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BANKRUPTCY AND THE REJECTION OF COLLECTIVE BARGAINING AGREEMENTS

I. Introduction

When a corporation becomes insolvent and faces bankruptcy, it may choose one of two general methods of satisfying its creditors' demands. The first is liquidation of corporate assets and subsequent distribution of the proceeds to the creditors and shareholders, thereby resulting in dissolution of the enterprise. The second, often less drastic, path is the corporate arrangement in bankruptcy.¹ The corporation is not dissolved but continues operations under the direction of a trustee appointed by a federal bankruptcy court.² Instead of taking a share in the sale of corporate assets at reduced value, creditors, in most instances, may realize a greater monetary recovery in a reorganization since they share in the going concern value of the business.³ In a broader economic sense, the preservation of corporate operations produces a beneficial, stabilizing effect in terms of continuity in employment and production.

Despite the practical goals of a corporate arrangement, some complex legal problems have developed with regard to a plan of corporate arrangement which calls for substantial cutbacks in employment in order to lower costs and bring about a faster recovery. This course of action is particularly problematic where the trustee in bankruptcy or debtor-in-possession⁴ rejects a collective bargaining agreement pursuant to § 313 of the Bankruptcy Act.⁵

The central issue arises in the context of current labor law as embodied in the Railway Labor Act (RLA) and the National Labor Relations Act (NLRA),⁶ dealing with the modification and protection of collective bargaining agreements:

1 11 U.S.C. § 1 *et seq.* (1970). Federal bankruptcy legislation is authorized by Article I, Section 8 of the U.S. Constitution, which gives Congress the power to pass "uniform laws on the subject of bankruptcies throughout the United States." Chapters 9, 10, and 11 of the Bankruptcy Act of 1898 deal with corporate reorganization and corporate arrangement in bankruptcy. For discussion of the history and development of the notion of corporate reorganization see *Nassau Smelting & Refining Works, Ltd. v. Brightwood Bronze Foundry Co.*, 265 U.S. 269 (1924).

2 11 U.S.C. § 743 (1970). (Section 343 of the Bankruptcy Act). "The trustee is an officer of the court. He is under the supervision and guidance of the court and accountable to it for all his official acts and omissions." 4A COLLIER ON BANKRUPTCY ¶ 70.43(5) (14th ed. 1975).

3 See LEON S. FORMAN, *Compositions, Bankruptcy and Arrangements* (5th ed.), ABA-ALI BUS. TRANS. (1971) [hereinafter cited as *Forman*]; and 8 COLLIER ON BANKRUPTCY ¶ 2.07 (14th ed. 1975).

4 A "trustee in bankruptcy" and "debtor-in-possession" have practically identical functions. They are appointed by the bankruptcy court to oversee the reorganization (in the case of the trustee in bankruptcy) or the corporate arrangement of the bankrupt or debtor corporation (in the case of a debtor-in-possession). Although corporate reorganization under Chapter 10 of the Bankruptcy Act and corporate arrangement in bankruptcy under Chapter 11 are distinct proceedings, for purposes of this note they will be treated together as the issue of rejection of collective bargaining agreements is equally relevant in both contexts.

5 11 U.S.C. § 713(1) (1970). Section 313(1) of the Bankruptcy Act provides:

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.

6 Railway Labor Act of 1926, 45 U.S.C. § 151 *et seq.* (1970); and National Labor Relations Act of 1935, 29 U.S.C. § 151 *et seq.* (1970).

whether in the event of a corporate reorganization or arrangement under the Bankruptcy Act, the trustee in bankruptcy must comply with provisions of the RLA and NLRA before it may reject a collective bargaining agreement.

The areas which must be examined in order to respond to this complex problem involve interpretation of statutory language, legislative history and case law. An examination of both the pertinent federal statutes which are at the heart of the controversy, and an analysis of two recent court decisions, *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*⁷ and *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express*,⁸ will reveal one court's method of dealing with this issue. The nature of the collective bargaining agreement and its relation to the Bankruptcy Act will then be discussed from the perspective of legislative history and judicial interpretation. Finally, a detailed scrutiny of the policy considerations inherent in the issue will aid a fuller understanding and suggest the need for a more workable solution for both the bankrupt corporation and the union worker.

II. Statutory Framework of the Controversy

A. The Bankruptcy Act

According to § 313 of the Bankruptcy Act, a federal bankruptcy court may "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."⁹ Traditionally, the courts have allowed trustees in bankruptcy to reject executory contracts which are onerous or burdensome to the bankrupt in order to provide for a more effective and efficient reorganization and recovery. This privilege has been interpreted to include the rejection of collective bar-

7 519 F.2d 698 (2d Cir. 1975). *Kevin Steel* involved a collective bargaining agreement entered into between Shopmen's Local Union No. 455, organized under provisions of the National Labor Relations Act and Kevin Steel Products, Inc., a steel fabricator and erector. The corporation filed a petition under Chapter 11 of the Bankruptcy Act and was appointed debtor-in-possession to operate the corporation under the bankruptcy court's supervision during corporate arrangement proceedings. Kevin Steel, as debtor-in-possession, petitioned the bankruptcy court for permission to reject, as an onerous executory contract, the collective bargaining agreement in force with the labor union. The bankruptcy court granted the petition, but the union pressed an appeal. The U.S. District Court for the Southern District of New York reversed the bankruptcy court's order and held that the power of the bankruptcy court to relieve a debtor from the burdens of any executory contract did not apply to collective bargaining agreements, 381 F. Supp. 336, 338 (S.D.N.Y. 1974). The debtor then appealed to the United States Court of Appeals for the Second Circuit.

