BANKRUPTCY II

THE ACCOMMODATION OF THE BANKRUPTCY AND LABOR ACTS IN CHAPTER 11 REORGANIZATIONS

INTRODUCTION

This article addresses the issue of whether a trustee-in-bankruptcy under Chapter 11 of the Bankruptcy Reform Act of 1978 (Bankruptcy Code) may void or reject a collective bargaining agreement between a bankrupt employer and an employee union. Resolution of this issue requires an analysis of two very important, yet diverse, federal statutory schemes, the Bankruptcy Code and the National Labor Relations Act (NLRA).

The congressional policies behind these acts are particularly illustrative of the existing diversity. The Bankruptcy Reform Act, especially Chapter 11, is generally designed to restructure a financially troubled entity’s finances in order to preserve the continuing existence of the entity as well as preserve its employees’ jobs. The creditors hopefully will be able to recover more on the existing debts and society will receive benefits from the continued production of goods and services. In contrast, the NLRA was enacted in 1935 in order “to promote industrial peace by facilitating collective bargaining and to reduce the disparity in bargaining power between employers and employees.”

The relevant Bankruptcy Code sections pertaining to this issue are section 313(1) of the Bankruptcy Act of 1898, and sections 365 and 1167 of the Bankruptcy Reform Act of 1978, which super-

---

4. Bildisco, 682 F.2d at 77.
5. Id.
   Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties conferred and imposed upon it by this chapter—
   (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate.
8. 11 U.S.C. § 365 (Supp. V 1981) (allowing a trustee, with court approval, to assume or reject debtor’s executory contracts); id. at § 1167: “Notwithstanding section 365 of this title; neither the court nor the trustee may change the wages or working conditions of employees of the debtor established by a collective bargain-
sedes section 313(1). The NLRA section in apparent conflict with the Bankruptcy Code is section 8(d), which limits the power to change a collective bargaining agreement.

Although the issue of whether a trustee-in-bankruptcy may void a collective bargaining agreement has yet to appear before the Eighth Circuit Court of Appeals, it has been ruled upon in the Second, Third, and Ninth Circuits, as well as numerous district courts. Since more than 20,000 businesses are presently attempting to reorganize under the bankruptcy law, and with this number expected to increase, this issue may be expected to come before the Eighth Circuit in the near future. In anticipation of such a case, this article traces the approaches and conclusions of other courts addressing the issue, both prior and subsequent to the Bankruptcy Reform Act of 1978. This article also suggests possible approaches that the court may consider when confronted with this issue as a matter of first impression.

BACKGROUND

"Collective bargaining agreements are unique in character and a field unto themselves." These agreements have been described by judicial opinion and treatises as sui generis and necessitating unique treatment. In addition, the United States Supreme Court views a collective bargaining agreement as "more than a contract; it is a generalized code to govern a myriad of cases which the

9. National Labor Relations Act § 8(d), 29 U.S.C. § 158(d) (1976). NLRA § 8(d) requires a party seeking to change a collective bargaining agreement to:

1. serve written notice of such a change to the other party sixty days before the termination of the contract,
2. offer to meet and confer with the other party to negotiate any changes or a new contract,
3. notify Federal and/or State mediation within 30 days of termination if no agreement is reached,
4. recognize existing contract as in effect until sixty days has expired or the contract has terminated.

draftsmen cannot wholly anticipate."\(^{14}\) The Court also views bargaining agreements as efforts to erect a system of industrial self government.\(^{15}\)

Courts recognize the sanctity of bargaining agreements, in comparison to typical commercial contracts, due to the nature of the agreements and the policies behind the NLRA.\(^{16}\) As the end result of bargaining between company and employee representatives, collective bargaining agreements are more akin to trade agreements.\(^{17}\) Labor contracts differ from commercial contracts in that they primarily affect the rights of third parties, i.e., employees.\(^{18}\) Labor agreements, rather than contemplating a single momentary transaction, govern relationships extending contractually up to three years\(^{19}\) and may expect to continue in the same or modified form beyond the initial contract period.\(^{20}\) Labor contracts also differ in regard to interpretation and scope as such contracts are not limited to what appears in print on the face of the document. Rather, such contracts are often viewed as incorporating trade or industry customs and informal agreements and concessions made during the bargaining process which are not included in the final formal agreement.\(^{21}\)

For the past fifty years the Bankruptcy Code "has contained provisions authorizing assumption or rejection of executory contracts..."\(^{22}\) Today, section 365 allows a trustee to assume or reject a debtor's executory contracts upon the approval of the court.\(^{23}\)

Because of the special treatment afforded collective bargain-

---


\(^{15}\) Id. at 580.


\(^{17}\) J.I. Case Co. v. NLRB, 321 U.S. 332, 335 (1944).


\(^{19}\) The National Labor Relations Board has adopted contract bar rules precluding elections among employees currently under a valid collective bargaining agreement. The contract, to operate as a bar, must be in writing and remain in effect for no longer than three years. This three year period allows employees to reevaluate the union periodically and make a change if unsatisfied. It also gives the union time to perform without fighting elections from other unions. See 35 NLRB ANN. REP. 32 (1970).

