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The Rejection of Collective Bargaining Agreements Within Bankruptcy Reorganization: Reconciling a Legislative Dilemma

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THE REJECTION OF COLLECTIVE BARGAINING AGREEMENTS WITHIN BANKRUPTCY REORGANIZATION: RECONCILING A LEGISLATIVE DILEMMA

INTRODUCTION

In 1981, a Dallas based conglomerate, LTV Corporation, spun-off a subsidiary known as Wilson Foods. The purpose for this action was that Wilson Foods, the nation’s fifth largest meat packer was suffering from financial difficulties. Shortly after the spin-off, Wilson Foods entered into a collective bargaining agreement with its unionized employees, initiating a wage freeze through 1985. Under this arrangement, Wilson Foods’ losses continued to escalate.

On April 22, 1983, Wilson Foods sought protection from its creditors pursuant to Chapter 11 of the Bankruptcy Reform Act of 1978 (BRA). Though by no means insolvent, Wilson feared that escalating losses would jeopardize its credit line. Chairman and Chief Executive Officer, Kenneth J. Griggy stated, “this was the only way [the company] could survive.”

Under Chapter 11 Wilson was given protection from litigation, creditors, and contractual obligations. Wilson Foods believed that its collective bargaining agreement with the United Food and Commercial Workers Union was the cause of its financial troubles. Therefore, pursuant to statutory authority of the BRA, Wilson unilaterally rejected the collective bargaining agreement of 1981.

2Id.
5Winans, Some Say Wilson Foods Results May Rebound in Fiscal ’84 if Court Upholds Sharp Wage Cuts, Wall St. J., May 3, 1983 at 59, col. 2. (Financial analyst William Leach of Donaldson, Lufkin, and Jenrette estimates the company’s book value at sixty million dollars). See, Wall St. J., April 25, 1983 at 16, col. 2. (Wilson Foods Chairman and Chief Executive Officer, Kenneth J. Griggy “noted that Wilson has ‘sufficient’ cash * * * and a sixty million dollar revolving credit line to meet its needs.” Id.
6Sorenson, supra note 1.
7Id.
9Sorenson, supra note 1; Barmash, Wilson Foods in Chapter 11 Filing, Wall St. J., April 23, 1983 at 29, col. 3. See, Winans, Some Say Wilson Foods Results May Rebound in Fiscal ’84 if Court Upholds Sharp Wage Cuts, Wall St. J., May 3, 1983 at 59, col. 2. (The forty percent reduction in wages is predicted to result in savings of between seventy to one hundred million dollars).
On April 22, unionized workers went to work believing they were being paid $10.69 per hour. That afternoon a radio broadcast announced Wilson Foods had unilaterally rejected the 1981 wage freeze and was now paying its unionized workers only $6.50 per hour. This forty percent reduction in pay raised both economic and legal concerns among the union and the 6200 unionized workers at Wilson Foods.

To the unionized workers' shock and dismay, they found that the BRA, like its predecessor the Bankruptcy Act of 1898 (Act), permitted the unilateral rejection of executory contracts. Furthermore, except for one specific statutory exception, appellate courts had held that collective bargaining agreements, were executory contracts within the Act and the BRA.

Wilson Foods was not the first nor the most recent company to seek bankruptcy court relief from its collective bargaining agreements. Wilson Foods represents but one example of the many companies which have recently sought refuge in bankruptcy court from their collective bargaining agreements.

The case of Wilson Foods demonstrates a legislative dilemma which has existed for over half a century. The dilemma is that whereas the National Labor Relations Act (NLRA) prohibits the unilateral rejection of collective bargaining agreements, the Bankruptcy Laws permit such action. Why a situation which has existed for so long should just recently raise such heightened congressional and public concern may be "perhaps because more and more marginal businesses now find the Chapter 11 refuge a practical alternative" to wage concessions.

The legislatively created dilemma between the Bankruptcy Laws and the

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1. Sorenson, supra note 1.
2. Id. The economic concern is that as wages had risen, so too had the union worker's standard of living, which included mortgage payments.
8. See Id.
11. The term, "Bankruptcy Laws" will refer to both the Bankruptcy Act of 1898 and the Bankruptcy Reform Act of 1978, collectively.
12. 605 LAB. L. REP. (CCH) No. 1299 at 3 (Oct. 14, 1983). Congressman George Miller of the House Subcommittee on Labor-Management Relations said that the practice of avoiding collective bargaining agreements through bankruptcy proceedings "is one of the most critical problems in the field of labor relations in the last thirty years." Id.

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NLRA is the basis of this comment. Though the dilemma exists equally under liquidation, 24 this comment will deal exclusively with the problem under reorganization. 25 Part I will deal with the relevant legislation. Part II will analyze how the limited number of federal circuit courts have confronted the conflict. Part III will look at various "tests" formulated by the circuits in determining if rejection of a collective bargaining agreement should be permitted in a given situation. In Part IV this comment will analyze how the United States Supreme Court has recently attempted to resolve the legislative dilemma. 26 It will conclude with the issue of how Congress can and should initiate legislative reform in light of the Supreme Court's recent decision.