8 523 F.2d 164 (2d Cir. 1975). In this case, the two collective bargaining agreements in question were entered into under the Railway Labor Act between the Brotherhood of Railway, Airline and Steamship Clerks (BRAC), the International Association of Machinists and Aerospace Workers (IAM) and REA Express, Inc., a corporation engaged in the surface and air transport of express shipments. REA filed a petition under Chapter 11 and was appointed debtor-in-possession of its property. The agreements governed the wages and working conditions and substantially affected REA's right to close or consolidate facilities and transfer or lay off workers. REA petitioned the court for an order permitting rejection of the two collective bargaining agreements as onerous and burdensome. The bankruptcy court denied the petition. The U.S. District Court for the Southern District of New York reversed. The District Court found the collective bargaining agreements to be onerous and burdensome and concluded there existed no limitation on the type of executory contract which a trustee or debtor-in-possession was permitted to reject under § 313(1). The union took its appeal to the United States Court of Appeals for the Second Circuit.

9 11 U.S.C. § 713(1) (1970).

gaining agreements as executory contracts.¹⁰ Without an opportunity to reject an executory contract, a bankrupt corporation may be unable to continue operation and would be forced to liquidate.

B. *The RLA and NLRA*

The RLA and NLRA, however, forbid unilateral rejection of collective bargaining by either management or labor.¹¹ Both acts require that specific procedures be followed when a labor agreement is sought to be modified during its term. For example, § 8(d) of the NLRA¹² provides that no party to a collective bargaining agreement shall "terminate or modify it" unless the party desiring such termination or modification:

- (1) serves a written notice upon the other party to the contract. . . ;
- (2) offers to meet and confer with the other party. . . ;
- (3) notifies the Federal Mediation and Conciliation Service . . . and simultaneously therewith notifies any state or Territorial agency established to mediate and conciliate disputes within the State or Territory. . . ;
- (4) continues in full force and effect, without resorting to strike or lockout, all the terms and conditions of the existing contract for a period of sixty days after such notice is given or until the expiration date of such contract, whichever occurs later. . . .¹³

Section 6 of the RLA contains similar requirements and emphasizes that the collective bargaining agreement sought to be terminated or modified "shall not be altered . . . until the controversy has been finally acted upon."¹⁴

The conflict between two major areas of federal law is readily apparent. The Bankruptcy Act provides for the summary rejection of executory contracts, including labor agreements, while conversely, the RLA and NLRA mandate adherence to certain procedures of mediation and renegotiation before a collective bargaining agreement may be terminated. Moreover, these labor law provisions, like the Bankruptcy Act provisions, seek to implement an important policy: the preservation of industrial peace.

III. Recent Developments—*Kevin Steel* and *REA Express*

Whether § 313 was intended to authorize or should authorize the rejection of collective bargaining agreements as executory contracts has produced recent

¹⁰ See *In re Klaber Bros., Inc.*, 173 F. Supp. 83 (S.D.N.Y. 1959); 8 COLLIER ON BANKRUPTCY ¶ 3.15(1) (14th ed. 1975); and 4A COLLIER ON BANKRUPTCY ¶ 70.43(2) (14th ed. 1975). See also *In re American R. Co. of Porto Rico*, 110 F. Supp. 45 (D.C. Puerto Rico 1952); and *In re Public Ledger, Inc.*, 63 F. Supp. 1008 (E.D. Pa. 1945).

¹¹ 29 U.S.C.A. §§ 158(a)(5) and (d) (Supp. 1976); and 45 U.S.C. §§ 155 and 156 (1970).

¹² 29 U.S.C.A. § 158(d) (Supp. 1976).

¹³ *Id.*

¹⁴ 45 U.S.C. § 156 (1970).

litigation. In *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*¹⁵ and *Brotherhood of Railway, Airline and Steamship Clerks v. REA Express*,¹⁶ the Second Circuit Court of Appeals for the first time grappled with the problem of rejection of collective bargaining agreements in corporate arrangement proceedings. The court concluded in both cases that § 313 of the Bankruptcy Act clearly allows the rejection of collective bargaining agreements during a bankruptcy proceeding. However, recognizing the policy considerations behind the NLRA and the RLA of protecting labor agreements, the court held in *Kevin Steel* that the bankruptcy court must move cautiously in allowing rejection of labor contracts.¹⁷ And, in *REA Express*, the court held that the rejection of the labor agreement must clearly be the "lesser of two evils—that unless the labor contract is rejected, the bankrupt company will collapse."¹⁸ Clearly, the Second Circuit attempted to reach an equitable compromise between allowing summary rejection of collective bargaining agreements in corporate reorganization under § 313 and permitting rejection or modification of the labor contract only in accordance with elaborate and time-consuming procedures outlined in the NLRA and RLA.¹⁹