\(^{20}\) R. Gorman, supra note 18, at 540.

\(^{21}\) Id.


\(^{23}\) See note 8, supra.
ing agreements by the courts, as well as the differences between typical commercial contracts and labor contracts, unions and the NLRB have argued that collective bargaining agreements are not the type of executory contract Congress intended to be rejectable under the Bankruptcy Code.\(^\text{24}\) The courts, however, have consistently held collective bargaining agreements to be executory agreements, i.e., contracts not yet fully completed or performed,\(^\text{25}\) and therefore rejectable under the Bankruptcy Code.\(^\text{26}\)

Pre-\textit{Kevin Steel} and -\textit{REA Express}

Executory contracts are those which are yet to be fully completed or performed. However, it has been argued that all contracts can be said to be executory in some sense.\(^\text{27}\) Professor Countryman argues that executory contracts in bankruptcy must be defined in relation to the purpose for which the trustee-in-bankruptcy may assume or reject the contract. The option is to be exercised in order to benefit the debtor's estate and should not be used or abused for the purpose of prejudicing other creditors of the estate.\(^\text{28}\)

Prior to 1975, when the Second Circuit decided \textit{Shopmen's Local 455 v. Kevin Steel Products, Inc.}\(^\text{29}\) and \textit{Brotherhood of Railway, Etc. v. REA Express, Inc.,}\(^\text{30}\) it was generally accepted that courts could reject collective bargaining agreements upon application of the trustee-in-bankruptcy under section 313(1) of the previous Bankruptcy Code.\(^\text{31}\) This general rule was based upon many prior decisions in the federal courts.\(^\text{32}\)

In one of the early decisions, \textit{In re Mamie Conti Gowns, Inc.},\(^\text{33}\) the United States District Court for the Southern District of New York refused to void a bargaining agreement between the debtor, a

\(^{24}.\) \textit{Shopmen's Local 455 v. Kevin Steel Products, Inc.}, 519 F.2d 698, 702-03 (2d Cir. 1975).

\(^{25}.\) \textit{BLACK'S LAW DICTIONARY} 512 (5th ed. 1979).


\(^{27}.\) 3A \textit{COLLIER ON BANKRUPTCY} ¶ 63.33(2) (14th Ed. 1971).

\(^{28}.\) Countryman, \textit{supra} note 22, at 439, 450-51.

\(^{29}.\) 519 F.2d 698 (2d Cir. 1975).

\(^{30}.\) 523 F.2d 164 (2d Cir.) \textit{cert. denied}, 423 U.S. 1017 (1975).


\(^{32}.\) Id. "Federal district courts have consistently affirmed the power of the trustee or referee to set aside bargaining agreements as executory contracts..." \textit{Id.} \textit{See also} Carpenters Local Union No. 2746 v. Turney Wood Products, Inc., 289 F. Supp. 143 (W.D. Ark. 1968) (the court allowed rejection of executory contracts, which include collective bargaining agreements); \textit{In re Klaber Brothers, Inc.}, 173 F. Supp. 83, 85 (S.D.N.Y. 1959) (the court allowed rejection upon showing benefit to the estate).

dress manufacturer, and its employees' unions. The court based its decision on the manufacturer's disproportionate amount of assets over liabilities, and the manufacturer's failure to persuade the court that the procedure was not instigated merely in an attempt to discard the particular union contract. The court, although refusing to void the labor contract, did not find such contracts to be nonvoidable under all circumstances.

Almost twenty-five years later, in In re Klaber Brothers, Inc., the same court agreed with the referee's findings that a bankruptcy trustee could reject a collective bargaining contract with a union, since "[t]he Bankruptcy Act makes no distinction among classes of executory contracts." The court's test for rejection in Klaber appeared to overrule the limitation evidenced by its earlier holding in Mamie Conti Gowns. Klaber allowed rejection of a contract when rejection would be to the advantage of the estate or, stated in the alternative, when preservation of the contract would be detrimental to the estate. After the 1959 decision in Klaber, and until the Second Circuit's holdings in Kevin Steel and REA Express, federal courts continued to recognize the power of the trustee-in-bankruptcy to disaffirm executory collective bargaining agreements.

**The Second Circuit's Approach**

In 1975, the issue of rejection of a collective bargaining agreement under section 313(1) of the previous Bankruptcy Code came before the Second Circuit for the first time in the case of Kevin Steel. After filing for a Chapter 11 reorganization, Kevin

