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When Can an Employee Sue for the Bad Faith Failure to Pay Benefits Provided by a Collective Bargaining Agreement?

by Jay E. Grenig

Allis-Chalmers Corporation

v.

Roderick S. Lueck
(Docket No. 83-1748)

Argued January 16, 1985

The comprehensive regulation of industrial relations by Congress has given rise to difficult problems of federal-state relations. The task of accommodating the imperatives of the federal scheme with the diverse and particular local needs of the states has generally been left to the courts. Here, the Supreme Court is called upon to consider whether an employee can bypass the grievance arbitration procedure provided in a labor contract and bring an independent state tort action over an employer's alleged bad faith failure to pay a contractual disability benefit in a timely fashion. Its decision will have a significant affect on employees, employers and labor organizations throughout the country.

ISSUE

At issue in *Allis-Chalmers Corp. v. Lueck* is the extent to which the states may by applying their own laws, determine the legal consequences of conduct related to the breach of obligations arising out of a collective bargaining agreement. Specifically, this case involves the question of whether federal labor law prevents an employee from suing an employer in state court for the employer's alleged bad faith delay in making disability benefit payments provided by a collective bargaining agreement. It also questions whether an employee is required to go through the collective bargaining agreement's grievance procedure before bringing suit in state court.

FACTS

Roderick S. Lueck was employed by Allis-Chalmers. After suffering a nonwork-related back injury (while carrying a pig to a pig roaster at a friend's house), he applied for disability benefits. The health and disability plan was funded by Allis-Chalmers and administered by an insurance company. The disability plan was incorporated by reference in a collective bargaining agreement

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between Allis-Chalmers and the United Auto Workers. The agreement provided that questions regarding the disability plan were to be resolved in accordance with a three-step grievance procedure culminating in binding arbitration.

Although Lueck received payments under the disability plan, benefit payments were stopped for a portion of his disability period. Lueck sued Allis-Chalmers and the insurance company in state court, alleging that Allis-Chalmers and the insurer had intentionally, contemptuously and repeatedly stopped the disability payments. He sought \$10,000 in compensatory and \$300,000 in punitive damages. Lueck did not grieve or attempt to grieve the interruption of disability benefits.

Responding to the action Allis-Chalmers claimed that Lueck's claim was preempted by section 301 of the Federal Labor Management Relations Act, and that it was also barred because Lueck had not exhausted his contractual remedies before bringing suit. The trial court granted Allis-Chalmers' motion for a summary judgment and Lueck appealed. Relying on principles of state insurance law involving bad faith conduct by insurance carriers, the Wisconsin Supreme Court reversed the trial court. It held that any violation of the labor agreement was irrelevant to the issue of bad faith handling of Lueck's disability claim and that Lueck's complaint was not preempted by section 301.

BACKGROUND AND SIGNIFICANCE

The extent to which Congress has comprehensively regulated industrial relations and has thus displaced state laws has been a matter of frequent and recurring concern. In determining when state action must yield to federal authority, the Supreme Court generally considers the impact of the state action on the entire scheme of federal labor law.

Section 301 of the Federal Labor Management Relations Act provides that suits to enforce collective bargaining agreements may be brought in federal court. Interpreting section 301, the United States Supreme Court has held that state and federal courts deciding cases involving claims arising from a collective bargaining agreement must apply federal law derived from national labor policy. The federal labor policy was construed as being designed to promote stable and uniform labor relations and to encourage use of dispute resolution procedures.

Under this policy, employees wishing to assert claims covered by a contractual grievance procedure must attempt to use that procedure before resorting to the courts. Permitting individual employees to sidestep the grievance procedure would deprive the employer and union of the ability to establish a uniform and exclusive method for settling employee grievances in an orderly way.

If the Supreme Court rules in favor of Lueck, the decision would signal that employees have an avenue of redress in addition to or instead of the grievance procedure provided in a collective bargaining agreement. Employers and unions could be faced with litigating state court claims they thought would be resolved under the grievance procedure. Not only might this reduce the popularity of grievance arbitration provisions in industrial relations, but it would open the way for employees to recover substantial punitive damages from employers—a type of damages labor arbitrators rarely award. Such a decision, upholding the state supreme court, could also result in other state court rulings that employees covered by collective bargaining agreements also have a tort cause of action for wrongful discharge.

A reversal of the Wisconsin Supreme Court's decision could be seen as reemphasizing the federal labor policy that the desirable method for settling disputes arising under a collective bargaining agreement is the dispute resolution process agreed upon by the employer and the union.

ARGUMENTS

For Allis-Chalmers Corporation (Counsel of Record, Theophil C. Kammholz, 115 S. LaSalle Street, Chicago, IL, 60603; telephone (312) 781-2300)

1. Because both the employee's rights to disability benefits and remedies for infringing such rights are governed by a labor contract with a grievance procedure culminating in final and binding arbitration, the employee was required to exhaust labor contract remedies before bringing suit in state court.
2. State law cannot be an independent source of employee rights under collective bargaining agreements since to hold otherwise would undermine principles of uniformity and consistency which are cardinal to applying federal labor law.

For Roderick Lueck (Counsel of Record, Gerald S. Boisits, 606 W. Wisconsin Avenue, Suite 1906, Milwaukee, WI 53203; telephone (414) 277-0377)

1. An employee who seeks damages for the outrageous and reckless manner in which he was treated and not the recovery of disability benefits under a labor contract may sue in state court without exhausting remedies provided under the labor contract.
2. Because the employee's relationship with the employer was one of insured and insurer, the state was free to regulate this relationship.
3. The state has an overriding interest in allowing the employee's claim, as the state's interests are deeply rooted in local feelings and responsibility and not in the collective bargaining agreement.

AMICUS ARGUMENTS

In Support of Allis-Chalmers Corporation

The Chamber of Commerce of the United States filed an amicus brief in support of Allis-Chalmers, arguing that the action in this case was a section 301 claim since Lueck was entitled to disability benefits only by virtue of the negotiated contract. The Chamber of Commerce asserts that the national labor policy of peacefully resolving disputes through grievance arbitration procedures would be undermined if the state court's action were upheld.

The AFL-CIO also filed an amicus brief in support of Allis-Chalmers, asserting that, even if Lueck's action in state court were considered as a wrong independent of any contract breach, the tort action is preempted by federal law because of the state's attempt to regulate the legal consequences of the parties' signing a labor contract governed by section 301. Arguing that the Wisconsin tort of bad faith is merely a rule of extraordinary damages for willful breaches of insurance contracts, the AFL-CIO contends that under section 301, it is for federal law to determine the remedies available for breach of a collective bargaining agreement.

In Support of Roderick Lueck

The states of Wisconsin and Hawaii filed an amicus brief siding with Lueck. They assert Lueck's rights do not turn on a meaning or interpretation to be placed on a contract, but on common law tort rules imposing fiduciary obligations on insurers of disability pay claims. The states argue that the federal interest in controlling the dispute resolution relationship between an employer and union is peripheral to the state's interest in requiring a good faith disposition of undisputed matters involving individual employees.