Whether the Supreme Court's decision will be the final word upon these issues is not yet certain. 27 Various legislators have stated that they "would introduce legislation to assure the 'fairness and equity' of our industrial relations system, if it was determined that the use of the Bankruptcy Laws undermines our labor statutes." 28 Therefore, regardless of how the Supreme Court has recently ruled, this comment will demonstrate where Congress and the courts have failed, and how the present dilemma can be rectified. Furthermore, this comment demonstrates that a potential for abuse exists and that judicial scrutiny is necessary to minimize abuse.

I. THE ORIGIN OF THE DILEMMA

A. The Labor Law

In 1935, Congress enacted the National Labor Relations Act (NLRA) 29 "to promote industrial peace by facilitating collective bargaining and to reduce the disparity in bargaining power between employers and employees." 30 Congress believed that industrial peace would result in enhanced commerce which in turn would benefit both management and labor. 31

To achieve the stated purpose of the NLRA, Congress enacted procedural requirements 32 which granted to collective bargaining agreements a favored and

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24 11 U.S.C. § 700 (1982). The author does not believe that the Bankruptcy Laws under liquidation are in any way used to avoid collective bargaining agreements due to the severity of the results. If liquidation was used solely for this purpose one could say the debtor was cutting off his nose to spite his face.


27 See, Interim Report Urges Action on Bankruptcy Reform, 20 TRIAL 12, 13 (1984). "The need (for reform) is highlighted by cases such as Braniff, Manville, Wilson Foods, Baldwin-United and Continental, involving billions of dollars, tens of thousands of employees, and thousands of stockholders." Id.


... no party to a [collective bargaining agreement] shall terminate or modify [the agreement] unless the party desiring [the] 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 for the purpose of negotiating a new contract
protected status not common to contracts in general. The NLRA did not
absolutely preclude any termination or modification of collective bargaining
agreements. It merely required that certain procedures be followed before a
collective bargaining agreement could be terminated or modified.

An important mandate of the NLRA is that neither party to a collective
bargaining agreement may unilaterally reject or modify the agreement. This
mandate is in complete conflict with the present Bankruptcy Law which does
permit the unilateral rejection of any executory contract.

The collective bargaining agreement’s favored status and protection under
the NLRA explains why such contracts are considered “extraordinary” by
organized labor. This favored status has been the basis of organized labor’s
futile argument that collective bargaining agreements should not be treated
as ordinary executory contracts within the Bankruptcy Laws. Unfortunately,
labor’s argument, to its dismay, has not succeeded.

B. The Bankruptcy Laws

Prior to the adoption of the United States Constitution, “in most of the
American Colonies, the administration of the debtor’s estate followed more
or less the English Common Law.” Under the English Common Law, the
primary goal of bankruptcy legislation was to aid the creditor by affording
him the opportunity to be made whole. During this period there were no
reorganization provisions whereby the debtor was protected in order to
rehabilitate himself and survive financially. The English Law instead, “preceeded
upon the assumption that the debtor was necessarily to be dealt with as an
offender” who was worthy of punishment.

Due to the American Revolution there was a disruption of commerce which
resulted in widespread bankruptcy and the resulting oppression of debtors.

or a contract containing the proposed modifications;
(3) notifies the Federal Mediation and Conciliation Service . . . and 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. Id.

Note, The Bankruptcy Law’s Effect on Collective Bargaining Agreements, 81 COLUM. L.

“... the trustee, subject to the court’s approval may assume or reject any executory contract . . . .”

519 F.2d 698 (2d Cir. 1975). The district court agreed with organized labor and held that the bankruptcy
court had no authority to relieve a debtor-in-possession of the requirements of a collective bargaining
agreement, in that such was not an executory contract within the scope of § 313(1); (former analogous
section to 11 U.S.C. § 365(a) (1982)).

See generally cases cited supra notes 15 and 16.

A. NAMDAR, CONTRACTS IN BANKRUPTCY, § 1.2 at 6 (1977).

Id., § 1.2 at 5.


A. NAMDAR, supra note 37.
In order to alleviate present and future oppression, Congress, pursuant to Constitutional authority, enacted various short-lived bankruptcy acts which dealt exclusively with liquidation.

With the enactment of the Bankruptcy Act of 1898 (Act), the concept of reorganization began to emerge. Like its predecessors though, the Act's primary relief was liquidation and not reorganization. In 1938, with the enactment of the Chandler Act, reorganization was finally made available to all corporate entities and became a major element of bankruptcy relief.

The Bankruptcy Laws evolved significantly from the concepts and objectives of the English Common Law. Under the Bankruptcy Laws, rather than being punished the debtor within reorganization was protected. The rationale for this protection was that through reorganization the debtor could survive, repay his creditors, and provide continued employment for his employees.

With the enactment of the BRA, Congress retained the concept, scope, and procedures of the Act. Unfortunately, Congress perpetuated an important conflict between the Act and the NLRA.

Whereas the NLRA affords collective bargaining agreements manditory procedural protections, the Bankruptcy Laws are not so protective. The BRA, with one exception, treats all collective bargaining agreements as executory contracts in general and thus affords them no special protection.
Under the BRA reorganization may be instituted by a voluntary or involuntary petition. The trustee or debtor-in-possession may then reject or assume any executory contract subject to court approval. Thereafter, the debtor-in-possession submits for court approval a reorganization plan. As part of the plan the debtor-in-possession may reject or accept executory contracts not previously acted upon.