---

34. Id. at 480.
35. Id. at 479-80 (the manufacturer showed assets of $63,390.39 compared with liabilities of $31,063.11).
36. Id. at 480.
37. Id. at 479-80. See Note, Hotel Circle, supra note 16, at 315 n.33 (although rejection was not allowed in Mamie Conti Gowns, the court implicitly recognized the debtors right of rejection).
39. Id. at 85 (the court stated further: "I likewise conclude that there should be no differentiation in the treatment of executory employment or collective bargaining contracts as to termination under the circumstances of this case."). Id.
40. Id. In Klaber, the court allowed rejection where there is a benefit to the estate. Id. at 85. Whereas previously, in Mamie Conti Gowns, rejection was not allowed due to improper notice on the part of the debtor. 12 F. Supp. at 480.
41. 173 F. Supp. at 85.
42. 519 F.2d 698 (2d Cir. 1975).
43. 523 F.2d 164 (2d Cir. 1975).
44. See note 32, supra.
45. See note 7, supra.
46. 519 F.2d 698 (2d Cir. 1975).
Steel, as debtor-in-possession (debtor), sought to reject its collective bargaining agreement with the employee union, arguing that it was an onerous and executory contract. Although the bankruptcy judge allowed the rejection, his decision was reversed on appeal to the district court. Kevin Steel appealed the district court’s decision to the Second Circuit, which concluded that “section 313(1) of the Bankruptcy Act does permit rejection of a labor agreement.”

The debtor posed three major arguments before the Second Circuit in favor of allowing rejection of the collective bargaining agreement. The first argument in favor of rejection referred to the leading text on the subject and stated that the language of section 313(1) contains “no restriction on the type of executory contract that may be rejected.” The second argument posed by the debtor cited federal court precedent supporting the proposition that collective bargaining agreements are among the types of executory contracts rejectable under section 313(1) of the Bankruptcy Act. The final argument posed by the debtor, closely related to its first argument, was premised on the fact that “Congress certainly knew how to carve labor agreements out of a general grant of power to reject executory contracts.” Kevin Steel argued that had Congress intended to exempt bargaining agreements under section 313(1), it could have done so by express language. Absence of such an express exemption led to the conclusion that no such congressional intent existed.

The union and the NLRB countered with arguments that were

47. Id. at 700.
48. 28 U.S.C. § 1334 (Supp. IV 1980) and FED. R. BANKR. P. 801 allow appeal from a judgement or order of a bankruptcy court to a district court.
49. 519 F.2d at 706.
50. Id. at 701.
51. Id. See Carpenters Local Union No. 2746 v. Turney Wood Products, Inc., 289 F. Supp. 143, 150 (W.D. Ark. 1968). In this case, the Union brought an action seeking to compel specific performance of the labor contract and to review the referee’s order allowing for rejection. The court dismissed the claims and stated, “[s]ection 313 of the Bankruptcy Act allows the Court . . . under Chapter XI to permit the rejection of executory contracts. . . . It has been held that this power extends to a collective bargaining contract.” Id. See also In re Overseas Nat’l Airways, Inc., 238 F. Supp. 359, 367-62 (E.D.N.Y. 1965) (although refusing to allow rejection, the court agreed that under the proper circumstances collective bargaining agreements were rejectable under 313(1)); In re Klaber Brothers, Inc. 173 F. Supp. 83, 85 (S.D.N.Y. 1959) (rejecting a collective bargaining agreement under 313(1) as a burden to the estate).
52. 519 F.2d at 701.
53. Id. at 702.
54. “[S]ection 77(N) of the Bankruptcy Act . . . specifically prohibits a bankruptcy court or trustee from changing wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act. . . . The failure
successful in the district court but were subsequently rejected by the Second Circuit. The NLRB and the union contended that the precedent cited by the debtor were few, and their value questionable, since the issue had previously never appeared before the circuit courts of appeal.\footnote{Id. at 702-03.} Although the court acknowledged that it was not bound by the precedent, it refused to dismiss it as irrelevant.\footnote{Id. at 704.} Nevertheless, the union further contended that the debtor's interpretation of section 313(1) was erroneous because it failed to take into account the unavoidable conflict with sections 8(a)(5) and 8(d) of the NLRA.\footnote{See National Labor Relations Act § 8(a)(5), 29 U.S.C. § 158(a)(5) (1976) (making a company's refusal to bargain collectively with the representative of its employees an unfair labor practice). See also \textit{id.} at § 8(d), 29 U.S.C. § 158(d) (1976); note 9 supra.} Such an interpretation, argued the union, would mean "a company can accomplish indirectly what it could not do directly without violating the Labor Act. . .."\footnote{519 F.2d at 702.} The union coupled this argument with policy arguments and the theory that, because of the unique nature of labor agreements, Congress would not have considered these contracts rejectable in the same degree and manner as executory commercial contracts.\footnote{Id. at 703 ("Any other ruling, they say, encourages the use of bankruptcy as a refuge for businesses that would prefer to operate free of union contracts. Furthermore, permitting rejection . . . impairs industrial peace. . ..").}

The Second Circuit, in holding that section 313(1) permitted rejection of labor contracts, dismissed the union's contention that 313(1) must give way to sections 8(a)(5) and 8(d).\footnote{Id. at 704.} The court felt the argument disappeared upon analysis since it failed to consider the nature of a bankruptcy proceeding.\footnote{Id. at 703.} "In a Chapter X or XI proceeding, which is designed to preserve a going business, only a hardy—some might say foolhardy—employer would provoke a strike by trying to terminate an existing labor contract."\footnote{Id. at 704.}