In reaching both holdings, the Second Circuit emphasized that a collective bargaining agreement came within the § 313 language of "executory contracts of the debtor"²⁰ and in each case found that the Bankruptcy Act provisions took precedence over RLA and NLRA provisions for modification of collective bargaining agreements. The court skirted the problem of reconciling the conflicting statutory provisions present in the Bankruptcy Act and the NLRA. It concluded that under the Bankruptcy Act a bankrupt corporation becomes an entirely new corporate entity when it enters into an arrangement in bankruptcy because control is transferred from the original shareholders to the court and the bankrupt's creditors.²¹ The court reasoned that NLRA and RLA provisions pertaining to modification or rejection of labor agreements do not apply to a debtor-in-possession because as a "new juridical entity" it is not a party to the original collective bargaining agreement. Hence, it is neither bound by the contract's terms nor by the provisions of the NLRA or RLA regarding modification.²²

In *REA Express*, the court ignored the union's claim that labor agreements entered into under the RLA were exempted from rejection under § 313 by § 77(n) of the Bankruptcy Act which provides that "no judge or trustee acting under this (Act) shall change the wages or working conditions of railroad employees except in the manner prescribed in (the Railway Act)."²³ The court held that this exception must be interpreted strictly and applies only to collective bargaining agreements of "railroad employees." Although the RLA has been

15 519 F.2d 698 (2d Cir. 1975).

16 523 F.2d 164 (2d Cir. 1975).

17 519 F.2d at 707.

18 523 F.2d at 172.

19 See note 11, *supra*.

20 See note 5, *supra*.

21 Forman, *supra* note 3, at 3.

22 519 F.2d at 704.

23 11 U.S.C. § 205(n) (1970).

extended to cover labor contracts of airline and other transportation workers,²⁴ by statute and case law the court determined that § 77(n) of the Bankruptcy Act could not be similarly expanded.

IV. Is a Collective Bargaining Agreement An "Executory Contract" Within § 313?

Kevin Steel and *REA Express* approved a broad reading of § 313 of the Bankruptcy Act that would include collective bargaining agreements. Since, however, the Bankruptcy Act provided for the rejection of executory contracts long before the collective bargaining agreement became a major part of American industry,²⁵ it is arguable that Congress considered only the rejection of traditional commercial contracts when it passed this provision. The interpretation of § 313 must be examined on the basis of case law and legislative history to determine the propriety of the broad scope attributed to it by the Second Circuit.

A. The Cases

1. Expansive Interpretation of § 313—*Klaber Bros.*

The sparse case precedent considering this problem generally indicates that collective bargaining agreements are within the ambit of § 313,²⁶ except where the only purpose of the reorganization or arrangement proceeding is to avoid a collective bargaining agreement.²⁷ This notion of § 313 rejection power was initially developed in *In re Klaber Bros., Inc.*,²⁸ where a debtor-in-possession moved to reject a collective bargaining agreement entered into between the bankrupt and the union. A union representative testified at the referee's hearing that continued adherence to the collective bargaining agreement would injure the bankrupt financially. Therefore, the union offered to make certain concessions to alleviate the burden on the bankrupt corporation, but the referee disregarded these concessions and rejected the²⁹ collective bargaining agreement.

The United States District Court for the Southern District of New York held that the Referee's order of rejection was sound on the ground that "the Bankruptcy Act makes no distinction among classes of executory contracts. The power to permit rejection of an executory contract should be exercised where rejection is to the advantage of the estate."³⁰ Citing no case precedent or basis in

24 45 U.S.C. §§ 181-85 (1970); See, e.g., *Int'l Ass'n of Machinists v. Central Airlines*, 372 U.S. 682 (1963); *In re Overseas Nat'l Airways, Inc.* 238 F. Supp. 359 (E.D.N.Y. 1965); and *Manning v. Am. Airlines, Inc.* 221 F. Supp. 301 (S.D.N.Y. 1963) *aff'd* 329 F.2d 32 (2d Cir.) *cert. denied*, 379 U.S. 817 (1964).

25 The collective bargaining agreement gained federal statutory recognition with the passage of the RLA in 1926 and the NLRA in 1935. Since the early 1900's the Bankruptcy Act has recognized rejection of executory contracts in the forerunner of reorganization — the composition proceeding in bankruptcy. For a fuller discussion of this provision see Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479 (1974).

26 See note 10, *supra*.

27 *Int'l Brotherhood of Teamsters Loc. No. 886 v. Quick Charge*, 168 F.2d 513 (10th Cir. 1948); and *In re Mamie Conti Gowns*, 12 F. Supp. 478 (S.D.N.Y. 1935).

28 173 F. Supp. 83 (S.D.N.Y. 1959).