The statutory provisions allowing for rejection are very broad. There is no requirement in the BRA of compliance with the procedures of existing and conflicting legislation.

Though case law as early as 1935 demonstrated the dilemma's existence, Congress failed to correct the situation in enacting the BRA. There are conflicting views as to whether this congressional inaction was intentional or inadvertant.

As a result the federal courts have been left with the burden of reconciling two equally important and equally conflicting federal acts. Yet even the courts have been unable to uniformly resolve this perplexing conflict.

II. RECONCILING THE DILEMMA

A. Collective Bargaining Agreements as Executory Contracts

Under state law an executory contract may be defined as "a contract that has not yet been fully completed or performed." Thus, any contract in which some performance is due from either side is considered to be executory.

It has been suggested that an executory contract under the Bankruptcy Laws has a different and more limited meaning than under state law. Under

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111 U.S.C. § 323 (1982). The trustee in a bankruptcy proceeding is one who is the representative of the estate and who in such capacity can sue and in turn be sued.
1211 U.S.C. § 1107 (1982). In Chapter 11, where the debtor remains in possession and continues to operate the business, he is deemed a debtor-in-possession. The debtor-in-possession has the same rights and duties as the trustee, except that he is not entitled to compensation.
16Rejection under § 1123(b)(2) (1982) is only restricted by the requisites of § 365 which in turn limits rejection or assumption to court approval.
19BLACK'S LAW DICTIONARY (5th ed. 1979). Professor Williston suggests, "all contracts to a greater or less extent are executory. When they cease to be so they cease to be contracts." 1 S. WILLISTON, CONTRACTS § 14 (3d ed. 1957).
the Bankruptcy Laws it is not the rationale that some performance is due which makes the contract subject to rejection, but whether the contract will impose a burden upon the estate and deter rehabilitation. 68

Whether a collective bargaining agreement is viewed as an uncompleted contract or a burdensome contract, it still falls within the definition of an executory contract. The issue is whether a collective bargaining agreement is the type of executory contract subject to rejection under the Bankruptcy Laws when read in conjunction with the NLRA.

B. The "New Entity" View

The first case in which a federal circuit court had to decide whether collective bargaining agreements are subject to special protection or general rejection through bankruptcy according to the NLRA was Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc. 69

Kevin involved a situation where a debtor-in-possession had filed a petition for reorganization under Chapter XI. 70 The debtor-in-possession sought court approval to reject a collective bargaining agreement entered into prior to the filing of the bankruptcy petition. 71 The bankruptcy court approved the rejection, but on appeal to the district court the rejection was denied. 72 At the circuit court level, both the debtor-in-possession 73 and the union 74 articulated persuasive arguments. In the end the circuit court agreed with the debtor-in-

44 See, A. NAMDAR, supra note 37. Rejection of executory contracts is derived from the judicial doctrine of abandonment where the contract was viewed as burdensome property and was thus, "abandoned".
45 519 F.2d 698 (2nd Cir. 1975). Accord, Local Joint Executive Board AFL-CIO v. Hotel Circle, Inc., 613 F.2d 210 (9th Cir. 1980).
46 519 F.2d 698, 700 (2nd Cir. 1975).
47 Id. The debtor-in-possession only sought the rejection of one of three existing collective bargaining agreements.
49 519 F. 2d 698 at 701-702. The debtor-in-possession set forth the following arguments:
   (1) § 313(1) is phrased in broad terms and does not exclude collective bargaining agreements from its scope.
   (3) If Congress had wanted to carve out an exception, it could easily have done so as it did in Section 77(n) of the Bankruptcy Act of 1898, 11 U.S.C. § 205(n) (Former analogous section to 11 U.S.C. § 1167, which exempts collective bargaining agreements subject to the Railway Labor Act).
50 519 F. 2d at 702. The union, desiring that collective bargaining agreements be given special treatment within bankruptcy presented the following arguments:
   (1) What case law exists, is only district court opinions and thus not controlling on the circuit court.
   (2) U.S. Supreme Court decisions have held that collective bargaining agreements are not ordinary contracts, therefore, the court here should not treat them as such. See, John Wiley and Sons, Inc., v. Livingston, 376 U.S. 543 (1964).
   (3) To allow rejection of collective bargaining agreements in bankruptcy, would permit employers to circumvent the policy of the NLRA and would thus encourage employers to use the Bankruptcy Laws as a means of avoiding undesirable collective bargaining agreements.
possession’s contention that collective bargaining agreements are executory contracts within the scope of the Act and are, therefore, subject to rejection. 75

The Kevin court allowed rejection reasoning that congressional failure to expressly exempt all collective bargaining agreements from the scope of the Bankruptcy Laws was not legislative oversight. 76 Secondly, Supreme Court decisions that favored collective bargaining agreements in one context did not protect them in the bankruptcy context. 77 Thirdly, as to encouraging businesses to seek refuge from collective bargaining agreements through bankruptcy, the court held that “the adverse consequences of bankruptcy are ordinarily far too harsh for that.” 78

In order to reconcile the dilemma between the Act and the NLRA, the Kevin court put forth what it called the “New Entity” theory. 79 This theory stated that the debtor-in-possession and the original debtor, who was a signator to the collective bargaining agreement, were not the same person. 80 The basis for this conclusion was that the debtor-in-possession is under the supervision of the court, whereas the original debtor is not. 81 Furthermore, the debtor-in-possession should not be in any worse position than a successor employer who can generally reject an existing collective bargaining agreement. 82

The Kevin court thus held that “until the [debtor-in-possession] ... assumes the old agreement or makes a new one, [he] is not a ‘party’ under section 8(d) to any labor agreement with the union and is simply not subject to the termination restrictions of the section.” 83 By the use of a legal fiction, 84 the Kevin court was able to reconcile the co-existence of two conflicting federal statutes.