In interpreting the statute to avoid conflict, the court determined that a debtor-in-possession is a different judicial entity than the pre-bankruptcy company and, therefore, is neither a party to the contract nor in violation of section 8(d). To become a party subject to 8(d), the debtor must either assume or accept the contract.\footnote{See also Local Joint Executive Board v. Hotel Circle, Inc., 613 F.2d 210, 216 (9th Cir. 1980) (required permission of the bankruptcy court to assume}
In addressing the union's argument that Congress never intended section 313(1) to apply to labor agreements—the so called legislative oversight argument—the court found this argument attributed too much to congressional silence. The court stated further that it could not be assumed that whatever Congress intended to apply to railroad employees, i.e., section 77(N), was meant to apply to all employees. Section 77(N) specifically prohibited a bankruptcy court or trustee from changing the working conditions of railroad employees except as provided by the RLA. Because Congress omitted such a requirement from section 313(1), it could be argued that Congress had manifested a clear intention to include labor contracts among those contracts rejectable under section 313(1). “Both the Bankruptcy Act and the Labor Act, particularly the latter, have been subject to close scrutiny and amendments, and despite numerous opportunities to change either or both acts with regard to the question before us, Congress has not done so.” Even if the situation could be explained by oversight, “[t]he remedy for any such ‘oversight,’ affecting two very important statutes, rests with the legislature.”

The major significance of the Second Circuit's holding in *Kevin Steel* was its assertion that although section 313(1) allowed rejection of labor contracts, this rejection was not to be based solely on the financial benefit to the debtor. The court, in the interest of accommodating the two acts, determined that disaffirmance should be allowed “only after thorough scrutiny, and a careful balancing of the equities on both sides.”

One month later, the Second Circuit once again faced the issue of rejection in *REA Express*. As in *Kevin Steel*, the debtor, REA Express, attempted to avoid its collective bargaining agreement with the employee union. However, the case differed from *Kevin
Steel in that the Railway Labor Act (RLA)\(^73\) was involved rather than the NLRA.\(^74\) The union argued that the literal applications of sections 1, 2 and 6\(^75\) of the RLA operated to prevent disaffirmance of labor contracts.\(^76\) Section 2 prevents carriers, defined in section 1 as including receivers or trustees in the possession of any carriers, from unilaterally changing certain conditions embodied in the labor contract unless provided for in the contract itself or under section 6 of the RLA.\(^77\) Section 6 requires a carrier to give thirty days written notice, and to attend meetings with the union to discuss any allowed unilateral changes.\(^78\) In an argument similar to that utilized in Kevin Steel, the union in REA Express stressed the policies behind the RLA as precluding a finding that labor contracts may be subject to disaffirmance.\(^79\)

In its REA Express decision, the Second Circuit concluded that section 313(1) allowed the rejection of labor contracts governed by the RLA,\(^80\) and remanded the case to determine whether the labor agreement was sufficiently onerous and burdensome to justify rejection.\(^81\) In attempting to accommodate the RLA and the Bankruptcy Code, the court stated:

To hold that the RLA precludes rejection under such circumstances [onerous and burdensome contracts] would ultimately be to defeat the purpose of the RLA itself, which is to avoid disruption of commerce by insuring that the carrier will continue operations pending resolution of labor disputes, since the end result could well be to preclude financial reorganization of the carrier and thus lead to its demise.\(^82\)

Again, as in Kevin Steel, the court viewed the trustee-in-bankruptcy as a new employer, analogous to a successor employer, not required to abide by section 6 of the RLA and not required to keep the status quo in regard to the old contract.\(^83\) The court in REA Express reasoned that if a trustee was restricted from promptly discharging onerous employment terms, the continuing existence

\(^74\) 523 F.2d at 168.
\(^75\) Railway Labor Act §§ 1, 2, 6, 45 U.S.C. §§ 151, 152, 156 (1976).
\(^76\) 523 F.2d at 168.
\(^77\) See note 75 supra.
\(^78\) Id.
\(^79\) 523 F.2d at 168. Compare Kevin Steel, 519 F.2d at 703. Both cases contained arguments based on the policies behind the relevant Acts: the RLA in REA Express, and the NLRA in Kevin Steel.
\(^80\) 523 F.2d at 169.
\(^81\) Id. at 172.
\(^82\) Id. at 169.
\(^83\) Id. at 170. See Kevin Steel, 519 F.2d at 704.
of the company itself, as well as the employees' jobs, may be placed in jeopardy.\textsuperscript{84}

The court reiterated the caution it gave in \textit{Kevin Steel} for dealing with the possible rejection of labor contracts. Bargaining agreements should be sufficiently onerous and burdensome, and the equities should tip in favor of rejection before allowing disaffirmance.\textsuperscript{85} The court added that due to the serious effects of disaffirmance upon the employees,\textsuperscript{86} it should not be used unless it clearly appears to be the lesser of two evils, and financial collapse of the employer with the employees' resultant loss of jobs is imminent.\textsuperscript{87}