29 *Id.* at 85.

30 8 COLLIER ON BANKRUPTCY ¶ 3.15(8) (14th ed. 1975).

legislative history, the court based its decision solely on bankruptcy treatise material.³¹ On this same authority, it held that the union's offer to make concessions was not permissible since "an executory contract cannot be rejected in part, and assumed in part." The opinion shed little light on why the court felt § 313 embraced the labor contract.

2. The Effect of Labor Legislation on § 313

In *Carpenter's Local 2746 v. Turney Wood Products, Inc.*,³² a federal district court focused on a finding of no apparent conflict between the NLRA and the Bankruptcy Act in dismissing a suit brought by a labor union challenging the rejection of its collective bargaining agreement by a trustee in bankruptcy under § 313. Although the union and the court agreed that collective bargaining agreements were executory and therefore of the type included under § 313, the union argued that federal labor legislation had "so preempted the field as to take the collective bargaining agreement out of the scope" of § 313. The court, however, bolstered the *Klaber Bros.* holding further by insisting:

Neither labor legislation of the Congress nor the Bankruptcy Act contains any language which would generally exclude collective bargaining agreements from . . . [rejection under § 313]. Had Congress desired that there be such general exclusion, it would have said so.³³

It is evident that the case law dealing with § 313 is tenuously based on a reading of Congressional silence and treatise law. Both of the courts above chose a literal interpretation of § 313 and failed to recognize that there exists a direct conflict between the language of that section and sections 8(a)(5) and (d) of the NLRA. Section 8(a)(5) makes it an unfair labor practice for an employer to refuse to bargain collectively with the representatives of his employees. Section 8(d) of the NLRA defines the § 8(a)(5) duty to bargain collectively as meaning that no party to a collective bargaining agreement shall "terminate or modify it" unless the party desiring such termination or modification complies with the notice and mediation procedures set out in this section.³⁴

3. The Legislative History and the *Turney Wood* Decision

While it is evident that Congress in the RLA and NLRA did not specifically provide for special procedures in the event of bankruptcy, it is readily apparent that Congress condones the modification of collective bargaining agreements only after resort to mediation procedures during which the labor agreement remains

31 173 F. Supp. at 85. The court cited 8 COLLIER ON BANKRUPTCY ¶ 3.15(7) (14th ed. 1975).

32 289 F. Supp. 143 (W.D. Ark. 1968).

33 *Id.* at 149.

34 See note 11, *supra*.

in full force and effect.³⁵

An examination of the legislative history of the NLRA shows that § 8(d), enacted in 1947, is absolute on its face and that there is no mention of Congressional intent to limit its application by operation of the Bankruptcy Act. The courts in interpreting § 313 as allowing the rejection of collective bargaining agreements force the union to accept rejection of its agreement contrary to § 8(d). The courts are permitting a bankrupt corporation to accomplish indirectly what it could not accomplish directly without violating the NLRA or the RLA. It is doubtful that Congress would have specified how collective bargaining should be treated in the Bankruptcy Act since the notion of rejection of executory contracts was incorporated in federal bankruptcy law long before the labor contract came into existence.³⁶ It is also significant that the problem of rejection of labor agreements in corporate reorganization or arrangement has only infrequently and recently resulted in litigation.³⁷

B. *The Unique Nature of the Collective Bargaining Agreement*

The unique legal nature of the collective bargaining agreement also dictates that it not be included within § 313. Section 313 speaks of rejection of "executory contracts" of the debtor.³⁸ An executory contract is usually defined as a contract wherein the contractual duties have not been substantially performed by the contracting parties.³⁹ In the corporate arrangement setting, the courts have generally allowed rejection of executory contracts of the bankrupt where rejection was to its financial advantage.⁴⁰ Although § 313 ordinarily operates to allow rejection of contracts for goods and services, the provision, as indicated above, has been interpreted by various writers to include labor contracts.⁴¹ This extension is questionable, however, in light of the basic differences between an executory contract for goods or services and a collective bargaining agreement.

The collective bargaining agreement is a unique type of legal undertaking in both its form and history. Created to solve the growing problems of labor unrest during the 1930's, these contracts have become the accepted mode of ordering the employment relationship between labor and corporate management. The passage of the Railway Labor Act and the National Labor Relations Act manifested congressional interest in the preservation of industrial peace through collective bargaining and the arbitration of grievances.⁴²

35 *Id.* In *Manning v. American Airlines*, the Court explained § 156 of the RLA:

Congress has forbidden a change by defendant of 'rates of pay, rules, or working conditions' during the processes required by the Act. Congress believed that labor peace in the air carrier industry would be promoted by maintaining the status quo while efforts were being made to reach agreement. . . .

221 F. Supp. 301, 306 (S.D.N.Y. 1963) *aff'd* 329 F.2d 32 (2d Cir. 1964) *cert. denied* 379 U.S. 817 (1964).

36 See Countryman, *supra* note 25, at 553.

37 "We recognize that there appear to be no appellate decisions squarely on point. The issue [in *Kevin Steel*] . . . has not been litigated frequently." 519 F.2d at 703.