7519 F. 2d at 706.
76Id. at 705. The court listed several opportunities that Congress had to reform the existing Bankruptcy Act, yet failed to do so, regarding collective bargaining agreements. E.g., Act of July 1, 1946, 60 Stat. 409; Act of Sept. 25, 1962, 76 Stat. 570; Acts of Nov. 28, 1967, 81 Stat. 510, 511, 516; Act of Oct. 1970, 84 Stat. 990. This argument is even more persuasive since the enactment of the BRA which was a comprehensive reform statute.
7719 F. 2d at 703; U.S. v. Embassy Restaurant, Inc., 359 U.S. 29 (1959). (Fringe benefits, though considered wages under the NLRA, are not wages under the Bankruptcy Act).
7819 F. 2d at 706. It is interesting to note that the adverse consequences of bankruptcy should be weighed against the adverse consequences of the collective bargaining agreement that is sought to be avoided. See generally, Hide and Seek: Bankruptcy in America, 287 ECONOMIST 102 (1983); Asbestos Litigation Group Challenges Manville, 19 Trial 8 (1983).
8019 F. 2d at 704.
81Id.
82Id., NLRB v. Burns International Security Services, Inc., 406 U.S. 272 (1972), (Successor employer is not bound by an existing contract. Rationale is to encourage the free flow of capital).
8319 F. 2d at 704, referring to 29 U.S.C. § 158(d) (1976) which is set out supra note 32.
C. The "Legislative Intent" View

The second theory which justified rather than reconciled the dilemma between the Bankruptcy Law and the Labor Law is the "Legislative Intent" theory. This theory finds its origin in In re Brada Miller Freight System, Inc.

Brada dealt with a financially distressed trucking company that filed for reorganization under Chapter 11 of the BRA. The debtor-in-possession sought and obtained court approval to reject its collective bargaining agreements with the union. The debtor-in-possession negotiated new collective bargaining agreements with most of its locals, but a few refused to bargain. Instead, the non-bargaining locals appealed the bankruptcy court-approved rejection arguing that collective bargaining agreements were excluded from the coverage of section 365(a) of the BRA. The unions' argument was consistently rejected by both the district and circuit courts.

In reaching its decision the Brada court relied entirely on legislative intent and criticized and rejected the "New Entity" theory. To justify its decision the court looked to cases decided under the Act. The court noted that even case law decided under the Act was relevant to the resolution of the Bankruptcy/Labor Law dilemma.

The Brada court stated "that Congress intended collective bargaining agreements to be subject to unilateral rejection by the bankruptcy trustee (with the approval of the court) under section 365." The Brada court based its holding on three factors that indicated a congressional intent that collective bargaining agreements should not be exempt from the scope of the Bankruptcy Laws. First, the court looked to the language of section 365. Here the court could not find, nor did the union present, any evidence that collective bargaining agreements were not included within the scope of section 365. The court, realizing that statutory language does not always express legislative intent, did not end its analysis but looked further.

Second, the Brada court looked to section 1167 of the BRA, which expressly and unambiguously excludes collective bargaining agreements subject...
to the Railway Labor Act, 94 from the scope of section 365.95 Here the Brada court agreed with the Kevin court whom they quoted as saying: "Congress knew how to remove labor agreements from the scope of a general power to reject executory contracts."96 Therefore, congressional inaction must have been intentional. Closely aligned with the aforementioned reason was the fact that Congress had numerous opportunities to correct the dilemma but had failed to do so.97

Third, the Brada court looked to the rehabilitative purpose of the reorganization provisions.98 The court reasoned that rehabilitation could not succeed if a collective bargaining agreement could never be rejected regardless of its onerous or burdensome nature. The Brada court did not believe that Congress intended that collective bargaining agreements should have such a "strangle hold" over the purposes of the BRA reorganization provisions.99

The Brada court relied entirely on legislative intent and refused to lend support to the "New Entity" theory. The court, like some commentators,100 believed that the "New Entity" theory was hindered by conceptual inconsistencies which did not reconcile the dilemma as efficiently as the Kevin court had believed.101

Two concepts were especially troublesome to the Brada court. First, the Brada court noted that section 365 requires court approval prior to rejection of an executory contract.102 This requisite indicated that Congress did not view the debtor-in-possession as a different person or new entity.103 The Brada court reasoned that had Congress intended the debtor-in-possession to be a new entity the statutory scheme would have allowed for automatic rejection of all executory contracts simply upon the filing of the bankruptcy petition.104

Second, the Brada court looked at the situation where a debtor-in-possession chose to accept the executory contract.105 The court could not understand how a "New Entity," who was not previously a party to an agreement

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95 702 F. 2d at 896.
96 Id. at 896, Citing, Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc., 519 F. 2d 698, 704 (2nd Cir. 1975).
97 702 F. 2d at 896; See also supra note 76.
98 702 F. 2d at 896.
99 Id.
101 702 F. 2d at 895.
103 Id. F.2d at 895.
104 Id.
105 Id.
could, by acceptance, bind himself retroactively to a time when he, in fact, did not exist.106

D. Analysis

Both the Second Circuit and the Eleventh Circuit reached the same result. These circuits held that collective bargaining agreements are subject to rejection under the Bankruptcy Laws. Each circuit, though, has reached this result through different means.