\textbf{The Approach of Other Circuits}

The Second Circuit's caution when considering disaffirmance of collective bargaining agreements has been recognized and followed by other courts.\textsuperscript{88} These courts have applied the same or a substantially similar test.\textsuperscript{89} For example, a Michigan federal district court, in \textit{In re Allied Supermarkets},\textsuperscript{90} held that the test to be applied in \textit{Kevin Steel} and \textit{REA Express} bargaining agreement avoidance disputes is whether the contract is sufficiently onerous and burdensome and whether the equities favor rejection by the debtor.\textsuperscript{91} As argued by the union, disaffirmance of bargaining agreements should only occur upon the debtor's showing that inability to reject would not allow the company to survive.\textsuperscript{92} However, a further argument was made: while balancing the equities, the interest of fellow employers in a multi-employer bargaining

\begin{footnotesize}
\begin{itemize}
    \item \textsuperscript{84} 523 F.2d at 170-71.
    \item \textsuperscript{85} Id. at 166.
    \item \textsuperscript{86} See note 65 and accompanying text \textit{supra}.
    \item \textsuperscript{87} 523 F.2d at 172.
    \item \textsuperscript{88} \textit{In re Allied Supermarkets}, 6 Bankr. 968, 971 (E.D. Mich. 1980) (the court refused to apply a test requiring disaffirmance to be merely advantageous to the debtor and instead required a balancing test prescribed by the \textit{Kevin Steel} and \textit{REA Express} cases); \textit{In re Alan Wood Steel Co.}, 449 F. Supp. 165, 169 (E.D. Pa. 1978) (first the court determines whether the contract is onerous and burdensome, and second determines whether the equities balance in favor of the debtor for rejection to occur); \textit{In re Penn Fruit Co.}, 92 LRRM 3548, 3548 (E.D. Pa. 1976) (approval of rejection of a collective bargaining agreement may occur if the contract is onerous and burdensome, and the equities favor the rejection of the agreement).
    \item \textsuperscript{89} \textit{Allied Supermarkets}, 6 Bankr. at 971; \textit{Alan Wood Steel}, 449 F. Supp. at 169; \textit{Penn Fruit}, 92 LRRM at 3548. See text at note 83 \textit{supra}.
    \item \textsuperscript{90} 6 Bankr. 968 (E.D. Mich. 1980). This case differs from those previously cited in that the union was not contesting the company's changes. Rather, other members of the company's multi-employer bargaining group were seeking to prevent disaffirmance of the bargaining agreement. Id. at 971.
    \item \textsuperscript{91} Id.
    \item \textsuperscript{92} Id. at 979.
\end{itemize}
\end{footnotesize}
In response, the district court found that a debtor is "required under the cases to prove that, absent a rejection of the collective bargaining agreement, its business would fail. The debtor is not required to guarantee to the Bankruptcy Court that following its rejection of the contracts, its business would be successful."94 The court, agreeing with the original finding of the bankruptcy court, questioned the necessity of applying the stricter Kevin Steel test with respect to the interests of the other employers since no employer-employee relationship existed between those parties and the debtor.95 The court felt that rejection of the agreement is justified where it would benefit the debtor.96 However, assuming the stricter test was necessary, it would be difficult to conceive of a situation in which much weight could be afforded to the interests of the multi-employer group when compared with the rights of the debtor and its employees.97

The reasoning behind the Second Circuit's stricter test, i.e., one requiring a showing of onerous terms and a balancing of the equities, is to recognize the importance of the NLRA and to alleviate a union's fear of company reorganization as a tactic to rid itself of an undesirable contract or union.98 Courts have used evidence of good faith in balancing the equities to determine whether a particular contract may be rejected.99 In In re Alan Wood Steel,100 the bankruptcy judge applied the Kevin Steel test, found it satisfied, and allowed disaffirmance of the labor contract.101 The district court, in affirming the decision, found two crucial factors present. First, the court found that the company had negotiated, bargained and otherwise dealt with the union in good faith and with a desire

93. Id. at 980.
94. Id. at 979-80.
95. Id. at 977.
96. Id. at 971.
97. Id. at 980.
98. Kevin Steel, 519 F.2d at 707.
99. See In re Ryan, 83 LAB. L. REP. ¶ 10,487 (CCH) (D. Conn. 1978) (originally filed as a Chapter X involuntary bankruptcy proceeding before becoming a Chapter XI, the court found the involuntary nature of the proceeding useful in determining that the procedure was not for the express purpose of ridding the debtor of an unwanted contract or union); Bohack Corp. v. Truck Drivers Local Union No. 807, 431 F. Supp. 646, 651 (E.D.N.Y. 1977) (The court allowed rejection after finding that the company was not motivated by a desire to be rid of the union. The company had attempted to negotiate agreements with other businesses to find work for the union); In re Mami Conti Gowns, 12 F. Supp. 478, 480 (S.D.N.Y. 1935) (although before Kevin Steel, the court refused rejection on the suspicion that the proceeding was more interested in ridding itself of the contract rather than reorganization).
101. Id. at 169.
to reach an agreement. No improper motivation was discovered on behalf of the debtor in its attempt at rejection.\textsuperscript{102} The second factor considered the employees' opportunities to recover their jobs.\textsuperscript{103} Alan Wood Steel had halted manufacturing operations with no possibility of recall. As a result, the court held that the payment of benefits to employees in this situation would have the effect of prejudicing unsecured creditors.\textsuperscript{104}