38 11 U.S.C. § 713(1) (1970).

39 Countryman, *supra* note 25, at 498. See also, Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, (1973).

40 See note 30, *supra*.

41 See note 10, *supra*.

42 See 45 U.S.C. § 151(a) (1970); and 29 U.S.C. § 151 (1970), stating the purposes of the two Acts.

The labor agreement differs from the commercial contract in several respects. Indeed, prior to the passage of the Taft-Hartley Act, the collective bargaining agreement was not perceived as a "contract."⁴³ Furthermore, a lack of voluntariness permeates the collective bargaining framework. The collective bargaining agreement was conceived by Congress to be the fruit of negotiation and necessary compromise between labor and corporate management as to rates of pay, rules and working conditions. In many instances, compromise is necessary since the corporate employer and the labor union bargain in an essentially "closed market," having only each other to bargain with.⁴⁴ This lack of voluntariness is the exception rather than the rule in the commercial context.

Most significantly, the collective bargaining agreement concerns workers' jobs and employment status while the commercial contract deals with manufactured goods and land. For these reasons and because the collective bargaining agreement did not exist when the Bankruptcy Act first allowed rejection of executory contracts that the application by the courts of §313 to all "classes of executory contracts" regardless of their nature needs to be more critically examined. While the Bankruptcy Act clearly allows for the rejection of executory contracts of a commercial nature, persuasive argument can be made that due to the unique nature of the collective bargaining agreement, § 313 should not supersede provisions in the NLRA and RLA dealing with changes in wages, rules, and working conditions.

V. Sections 77 and 272 of the Bankruptcy Act and Labor Agreements

A. *The NLRA and § 77 of the Bankruptcy Act*

The Bankruptcy Act does not ignore collective bargaining agreements entirely. Section 77(n)⁴⁵ prohibits bankruptcy courts and trustees in bankruptcy from interfering with collective bargaining agreements entered into under the Railway Labor Act, while § 272 prohibits interference by the bankruptcy court and trustee in bankruptcy with workers' rights to form and join labor unions.⁴⁶

While these provisions indicate an intent to specially treat the collective bargaining agreements existing in federal labor legislation, the courts, as in *Kevin Steel*, have narrowly interpreted § 77(n) to apply only to agreements entered into under the RLA. In doing so, the Court has confronted the perplexing ques-

⁴³ Chamberlain, *Collective Bargaining and the Concept of Contract*, 48 COLUM. L. REV. 829, 832 (1948); and Note, *Corporate Reorganizations and the Rights of Labor*, 53 HARV. L. REV. 1360, 1363-64 (1940).

⁴⁴ A collective bargaining agreement is an effort to erect a system of industrial self-government. When most parties enter into contractual relationship, they do so voluntarily, in the sense that there is no real compulsion to deal with one another, as opposed to dealing with other parties. This is not true of the labor agreement. The choice is generally not between entering or refusing to enter into a relationship. . . . Rather it is between having that relationship governed by an agreed upon rule of law or leaving each and every matter subject to a temporary resolution dependent solely upon the relative strength, at any given moment, of the contending forces. *United Steelworkers of America v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 580 (1960).

⁴⁵ 11 U.S.C. § 205(n) (1970).

⁴⁶ 11 U.S.C. § 672 (1970).

tion of whether congressional silence as to agreements under the NLRA (NLRA labor agreements are not mentioned in the Bankruptcy Act) are to be treated differently from those under the RLA which enjoy the protection of § 77(n).

The lower district court in *Kevin Steel* examined whether the apparent lack of exclusionary language in the Bankruptcy Act as to collective bargaining agreements under NLRA was intentional or mere oversight by Congress. The lower court opted for an explanation of congressional oversight in interpreting the intent behind the § 77 exception. The court found that as between the policies of the Bankruptcy Act and the National Labor Relations Act, Congress intended labor policies to prevail "so that the debtor-in-possession . . . should not have been permitted to reject a collective bargaining agreement where the provisions of the (NLRA) were not followed."⁴⁷ The lower court reasoned that Congress intended that all labor contracts be treated similarly regardless of whether they were entered into under the RLA or NLRA.⁴⁸

The Second Circuit, in reversing the lower court, interpreted § 77(n) literally, viewing Congressional silence as to the exclusion of NLRA labor agreements from the reach of § 313 to mean that these agreements could be rejected because § 77 only applied to labor contracts under the RLA.

Although not based on literal interpretation of § 313 or § 77(n), the lower court's view seems to be a better, if not more logical, reading of congressional silence—namely, that such silence was oversight. Certainly, it is doubtful that Congress would create a great distinction between the treatment of labor contracts under the RLA and labor agreements under the NLRA. Because, however, the legislative history of § 77(n) is equivocal in nature, the Second Circuit in *Kevin Steel* found that congressional silence indicated § 77(n) was confined to agreements entered into only under the RLA;⁴⁹ the section was passed as part of the Railroad Reorganization Act of 1934. This legislation provided an alternative to equity receivership for the nation's bankrupt railroads. Since the Bankruptcy Act was passed after the RLA but before enactment of the NLRA, the use of the limited language "railroad employees" in § 313 is not surprising. Although at the time of its passage it clearly applied only to agreements under the RLA, the measure can be read as manifesting congressional intent to protect labor agreements from rejection without resort to statutory provisions for its modification. While, then, it is possible for the congressional silence to be read in either fashion,⁵⁰ the Second Circuit in *Kevin Steel* held that § 77(n) could not be extended by analogy to agreements under the NLRA.