It is true, as pointed out in Brada that the "New Entity" theory has conceptual flaws. Regardless of such flaws, the "New Entity" theory does reconcile the dilemma between the Bankruptcy Law and the Labor Law. The Second Circuit refused to ignore existence of the dilemma. Instead, the Second Circuit admitted the existence of a legislative conflict and chose to put forth a theory which reconciled and diminished this conflict.

The difficulty with the Eleventh Circuit's "Legislative Intent" theory is that the dilemma is avoided. The Eleventh Circuit's response appears to be more of a justification than a reconciliation. The "Legislative Intent" theory appears to be a "that's the way life is" response, and that no reconciliation is needed. The prevailing view is the "New Entity" view, which is followed in three circuits.107 The Eleventh108 Circuit alone follows the "Legislative Intent" view.

As has been shown, regardless of which view is followed, collective bargaining agreements are not absolutely immune from rejection under the BRA. Not one of the four circuits that has confronted the dilemma has been able to glean any protective treatment from the Bankruptcy Laws.

III. THE STANDARD FOR REJECTION

A. Minimal Scrutiny

As to non-collective bargaining agreements, the prevailing standard for review is the "business judgment test."109 This test is a very deferential and subjective test, whereby rejection is permitted whenever it will result in a benefit to the estate. The rationale for the business judgment test is that the debtor's estate should be free to abandon any burdensome property.110

104 Id. But see, Truck Drivers Local Union No. 807 v. Bohack Corp., 541 F. 2d 312, 320 (2d Cir. 1975). cert. denied 439 U.S. 825. (The court explained that the "New Entity" "cannot be taken literally, since neither affirmance nor rejection of the collective bargaining agreement would be possible by one not a party to it."). E.g., Local Joint Executive Board AFL-CIO v. Hotel Circle, Inc., 613 F. 2d 210 (9th Cir. 1980).
105 In re Bildisco, 682 F. 2d 72 (3d Cir. 1982), aff'd, 104 S. Ct. 1188 (1984); Local Joint Executive Board AFL-CIO v. Hotel Circle, Inc., 613 F. 2d 210 (9th Cir. 1980); Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc., 519 F. 2d 698 (2nd Cir. 1975).
106 In re Brada Miller Freight System, Inc., 702 F. 2d 890 (11th Cir. 1983).
108 2 COLLIER ON BANKRUPTCY, ¶ 365.03 (15th ed. 1983).
The prevailing view has been to reject the business judgment test whenever a collective bargaining agreement has been the focus of rejection. The rationale for this reasoning is that the business judgment test "totally ignores the policies of the Labor Act, and makes no attempt to accommodate to them."

Notwithstanding the prevailing view, some courts have applied the business judgment test in deciding whether rejection of a collective bargaining agreement should be permitted. The courts that have expressly approved the business judgment test do not include any circuit courts. The Ninth Circuit, though, may have approved the test by its refusal to expressly reject it in *Local Joint Executive Board AFL-CIO v. Hotel Circle, Inc.*

In *Hotel Circle* a debtor-in-possession under Chapter XI of the Act wished to sell the estate. The debtor-in-possession located a buyer who would consummate the sale only upon the rejection of the estate’s collective bargaining agreements. The bankruptcy court permitted the rejection based on the business judgment test, and the district court affirmed. On appeal to the Ninth Circuit, the district court decision was affirmed, but the circuit court failed to discuss whether the standard applied by the bankruptcy court was proper. One can reason that, by implication, the Ninth Circuit has given judicial approval to the applicability of the business judgment test in the case of collective bargaining agreements.

**B. Strict Scrutiny**

The strict scrutiny test is a two pronged test that was formulated by the Second Circuit in *Shopmen’s Local Union No. 455 v. Kevin Steel Products, Inc.* The Second Circuit believed that a deferential test, such as the business judgment test, ignored the policies of, and the conflict between, the Act and the NLRA. Furthermore, the *Kevin* court agreed with the union’s assertions that a potential for abuse existed and that such potential should be minimized.