In 1980, the Ninth Circuit Court of Appeals, in \textit{Local Joint Executive Board v. Hotel Circle, Inc.},\textsuperscript{105} in construing the previous Bankruptcy Act, affirmed the rejection of a labor contract in order to facilitate the sale of the business.\textsuperscript{106} In \textit{Hotel Circle}, many of the same arguments were made as had been made previously in \textit{Kevin Steel}, with the Ninth Circuit generally agreeing with the Second Circuit's analysis of those arguments.\textsuperscript{107} However, the district court had stated "[t]he court should exercise its power to reject an executory contract where rejection is to the advantage of the estate. . .."\textsuperscript{108} This test failed to accommodate the Bankruptcy Code with the NLRA and RLA to the same extent as the \textit{Kevin Steel} test.\textsuperscript{109} However, the Ninth Circuit apparently considered the scrutiny required by the Second Circuit.\textsuperscript{110} Failure to employ such scrutiny may encourage reorganizations by employers simply to rid themselves of a union.\textsuperscript{111} At the very least, companies seeking rejection will have an easier task if they are merely required to show an advantage to the estate. The Ninth Circuit's failure to expressly mention any requirements, \textit{i.e.}, balancing the equities or application of a higher standard, may well lead to uncertainty and confusion in the future.\textsuperscript{112}

\textit{Hotel Circle} also established a test for determining whether a trustee has assumed a collective bargaining agreement, therefore becoming subject to section 8(d) of the NLRA.\textsuperscript{113} According to the Ninth Circuit, assumption may only occur through the express ap-

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} at 169-70.
\item \textit{Id.} at 170.
\item \textit{Id.}
\item 613 F.2d 210 (9th Cir. 1980).
\item \textit{Id.} at 219.
\item \textit{Id.} at 212-14.
\item \textit{Local Joint Executive Board v. Hotel Circle, Inc.}, 419 F. Supp. 778, 786 (S.D. Cal. 1976). \textit{Compare In re Klaber Bros.}, 173 F. Supp. at 85 (rejection allowed upon a showing of benefit to the estate).
\item \textit{See Kevin Steel}, 519 F.2d at 707.
\item \textit{See Note, Hotel Circle, supra note 16, at 321.}
\item 519 F.2d at 703. The court felt that such an argument is without merit due to the nature of a bankruptcy proceeding. \textit{Id.}
\item \textit{See Note, Hotel Circle, supra note 16, at 321.}
\item \textit{See text at note 63 supra.}
\end{enumerate}
\end{footnotesize}
proval of the court.\textsuperscript{114} The approach of the Ninth Circuit in considering assumption of labor contracts has been incorporated in section 365 of the Bankruptcy Reform Act of 1978, which now requires the approval of bankruptcy courts for either rejection or affirmance of labor contracts.\textsuperscript{115}

\textit{Partial Rejection}

A trustee may assume or reject a contract in toto. However, partial rejection or partial affirmation of a collective bargaining agreement is not a recognized option for a trustee. As stated by the Third Circuit in \textit{In re Italian Cook Oil Co.},\textsuperscript{116} "[t]he trustee, however, may not blow hot and cold. If he accepts the contract he accepts it \textit{cum onere}. If he receives the benefits he must adopt the burdens. He cannot accept one and reject the other."\textsuperscript{117} Generally, the purpose behind the policy disallowing partial rejection is to prevent debtors from extracting unfavorable terms from labor contracts while preserving favorable ones.\textsuperscript{118} Nevertheless, arguments can be made that partial rejection would be beneficial and hence should be allowed. In appropriate situations, onerous provisions may be removed without affecting other terms which are important to the employee, do not work undue financial strain on the debtor, and leave seniority and other benefits intact.\textsuperscript{119} Such an approach may tend to encourage unions to cooperate in the bankruptcy process, rather than oppose the debtor.\textsuperscript{120}

\textit{Effects of the Bankruptcy Reform Act}

In 1978, the Bankruptcy Reform Act was enacted, with sections 365 and 1167\textsuperscript{121} superseding section 313(1). In spite of this change, the Bankruptcy Reform Act did not render previous precedent based on old section 313(1) obsolete. In 1981, in \textit{In re David A. Rosow, Inc.},\textsuperscript{122} a bankruptcy judge was faced with the issues of whether the Reform Act made prior law arising under section 313(1) irrelevant, and whether a new method of determining rejec-