⁴⁷ *Shopmen's Local Union No. 445 v. Kevin Steel Products, Inc.*, 381 F. Supp. 336 (S.D.N.Y. 1974).

⁴⁸ *Id.* at 338.

⁴⁹ Senator Wheeler explained various oversights in legislative drafting of the Railroad Reorganization Act during Senate debate: "The Senate may remember that the original section 77 of the bankruptcy law was passed by Senate hurriedly, and almost without debate. . . ." 79 CONG. REC. 13764 (1935). However, the Congressional debates of 1933 show a conscious effort to protect labor agreements. Senator LaGuardia remarked: "Labor is fully protected by the specific provision that nothing in the bill be construed as in any way amending or altering the provisions of the railway labor act. It was thought necessary to put this provision in because in some instances equity receivers have disregarded the provisions of the RLA and have arbitrarily reduced the wage scale." 76 CONG. REC. 2927 (1933).

⁵⁰ 519 F.2d at 705.

B. Limiting § 77(n) to "Railroad Employees"

In *REA Express* where the labor contract in question was governed by the Railway Labor Act, the Second Circuit went even further in limiting the applicability of § 77(n). The court found that § 77(n) applied only to those collective bargaining agreements entered into by "railroad employees."⁵¹ The court thus drew an even finer distinction between different types of labor agreements, and determined that § 77(n) does not apply to all contracts under RLA but only to those of railroad employees. The court reasoned that if the reorganizing bankrupt corporation was forced to comply with the time-consuming mediation and negotiation provisions present in the RLA, the union would be defeating its own purpose. The corporation may not have been able to survive financially and still maintain the status quo during negotiations.

The Second Circuit's limitation of § 77(n) represents a myopic view of subsequent congressional policy which encourages collective bargaining and adherence to labor agreements in all types of business and industry. The notion that statutory interpretation is not limited to precise words such as "railroad employees" was adopted by the Supreme Court in *Boys Market v. Retail Clerks Union*.⁵² In resolving a question of statutory interpretation under the Norris-LaGuardia Act, the Court stated:

[s]tatutory interpretation requires more than concentration upon isolated words; rather consideration must be given to the total corpus of pertinent law and the policies that inspired ostensibly inconsistent provisions.⁵³

It is evident that the Second Circuit formulated an unwarranted narrow interpretation of § 77(n) for if it had considered congressional policy subsequent to the passage of the Railroad Reorganization Act, it would have found convincing indicia of congressional protection of the collective bargaining agreement.⁵⁴

Furthermore, the *Kevin Steel* and *REA Express* decisions present an interesting twist of statutory interpretation. In *Kevin Steel* the Court in interpreting § 77(n) explains that agreements entered into under the NLRA do not enjoy the same treatment in bankruptcy proceedings as those entered into under the RLA. The court emphasizes that these two types of agreements are distinct with

⁵¹ 523 F.2d at 170.

⁵² 398 U.S. 235 (1970). In *Nat'l Woodwork Mfrs. Ass'n v. NLRB*, 386 U.S. 612 (1967), rehearing denied 387 U.S. 926 (1967), the Supreme Court stressed the "familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers." *Id.* at 619. That principle has particular application in the construction of labor legislation which is "to a marked degree, the result of conflict and compromise between strong contending forces and deeply held views on the role of organized labor in the free economic life of the Nation and the appropriate balance to be struck between the uncontrolled power of management and labor to further their respective interests." *Id.*

⁵³ 398 U.S. at 250.

⁵⁴ The chronology of congressional action: 1926—Railway Labor Act (RLA), as amended, 42 U.S.C. § 151 *et seq.* (1970); 1934 — Railway Reorganization Act incorporating § 77(n) of the Bankruptcy Act, 11 U.S.C. § 205 (1970); 1935—National Labor Relations Act (NLRA), as amended, 29 U.S.C. § 151 *et seq.* (1970); 1938—Chandler Amendments to the Bankruptcy Act, 11 U.S.C. §§ 206 and 207 (1970); and 1947—Taft-Hartley Amendment (Labor Management Relations Act), 29 U.S.C. § 141 *et seq.* (1970).

regard to § 77(n). In *REA Express* the court ignores the *Kevin Steel* distinction and proceeds to carve out an even finer classification. The court found that only labor contracts entered into by "railroad employees" enjoy the protection of § 77(n). Thus, the decisions taken together show that the controlling distinction is not to be made on the basis of whether the labor agreement comes under RLA or NLRA but rather on whether the labor union is comprised of "railroad employees" or nonrailroad employees; a tenuous result at best.