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111 *In re* Brada Miller Freight System, Inc., 702 F. 2d 890 (11th Cir. 1983); *e.g.*, Shopmen’s Local Union No. 455 v. Kevin Steel Products, Inc., 519 F. 2d 698 (2nd Cir. 1975).
112 *Shopmen’s Local Union No. 455 v. Kevin Steel Products, Inc.*, 519 F. 2d 698, 707 (2nd Cir. 1975).
114 613 F. 2d 210 (9th Cir. 1980).
115 *Id.* at 212.
116 *Id.*
118 613 F. 2d 210 (9th Cir. 1980).
119 519 F. 2d 698 (2nd Cir. 1975); *See also*, Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc., 523 F. 2d 164 (2nd Cir. 1975), *Cert. denied* 423 U.S. 1017 (1975).
120 519 F. 2d at 707.
121 *Id.* The stipulated facts proved that the debtor-in-possession acted in bad faith by discriminatorally laying off union workers and refusing to bargain and sign any new collective bargaining agreements. The union asserted that prior to rejection the: Judge should have required, among other things, a showing that the employer is not improperly motivated merely by a desire to rid itself of the union and its adherents, more convincing proof of the company’s financial condition, the source of its difficulties and the benefit to be gained
The *Kevin* court stated that rejection should be permitted only after a thorough scrutiny, and a careful balancing of the equities on both sides, for, in relieving a debtor from its obligations under a collective bargaining agreement, it may be depriving the employees affected of their seniority, welfare and pension rights, as well as other valuable benefits which are incapable of forming the basis of a provable claim for money damages.\(^{122}\)

What the equities were, though, the court failed to say. The balancing of the equities constituted the second prong of the strict scrutiny test.

The Second Circuit did not formulate the first prong of the strict scrutiny test until one month later in *Brotherhood of Railway, Airline and Steamship Clerks vs. REA Express, Inc.*\(^{123}\) REA dealt with a debtor-in-possession who was subject to the requisites of the Railway Labor Act.\(^{124}\) The *REA* court, regarding rejection stated that "it should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the [debtor-in-possession] will collapse and the employees will no longer have their jobs."\(^{125}\)

A two prong test of strict scrutiny has thus evolved. The first prong requires a threshold showing that without rejection of the collective bargaining agreement the reorganization will fail and the debtor-in-possession will have to liquidate. If the debtor satisfies the first prong, the court must then balance the equities and determine if rejection is still permitted. Again the Second Circuit failed to set forth any factors to be considered in balancing the equities, leaving such to lower court interpretation.\(^{126}\)

C. Intermediate Scrutiny

The standard of intermediate scrutiny originated in *In re Bildisco*.\(^{127}\) *Bildisco* dealt with a building supply distributor who filed for reorganization under Chapter 11 of the BRA.\(^{128}\) The debtor-in-possession requested and received permission to reject its collective bargaining agreement with eighteen

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by rejecting the contract, and a careful weighing of the equities against rejection, including the loss of intangible employee rights.

*Contra*, 52 U.S.L.W. 3317 (U.S. Oct. 25, 1983) (No. 82-818, No. 82-852) (Deputy Solicitor General Lawrence G. Wallace stated that collective bargaining agreements should be treated as executory contracts in general and discounted the importance of bad faith).


\(^{125}\)523 F. 2d at 172.


First, the court should determine that the agreement is onerous and burdensome to the estate, so that failure to reject will make a successful arrangement impossible. Second, the equities must be balanced and found to favor the debtor. Then and only then, may rejection of a collective bargaining agreement be permitted.


\(^{128}\)682 F. 2d 72.
employees.129

On appeal, the Third Circuit questioned the proper standard for rejecting collective bargaining agreements. The court agreed that a stricter standard than the business judgment test was required.130 The court refused however to lend support to the strict two prong test that the court called not the test of Kevin, but rather the test of Kevin's "illegitimate progeny."131

The Bildisco court gave two important reasons for rejecting the strict scrutiny standard. First, it may not be possible, at the time rejection is requested, to determine if reorganization will fail without the rejection of the collective bargaining agreement.132 Second, a strict standard "unduly exalts the perpetuation of the collective bargaining agreement over the more pragmatic consideration of whether the employees will continue to have jobs at all."133

The test of intermediate scrutiny is a two prong test just as in strict scrutiny. The difference in intermediate scrutiny is the requisite first prong. First, the debtor-in-possession must "demonstrate that the continuation of the collective bargaining agreement would be burdensome to the estate."134 The debtor-in-possession need not show that reorganization will fail without rejection of the collective bargaining agreement. The second prong is similar to strict scrutiny. The debtor-in-possession must demonstrate that the equities favor rejection.135 Though the Bildisco court did not expressly list what equities were to be considered, the court did say that a reviewing "court must consider the rights of covered employees as supported by the national labor policy as well as the possible 'sacrifices which other creditors are making' in the effort to bring about a successful reorganization."136 Thus the test of intermediate scrutiny treats the policies of the NLRA and the BRA equally.

IV: THE SUPREME COURT VIEW

A. Affirmance of the "Legislative Intent" View

On February 22, 1984 the United States Supreme Court finally addressed the judicial inconsistencies concerning the NLRA/BRA legislative dilemma.137 In Part Two of a unanimous opinion, Justice William Rehnquist addressed two important issues.

129Id. At the time of the hearing, the number of employees had been reduced to three.
130Id.
131Id. The Bildisco court believed that the two prong Kevin test was a test of intermediate scrutiny that had been converted into strict scrutiny by REA Express. The Bildisco court believed that REA Express did not restate the two prong test, as REA said it had, but rather, reformulated it into a stricter standard.
132Id. at 80.
133Id.
134Id.
135Id.
136Id. at 81.
The first issue addressed was whether a collective bargaining agreement that is protected by the NLRA is subject to rejection under the BRA. The Supreme Court answered this issue in the affirmative. Though the Supreme Court’s result was consistent with the result reached by all the circuit courts, the Supreme Court’s ratio decidendi was not.