\begin{footnotesize}
\textsuperscript{114} 613 F.2d at 215-16.
\textsuperscript{116} 190 F.2d 994 (3rd Cir. 1951).
\textsuperscript{117} \textit{Id}. at 997. \textit{See also} \textit{8 Collier on Bankruptcy} ¶ 3.1517 (14th ed. 1978).
\textsuperscript{119} \textit{Id}. at 403-04.
\textsuperscript{120} \textit{Id}. The NLRA was enacted to promote industrial peace and aid the seemingly powerless industrial employee in joining together with fellow employees to become a stronger unit upon more equal grounds with the employer. \textit{Id}.
\textsuperscript{121} \textit{See} \textit{note 8 supra}.
\textsuperscript{122} 9 Bankr. 190 (D. Conn. 1981).
\end{footnotesize}
tion of a collective bargaining agreement was in order.\textsuperscript{123} The debtor argued that the balancing test of the Second Circuit need not be applied. The debtor asserted that Congress, when drafting the Bankruptcy Reform Act, neglected to incorporate the tests of prior case law and therefore did not intend the same analysis to be used as under former section 313(1).\textsuperscript{124} This argument has received some support in \textit{Collier on Bankruptcy}, which states: "[a]lthough a mere showing that rejection would improve the financial condition of the debtor did not suffice under the Act, the result may be different under the Code due to the failure of Congress to incorporate a requirement of burdensomeness into section 365."\textsuperscript{125}

In its decision, the bankruptcy court rejected the debtor's argument and refused to allow rejection on the grounds that the debtor had failed to show that the contract was so burdensome that the company would be forced into liquidation.\textsuperscript{126} The court quoted from another part of \textit{Collier on Bankruptcy}, which stated "there is little if any reason to expect the courts to apply a less stringent standard to collective bargaining agreements under section 365"\textsuperscript{127} than under former section 313(1). The court relied further upon the discretion still vested in it under section 365 and its belief that congressional silence, coupled with its discretion, was insufficient to discard pre-Bankruptcy Reform Act analysis.\textsuperscript{128} Since the \textit{Rosow} decision, courts in general have continued to rely upon pre-Bankruptcy Reform Act analysis.

The only case to appear before the circuit courts since the passage of the Bankruptcy Reform Act has been \textit{In re Bildisco}.\textsuperscript{129} In \textit{Bildisco}, the Third Circuit decided that the Bankruptcy Reform Act, as did section 313(1) of the Bankruptcy Act, allows labor contracts no immunity from rejection.\textsuperscript{130} As a result, the court remanded the case for determination of whether the contract was

\textsuperscript{123} \textit{Id.} at 192.
\textsuperscript{124} \textit{Id.} at 191-92.
\textsuperscript{125} 2 \textit{COLLIER ON BANKRUPTCY} ¶ 365.03, at 365-68 (15th ed. 1982). \textit{See also}, H. Hughes, "Waivering Between the Profit and the Loss": Operating a Business During Reorganization Under Chapter XI of the New Bankruptcy Code, 54 \textit{AM. BANKR. L.J.} 45, 86 n.286 (1980) ("In view of the lack of special treatment given labor contracts in § 365 and the failure by Congress legislatively to overrule cases under the Bankruptcy Act giving bankruptcy policy more weight than labor law policy, such a holding under § 365 has a less solid basis than such a holding under the Bankruptcy Act.").
\textsuperscript{126} 9 Bankr. at 192-93.
\textsuperscript{127} \textit{Id.} at 192, \textit{quoting} 2 \textit{COLLIER, supra} note 125, at ¶ 365-17.
\textsuperscript{128} 9 Bankr. at 192.
\textsuperscript{129} 682 F.2d 72 (3d Cir. 1982).
\textsuperscript{130} \textit{Id.} at 78.
burdensome to the estate and if the equities favored rejection. Thus, the pre-Bankruptcy Reform Act considerations of burdensomeness, as well as a weighing of the equities, remain viable.

In Bildisco, the debtor argued for the allowance of rejection upon a mere showing of an advantage to the estate. The union countered that rejection is allowable only upon a showing that reorganization would be otherwise impossible and that the equities favor rejection. The test adopted by the Third Circuit asks the threshold question of whether the contract is burdensome. The court distinguished itself from the tests utilized in other circuits by not requiring a showing that survival would be impossible without rejection. This latter requirement had first been suggested in the Second Circuit's REA Express opinion. The Third Circuit relied on a less stringent test, feeling that the stricter test works to the detriment of employees. The court reasoned that if the company is forced into liquidation the employees would lose their jobs, seniority and other benefits. The court set out the test for rejection as first, determining whether the agreement is onerous, and second, whether the equities favor rejection. The Third Circuit asserted that its Bildisco decision applied a pure Kevin Steel approach, and not the approach of its "illegitimate progeny," i.e., cases applying the more stringent test similar to that of REA Express and Alan Wood Steel.