VI. Avoidance of the Labor Law Provisions

A. The "New Entity" Concept

Although the court in *Kevin Steel* and *REA Express* secondarily relied on § 77(n), it did not base its holding on the narrow interpretation of that section. Instead, the court found that because a bankrupt corporation in an arrangement or reorganization becomes a new corporate entity, it is not therefore bound to the terms of a collective bargaining agreement entered into between the old corporate entity and the union.⁵⁵ The court's characterization of the "new entity" status of a corporation undergoing reorganization or arrangement is technically correct. This basic principle of bankruptcy law is based on the notion that a debtor in bankruptcy be afforded a "fresh start" after satisfying its previous creditors' demands in bankruptcy proceedings. As an entirely new entity in the eyes of the law, the debtor-in-possession such as in *Kevin Steel* or *REA Express* can escape the reach of the NLRA and RLA contract modification provisions since these statutes apply to the "parties" to the collective bargaining agreement.

B. A Critical Examination of the "New Entity" Rationale

Although the Second Circuit's conceptualization is legally sound, in some instances pragmatism dictates that the "new entity" concept is only a legal fiction adopted for convenience in dealing with a complex problem.⁵⁶ For instance, in both *Kevin Steel* and *REA Express* the debtor corporation was appointed as debtor-in-possession to supervise the corporate arrangement of its own enterprise. Although the debtor-in-possession takes upon itself the task of reaching agreement with the creditors and revising operations in order to best satisfy creditors' claims, the managers and the workers of the debtor corporation remained essen-

⁵⁵ 519 F.2d at 704.

⁵⁶ An example of this fiction can be found in *NLRB v. Baldwin Locomotive Works*, 128 F.2d 39 (3d Cir. 1942) where unfair labor practices had been committed by the respondent while it acted as debtor-in-possession of its business during a bankruptcy reorganization. The NLRB petitioned for enforcement of its order against the debtor-in-possession. The Court stated:

[I]t will hardly be denied that a debtor-in-possession is responsible for the unfair labor practices which occur during a reorganization. Its status as an employer is no different, so far as the NLRA . . . is concerned than that of any other employer. . . . And where managerial control and economic interest of the debtor-in-possession and the reorganized company are the same, it could be only the blindness of formalism that would suggest separately instituted proceedings against the predecessor and the successor for the redress of their respective but continuous unfair labor practice.

Id. at 43.

tially identical. Heretofore, the relationship between the two groups was governed by a collective bargaining agreement wrought of negotiation and compromise. Under the Second Circuit's "new entity" rationale, the corporation may at any time repudiate the collective bargaining by operation of § 313 although the union members are working at their same jobs and for the same management as in prebankruptcy times.

VII. Policy Considerations Involved with the "New Entity" Rationale

Because the process of corporate reorganization or arrangement can be abused by a "new entity" seeking only to rid itself of a collective bargaining agreement without regard to whether such rejection was necessary, the Second Circuit tempered the effect of its analysis by emphasizing several relevant policy considerations which had to be balanced in the rejection decision. In so doing, the court did not solely rely on technical legal reasoning but considered the practical realities present on each side of the rejection issue. An examination of the policy considerations will serve to introduce the new standards set out by the court.

A. The Employee Perspective

The court in both *Kevin Steel* and *REA Express* was cognizant of the policy implications of its decision with respect to workers' rights. In both cases, the court was influenced by an earlier decision, *In re Overseas National Airways, Inc.*⁵⁷ in which a federal district court refused to allow the summary rejection of a collective bargaining agreement between an airline workers' union and an airline undergoing corporate reorganization in bankruptcy. In that case, the court was concerned about the unrecoverable losses employees might suffer if rejection were allowed without a substantial showing of necessity on the part of the bankrupt. Namely, the court felt that seniority, insurance and other fringe benefits which workers had acquired over the years and which were included in their labor contracts would be lost by the employees. It was evident to the *Overseas National Airways* court that the worker could lose everything if the corporation went into corporate reorganization or arrangement and the bankruptcy courts allowed rejection of collective bargaining agreements. The worker faced cuts in wages, relocation, loss of seniority credits and possible loss of his job.⁵⁸

The injustice is enhanced by the fact that the corporate bankruptcy may have been caused by irresponsible financial management of the bankrupt by the company officers and managers over which the union has no control. Supreme Court Justice Douglas in his dissent in *Joint Industry Board v. United States*⁵⁹ expressed the need for affording "special protection to a class of wage-earners who generally have no substantial savings or other reserves to fall back on in case of adversity and therefore cannot afford to lose [their rights under a collective bar-

57 238 F. Supp. 359 (E.D.N.Y. 1965).

58 *Id.* at 361-62.