In resolving the first issue Justice Rehnquist relied entirely upon the "Legislative Intent" view. The Supreme Court, referring to the text of the BRA, found both express and implied legislative intent that collective bargaining agreements under the NLRA were not to be afforded absolute protection under the BRA.

The Supreme Court found express legislative intent in the text of section 365(a) and noted that express limitations did exist as to the debtor-in-possession’s power to reject executory contracts. The Supreme Court stated that "none of the express limitations on the debtor-in-possession’s general power under § 365(a) apply to collective bargaining agreements." Thus, the Supreme Court, relying on a maxim of statutory construction, found express legislative intent, that collective bargaining agreements under the NLRA are not absolutely protected by the BRA.

Next the Supreme Court looked at the text of section 1167 and found implied legislative intent that collective bargaining agreements in general, are not exempt from BRA rejection. Relying on section 1167 the Supreme Court held; "Obviously, Congress knew how to draft an exclusion for collective-bargaining agreements when it wanted to; its failure to do so in this instance indicates that Congress intended that § 365(a) apply to all collective-bargaining agreements covered by the NLRA."

By not expressly accepting the "New Entity" view the Supreme Court has impliedly rejected it. Although a similar result would have occurred under either view, the Supreme Court’s reliance solely on legislative intent indicates that the Court declined to make an attempt to reconcile the NLRA/BRA dilemma.

B. Qualified Intermediate Scrutiny

The main issue in Part Two of the opinion was: What is the standard for

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138 Id. at 1189.
139 Id.
141 104 S. Ct. at 1189.
143 104 S. Ct. 1188.
144 Id. at 1189.
145 See supra notes 127-136 and accompanying text.
the rejection of collective bargaining agreements?\textsuperscript{146} The Supreme Court admitted that a standard greater than the business judgment test was required,\textsuperscript{147} but refused to accept a standard as great as that of strict scrutiny.

The Supreme Court rejected the strict scrutiny test because it was "fundamentally at odds with the policies of flexibility"\textsuperscript{148} found in the BRA reorganization provisions. Instead of considering the interests of all persons such as the debtor, creditors and employees a strict scrutiny test would focus primarily upon the interests of the employees and could possibly frustrate a successful reorganization.

The Supreme Court instead accepted what appeared to be the test of intermediate scrutiny.\textsuperscript{149} The Supreme Court held that a collective bargaining agreement can be rejected when the agreement "burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."\textsuperscript{150}

Although facially adopting the test of intermediate scrutiny, the Supreme Court in reality formulated a new standard that limited the "balancing of equities" prong of the intermediate scrutiny test. The Supreme Court noted that the interests of all affected parties are to be considered and balanced, but the Court added that "[t]he Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization."\textsuperscript{151} Accordingly, although intermediate scrutiny treats the goals of the NLRA and the BRA equally, qualified intermediate scrutiny tends to favor the BRA.\textsuperscript{152} The Supreme Court’s favored treatment of the BRA further aggravates the NLRA/BRA dilemma instead of attempting to minimize it.

**CONCLUSION**

If Congress truly intends that collective bargaining agreements should be exempt from rejection under the BRA, Congress should expressly so provide in future bankruptcy reforms. Absolute exemption will eliminate the legislative dilemma that presently exists. Absolute exemption will also eliminate the abuse by employers who merely seek bankruptcy court refuge as a means of avoiding

\textsuperscript{146}104 S. Ct. at 1189.

\textsuperscript{147}Id. at 1191.

\textsuperscript{148}Id.

\textsuperscript{149}Id. Though the Supreme Court did not classify the standard as intermediate scrutiny, the Supreme Court held that it followed the view articulated in In re Bildisco, 682 F. 2d 72 (3d Cir. 1982) and In re Brada Miller Freight System, Inc., 702 F. 2d 890 (11th Cir. 1983).

\textsuperscript{150}104 S. Ct. at 1191 (1984).

\textsuperscript{151}Id. at 1192.

\textsuperscript{152}The term "qualified intermediate scrutiny" is used by the author in order to indicate that a conceptual difference does exist between the two tests. For example, whereas intermediate scrutiny treats the NLRA and the BRA equally, qualified intermediate scrutiny tends to favor the policies of the BRA over those of the NLRA.
their collective bargaining agreements.\textsuperscript{153}

Congress must realize, however, that absolute exemption is a two-edged sword that may result in the complete frustration of the BRA reorganization provisions. While absolute exemption will deter a wrongfully motivated employer, it will also deter a good-faith employer who, with the aid of the BRA, could survive and continue to provide his employees with needed employment.

There are two alternatives through which Congress can enact legislative reform without unduly frustrating the policies of the BRA and the NLRA. First, Congress can incorporate the intermediate scrutiny test\textsuperscript{154} into the statutory scheme of the BRA. The intermediate scrutiny test considers the existence and the purposes of both the BRA and the NLRA without undue favoritism. In order to insure incorporation of such a test and thus an equality of treatment, the statutory scheme should require the reviewing courts to look at various factors.\textsuperscript{155}

The courts should look to the possibility of liquidation. If the debtor-in-possession is very near to financial collapse, rejection should be permitted in an effort to deter default and thus provide continued employment. In some situations this factor alone may be determinative of whether rejection should be permitted. If possible, though, scrutiny should not end here but should continue on to consider other factors of equal importance.

