stronger in the instant case, diminishing the significance of the above distinction. Here, the Employer determined whether, when, and how to recapture control over the restaurant. In F & A Food Sales, on the other hand, the subcontractor cancelled the subcontract, in effect forcing F & A's hand. Further, here, the Employer knew the specific employees at the restaurant. In contrast, F & A had previously employed only three of the twenty employees it hired after the subcontract was cancelled. Finally, Imperial only ran the restaurant for five months before the Employer resumed control, a significantly shorter period than the eighteen-month subcontract in F & A Food Sales.

²⁸ See 11 U.S.C. § 1142(a) (debtor is under duty to carry out plan of reorganization and comply with orders of bankruptcy court).

This is not the kind of business transfer that was envisioned when the Burns privilege was established. Accordingly, the Employer was not free to unilaterally set terms and conditions of employment upon retaking control of the restaurant, and is liable for the unilateral changes it made within the 10(b) period.

We would reject any argument that successorship principles must apply here based on Board cases where a prospective purchaser or lessee, which ran a business during an interim period pending finalization of the sale or lease, was found to have become a successor during the interim operation.²⁹ In those cases, the purchaser's ultimate status as the successor employer was a given, and the analysis focused on whether its successor obligations began during the interim period or after the transaction was finalized. It was a matter of when, not whether, successorship principles should apply. This case, however, does not concern the bargaining obligation of an interim employer that ultimately continued as the employer after the sale was finalized. Here, the sale was never finalized, and even the IOA appears to have been ineffective. Accordingly, the analysis in East Belden Corp., and its progeny, *supra*, is inapplicable here.

C. Imperial was not an agent of the Employer.

We would not base any theory of liability on a claim that Imperial was the Employer's agent while Imperial ran the restaurant from November 2003 to March 2004. Imperial president Sarwar states that during this period he was "solely in charge of everything," and the terms of the IOA

²⁹ Cf. East Belden Corp., 239 NLRB 776, 791-92 (1978), *enfd.* mem. 634 F.2d 635 (9th Cir. 1980) (purchaser of restaurant and bar deemed successor at time it took over operations, during escrow period, even though it did not take legal title for almost two months); Sorrento Hotel, 266 NLRB 350, 356-58 (1983) (prospective long-term lessee that operated hotel under interim management agreement pending conclusion of lease negotiations had successor obligation during interim period); Golden Cross Health Care of Fresno, 314 NLRB 1201, 1205-06 (1994), *review denied* 87 F.3d 1318 (9th Cir. 1996) (nursing home operator was successor during interim period even though agreement to take over facility was contingent upon obtaining state license). Compare Fremont Ford, 289 NLRB 1290, 1293-94 (1988) (manager of car dealership did not have successor obligations during period when steps were being taken to accomplish ultimate transfer of business; only gained successor status after purchase finalized).

and APA indicate that Imperial was to operate the restaurant on its own account and for its own benefit. Based on the evidence before us, Imperial did not operate the restaurant on behalf of the Employer as its "managing agent."³⁰

CONCLUSION

In summary, the Region should argue that successorship principles do not limit the Employer's bargaining obligation in this case; rather, its duty to bargain is based on its initial, pre-Imperial relationship with the Union. The Employer is liable under 8(a)(5) for failing to recognize and bargain with the Union and for the unilateral changes it made to the established terms and conditions of employment within the 10(b) period. In any event, the Employer satisfies the criteria for Burns successorship, so, at the very least, it was obligated to recognize and bargain with the Union.

B.J.K.

³⁰ We note that the Union has not claimed that the Employer is responsible for Imperial's unilateral changes.