59 391 U.S. 224 (1968).

gaining agreement]."⁶⁰

In addition to the foregoing enumeration of possible hardships faced by the employee in the event the debtor-in-possession is allowed to reject the collective bargaining agreement, the worker's legal remedies against a bankrupt are severely limited. If the collective bargaining agreement is rejected in reorganization or arrangement proceedings, the employees have three basic means of recourse. First, when a trustee in bankruptcy rejects an executory contract, it is considered a breach of contract and the union may attempt to prove a claim for damages. If the claim is proven, the union is deemed a general creditor of the bankrupt and would not be satisfied until after the preferred creditors.⁶¹ Second, § 206 of the Bankruptcy Act provides that "[t]he judge may for cause shown permit a labor union or employees' association . . . to be heard on the economic soundness of the plan affecting the interests of the employees."⁶² Although this provision allows the union to request participation in the formulation of a reorganization plan, whether the union could appeal as to the workability or fairness of the plan adopted by the creditors is not clear.⁶³ The third alternative is economic coercion through a union strike of its bankrupt employer. Although this action may be effective in an ordinary labor context, the strike may likely be self-defeating in the bankruptcy context where the economic hardship could force the employer into liquidation.

B. *The Corporation's Dilemma*

Policy considerations favoring organized labor which moved the Second Circuit to refuse to allow summary rejection of collective bargaining agreement had to be balanced against those favoring the fast and efficient rehabilitation of bankrupt corporations. From a debtor-in-possession's perspective, requiring every bankrupt corporation to assume its collective bargaining agreements during reorganization and adhere to the negotiation and mediation requirements outlined in the NLRA and RLA could seriously undermine the reorganization in terms of time consumed and financial hardship. A debtor-in-possession such as *Kevin Steel* might find itself hamstrung by terms of a labor contract which would preclude it from making necessary cutbacks in the work force, closing unprofitable plant facilities, or making wage reductions. Moreover, unrealistic wage terms in the collective bargaining agreement might force the bankrupt into a serious liquidity problem forestalling payment to creditors and thereby prolonging the arrangement process.

VIII. Analysis of the New Standard

In light of these significant policy considerations the Second Circuit tempered the harsh effect of its interpretation of § 313 with certain standards which had to be met on remand before the bankruptcy court could approve rejection. In *Kevin Steel*, the court called for a thorough scrutiny of the benefits and draw-

60 *Id.* at 232.

61 Teton, *Reorganization Revised*, 48 YALE L. J. 573, 595-96 (1939); and Comment, *Collective Bargaining and Bankruptcy*, 42 SO. CAL. L. REV., 477, 486 (1969).

62 11 U.S.C. § 606 (1970).

63 See, e.g., 6A COLLIER ON BANKRUPTCY ¶ 9.24 (14th ed. 1975).

backs of rejection requiring a balancing of the equities on both sides.⁶⁴ In *REA Express*, the court stated that rejection of the collective bargaining agreement must be clearly "the lesser of two evils . . . unless the agreement is rejected, the carrier will collapse."⁶⁵ The *Kevin Steel* language is considerably weaker because of its vagueness. It must be remembered that in actual practice, it is the bankruptcy court which will apply the standard. Since this court's main function is to oversee the efficient administration of the Bankruptcy Act, it can be argued that the court may be unduly sympathetic to the "equities" favoring the debtor-in-possession.

The test set forth in *REA Express*, on the other hand, requires the debtor-in-possession or trustee to show that the collective bargaining agreement is so onerous that adherence will lead to liquidation in bankruptcy. At the same time, the court recognizes that retention of the labor agreement cannot be condoned at the expense of total failure of the business. This test thus possibly strikes a workable compromise between the policies of the NLRA and RLA and the Bankruptcy Act. The new standard takes into account the unique nature of the collective bargaining agreement as an embodiment of tangible and intangible human rights. Although the test does not require deference to the modification provisions of the RLA or NLRA, it requires a positive showing on the part of the bankrupt that rejection is the only alternative to complete liquidation—a burden of proof which protects the collective bargaining agreement and recognizes the importance of maintaining its stability in order to preserve industrial peace. With regard to the important policies of the Bankruptcy Act, the *REA Express* standard does not preclude or hinder corporate reorganization or arrangement with cumbersome or time-consuming procedures.

IX. Conclusion—Need for Congressional Clarification

Although the Second Circuit has set forth a well-reasoned compromise between the two areas of federal legislation, a more definitive solution can only be created through congressional action.

Since the law in this controversy is based on statutory provisions passed by Congress in the 1930's, it is highly likely that congressional silence as to whether labor agreements come within the reach of § 313 is due to the dearth of litigation on the question. In the face of the increasing importance of the collective bargaining agreement and the number of corporations choosing reorganization or arrangement over liquidation, Congress should fashion an amendment to § 313 whereby labor agreements are assumed by the trustee or debtor-in-possession and onerous terms can be renegotiated within a time frame appropriate to an expedient arrangement or reorganization plan. Not only would such a law reduce the confusion and burden placed upon the bankruptcy court in determining the "lesser of two evils," it would also strike a clear and definitive balance between two areas of law vital to the ordered growth of American business and industry.

Patricia S. Higgins

64 519 F.2d at 707.

65 523 F.2d at 172.