A second factor to look to is the wages of employees in similarly situated industries. For example, if the debtor-in-possession is an automaker, look to the wages paid by other automakers. This factor will deter an employer who is seeking reorganization merely as a means of avoiding what he believes to be a burdensome collective bargaining agreement. The burden of justifying rejection is upon the proponent. This burden will be difficult to justify when it is found that the debtor-in-possession is paying his employees as much, or even less than the industry norm.

Third, the courts should look to whether the burdens of reorganization are equally distributed. Here the courts should look to whether all employees are sharing in the loss or merely the unionized employees.\textsuperscript{156} Furthermore, is

\textsuperscript{153}In re David A. Rosow, Inc., 9 Bankr. 190 (D. Conn. 1981). (Employer was denied rejection of a collective bargaining agreement that would have resulted in savings of forty-one thousand dollars over a sixty-five week period, while not attempting the rejection or modification of a lease from family members costing fifteen thousand dollars per month). In re Figure Flattery, Inc., 88 Lab. Cas. (CCH) P 11,850 (S.D.N.Y. 1980).

\textsuperscript{154}See supra notes 127-136 and accompanying text.

\textsuperscript{155}Accord, In re Brada Miller Freight System, Inc., 702 F. 2d 890 (11th Cir. 1983).

\textsuperscript{156}In re Parrot Packing Co., Inc., 99 Lab. Cas. (CCH) P 10,550 (N.D. Ind. 1983). (Union employees had taken pay cuts and suffered lay-offs while at the same time management had received substantial wage increases and a larger proportion of salaried personnel had been hired. The court held "it is simply inequitable to force one group of employees to sustain a vastly disproportionate share of reductions when others could share in that burden for the common good . . . of the company,").
the loss in wages evenly distributed? For example, is management taking a ten percent reduction in wages while labor is taking a forty percent reduction? In this regard, the courts should look to all categories of losses including wages and benefits.157

Fourth, the courts should look at the impact of rejection upon similar competitive industries. The rejection of a collective bargaining agreement by one employer may result in a "domino effect" throughout a competitive industry. Rejection by one employer may have a detrimental effect upon the continued viability of a related employer.158 For example, the airline industry is highly competitive. Suppose through reorganization, one airline can substantially reduce its labor costs and in turn offer lower fares. If the debtor's competitors cannot reduce fares or reject existing collective bargaining agreements, they may be at a competitive disadvantage, which may in time result in the competitor's financial demise. In the alternative, the competitor may obtain voluntary concessions from its employees, which will result in increased profits if fares are not reduced or added competition for the original debtor-in-possession if fares are reduced. In essence there could be a price war with the loser being a competitor who could no longer reduce labor costs.

Lastly, the courts should look to the good faith efforts of the union and the debtor-in-possession in their extrajudicial efforts to resolve their mutually difficult situation. Here especially, the court can give support to the goals of the NLRA. The courts should encourage a debtor-in-possession to attempt renegotiation of the collective bargaining agreement prior to seeking court approved rejection.159

By closely scrutinizing the aforementioned factors, the courts will truly be "balancing the equities." Furthermore, by looking at all equities and not merely those that favor reorganization, the courts will truly be promoting the important policies of both the NLRA and the BRA.

As an alternative to incorporation of the intermediate scrutiny test, Congress could reform the BRA and permit the temporary suspension of collective bargaining agreements. Temporary suspension is not to be confused with partial rejection.160 Through temporary suspension a collective bargaining agreement could be suspended for a statutory period.

After the termination of the statutory period, the court could reevaluate

157 In re Brada Miller Freight System, Inc., 702 F. 2d 890 (11th Cir. 1983). Some of the benefits of a collective bargaining agreement are non-monetary and may not be recoverable since they cannot be reduced to a dollar amount. For example; work rules or seniority rights.

158 In re Allied Supermarkets, Inc., 6 Bankr. 968 (E.D. Mich. 1980). Two competitors complained that they would be financially ruined because their collective bargaining agreements could not be rejected and they could thus not be competitive with the debtor-in-possession.


160 2 COLLIER ON BANKRUPTCY, ¶ 365.01(1) (15th ed. 1983). The debtor-in-possession must completely accept or reject the contract. He cannot merely reject the burdensome provisions and accept the beneficial ones.
the circumstances of the debtor-in-possession. The court could then either mandate a continued suspension, a return to the original contract terms, or order rejection and renegotiation.

This alternative would further the goals of reorganization by granting the debtor-in-possession an opportunity to rehabilitate himself and financially survive. Temporary suspension would aid the unionized worker by deterring a wrongfully motivated employer from seeking reorganization simply to avoid a collective bargaining agreement.

Due to increased public concern, some type of legislative reform is inevitable. Congress must proceed cautiously, however, so that the important policies of both the NLRA and the BRA are promoted instead of frustrated.

GUST GOUTRAS