ANALYSIS

In spite of the conflicting approaches among the circuits it seems universal that, given the proper circumstances, the Bankruptcy Reform Act allows for rejection of collective bargaining agreements. However, circumstances allowing for rejection in one jurisdiction may be insufficient in another. Courts following REA Express require that reorganization be impossible absent rejection of onerous labor contracts before balancing the equities. In

131. Id. at 79, 84-85.
132. Id. at 81. The debtor's argument urged pre-Kevin Steel analysis. Id.
133. 682 F.2d at 81.
134. Id.
135. Id. The court specifically stated "[w]e are satisfied that Kevin Steel, isolated from its illegitimate progeny, provides the appropriate framework for an intelligent and equitable approach to the problem. . . ." Id.
136. 523 F.2d at 172.
137. 682 F.2d at 80.
139. 682 F.2d at 81.
140. Id. at 80-81.
141. 523 F.2d at 172.
contrast, courts following Bildisco would dispense with this more stringent test in favor of inquiring as to the onerousness of the contracts and a balancing of the equities. 142

The approaches of both the Second and Third Circuits seek to account for the important policies behind the NLRA. The Second Circuit's REA Express opinion required that reorganization be impossible absent rejection, in view of the serious effects rejection has upon the employees. 143 The Third Circuit, also in deference of the NLRA and employee welfare, required a less stringent test, reasoning that if the company's reorganization is made simpler, its chance of survival increases. Hence, the employees' jobs are preserved. 144

Due to the serious nature and stigma associated with filing for reorganization, a company filing a petition for the sole purpose of ridding itself of an unwanted labor contract would be highly unusual. 145 If, however, such an issue should present itself, an approach similar to that of either the Second or Third Circuits should be used. Such an analysis would require a showing of onerous and burdensome terms, plus a balancing of the equities. This analysis should preclude a finding of rejection. A crafty debtor, able to manipulate financial projections and other accounting procedures may, however, in an attempt to rid itself of a bargaining agreement, present a more onerous and burdensome picture than may actually exist. A stricter test, as required in REA Express, 146 may operate to preclude rejection in such a situation more so than the Bildisco approach. 147

The key to both approaches is the accommodation of the NLRA and Bankruptcy Code. Both approaches are valid and serve necessary functions, with their major difference being REA Express' requirement that reorganization be impossible absent rejection. 148 The Second and Third Circuits differ as to whether the interests of the employee are protected or hindered by imposing such an impossibility requirement.

The best approach may be a compromise between these two approaches, which seeks to preserve the best qualities of each.

142. 682 F.2d at 80-81.
143. 523 F.2d at 172.
144. 682 F.2d at 80.
145. See note 62 and accompanying text supra.
146. 523 F.2d at 172 (rejection is "authorized only where it clearly appears to be the lesser of two evils, and that unless the contract is rejected, the carrier will collapse. . . ").
147. 682 F.2d at 81 (rejection is allowed where "continuation of the collective bargaining agreement would be burdensome to the estate. . . ").
148. See note 146 supra.
The compromise is not too difficult to derive as both tests contain essentially the same elements derived from the original *Kevin Steel* decision. If a court may adopt a test where in determining its threshold question, evidence of good faith between the debtor and its union could be considered. If good faith is and has been present, the court may apply a less strict test, such as that in *Bildisco*, in the hope of encouraging the survival of the company and the employees' jobs. If evidence of bad faith exists, either past or present, the court may apply a stricter test, such as that in *REA Express*, requiring impossibility of reorganization absent rejection of the collective bargaining agreement. The use of an "advantage to the estate" test should never be applied to labor contracts, as to apply this test would render accommodation of the Bankruptcy Reform Act with the NLRA impossible.

A court may also consider other ideas in striving for proper accommodation. As mentioned previously, partial rejection is generally regarded as an impractical and invalid alternative. The complexity of modern labor contracts would present quite a task if a judge had to remold a particular collective bargaining agreement. However, a court with the necessary expertise may be able to form a workable alternative to total rejection through conservative use of partial rejection. If the court allowed each party to submit its own plan for partial rejection, the court may save time in determining the ultimate disposition and, further, the parties may have to cooperate in order to make necessary sacrifices and concessions.

**CONCLUSION**

Statistics project an increase in the already high rate of bankruptcies. Although the Eighth Circuit has yet to be confronted with the issue of rejection of a collective bargaining agreement

---

149. Both tests require a showing of onerous and burdensome terms and a balancing of the equities as suggested in *Kevin Steel*. See *Bildisco*, 682 F.2d at 79-80; *REA Express*, 523 F.2d at 169.

150. See *Alan Wood Steel*, 449 F. Supp. at 169 (wherein the court considered the company’s good faith history of dealing with the union before allowing rejection). See also note 99 supra.

151. See *Bildisco*, 682 F.2d at 80.

152. Id. See *REA Express*, 523 F.2d at 172.

153. *Bildisco*, 682 F.2d at 79.

154. See notes 114-18 and accompanying text supra.


156. See note 11 and accompanying text supra.
under the Bankruptcy Reform Act, the issue has been before other circuit courts. These courts have realized the importance of accommodating the NLRA with the Bankruptcy Reform Act, and of viewing such cases with thorough scrutiny. The best approach in accommodating the policies of the acts would be to follow the precedent requiring a showing of an onerous and burdensome contract, along with a balancing of the equities favoring rejection, before such rejection will be allowed. Moreover, a court should consider any or all relevant factors, e.g., the history of good faith, to determine whether the stricter test of impossibility of reorganization absent avoidance should be applied.

Michael P. Norris—’84

157. See Bildisco, 682 F.2d at 79; Kevin Steel, 519 F.2d at 70; Alan Wood Steel, 449 F. Supp. at 169.