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**The Role of Unions in the 1980s, Symposium, Chapter 11 of the Bankruptcy Act and Collective Bargaining Agreements: The Rejection of Collective Bargaining Agreements Under the Bankruptcy Code - An Abuse or Proper Exercise of the Congressional Bankruptcy Power**

**Cover Page Footnote**

The author wishes to thank Peter A. Langerman for his research assistance on this Article.

# CHAPTER 11 OF THE BANKRUPTCY ACT AND COLLECTIVE BARGAINING AGREEMENTS

## THE REJECTION OF COLLECTIVE BARGAINING AGREEMENTS UNDER THE BANKRUPTCY CODE—AN ABUSE OR PROPER EXERCISE OF THE CONGRESSIONAL BANKRUPTCY POWER?

HARVEY R. MILLER\*

### INTRODUCTION

Throughout American history, one or more sectors of the populace have characterized the bankruptcy law or the anticipated enactment of bankruptcy legislation as an abuse. As far back as 1792, Thomas Jefferson and nearly all of the representatives from Virginia were opposed to a national bankruptcy system because such a system would enable a creditor to reach the property of a debtor, "whereas under Virginia statutes freehold land could not be taken on execution."<sup>1</sup> By contrast, creditors holding liens and encumbrances on property of a debtor traditionally have argued that debtors abuse the bankruptcy law by abrogating their contracts and impairing the rights of secured creditors.<sup>2</sup> More recently, similar sentiments have been sounded by representatives of the consumer finance industry, who have prevailed on members of Congress to support legislation amending provisions of the current bankruptcy law. These representatives argue that, in the consumer bankruptcy context, the current provisions "have altered the balance of equities between debtors and creditors in bankruptcy excessively in favor of debtors."<sup>3</sup>

In contrast to the efforts of financial institutions and consumer finance companies to restrict the implementation of the "fresh start" policy of American bankruptcy law, organized labor has been a consistent supporter of a fresh start for individuals under the bankruptcy law.<sup>4</sup> With the decline in the economic viability of "smoke stack"

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1. C. Warren, *Bankruptcy in United States History* 16 (1935).

2. *See id.* at 30, 158-59.

3. 129 Cong. Rec. S.384-85 (daily ed. Apr. 27, 1983) (statement of Sen. Dole regarding S. 445 immediately prior to passage by Senate).

4. *See, e.g., Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Const. Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 2451-52 (1976) (statement of Robert A. Georgine, Pres., Building & Constr. Trades Dep't, AFL-CIO) (fully supporting proposed bankruptcy bill).

industries, however, and the deregulation of other heavily-unionized segments of the economy, we have come full circle and it is now the unions that are complaining of bankruptcy abuse.<sup>5</sup> They contend that the power of the bankruptcy court to approve the rejection of a collective bargaining agreement, which is an executory contract under the bankruptcy law,<sup>6</sup> is an abuse of the bankruptcy power vested in Congress by the Constitution.<sup>7</sup> This Article examines that complaint and concludes that the national policy for the reorganization and rehabilitation of financially distressed businesses does not irreconcilably conflict with the policy underlying the labor laws.

### I. OBJECTIVES OF BUSINESS REORGANIZATION

The essence of business reorganization as well as liquidation under the bankruptcy law is the "fresh start" policy.<sup>8</sup> Over 140 years ago, it was determined that American bankruptcy law should include provisions enabling businesses or individuals to rehabilitate themselves, without the necessity of liquidating and dismembering their assets and properties.<sup>9</sup> This concept developed and was substantially formalized in the passage of emergency legislation during the Great Depression,<sup>10</sup> and thereafter, in the Chandler Act of 1938.<sup>11</sup> These provisions, as well as the creation of the Reconstruction Finance Corporation and

5. Unions have not hesitated to seek the protection of the bankruptcy courts to serve their own purposes. In *In re American Fed'n of T.V. & Radio Artists*, 32 Bankr. 672 (Bankr. S.D.N.Y. 1983), the union attempted to use the Bankruptcy Code (Code) to relieve itself of a treble damage judgment for antitrust violations on the ground that such trebling constituted an unenforceable penalty under the Code. *Id.* at 673. The union's attempt failed. *Id.* at 674.

6. See *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1194 (1984).

7. U.S. Const. art. I, § 8, cl. 4 (Congress has the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."). Henry A. Duffy, president of the Air Line Pilots Association, stated that use of bankruptcy law to modify collective bargaining agreements creates "a scenario for the wholesale eradication of the rights of workers." BNA Daily Labor Report, Oct. 5, 1983, at E-3.

8. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137 pt. 1, 93rd Cong., 1st Sess. 71 (1973), reprinted in *Collier on Bankruptcy* app. 2 (15th ed. 1983); see *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1197 (1984) ("policy of Chapter 11 is to permit successful rehabilitation of debtors").

9. See C. Warren, *supra* note 1, at 60.

10. See, e.g., Act of June 7, 1934, ch. 424, 48 Stat. 911-12 (adding § 77B regarding corporate reorganizations generally); Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467 (adding provisions regarding general compositions and extensions, agricultural compositions, and reorganizations of interstate railroads).

11. Ch. 575, 52 Stat. 840 (1938) (adding chapters X, XI, XII regarding business reorganizations and chapter XIII regarding individual payment plans). This emergency legislation was incorporated into the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (superseded by 11 U.S.C. §§ 101-151,326 (1982)).

similar entities, express the national policy that the best interests of the nation are promoted by affording commercial and industrial concerns the protection of the bankruptcy law while they undergo financial and business rehabilitation. Such rehabilitation enables them to emerge from bankruptcy proceedings as viable economic units contributing to the gross national product, preserving jobs and promoting efficient use of economic resources.<sup>12</sup> This policy was reaffirmed and accentuated by the Bankruptcy Reform Act of 1978,<sup>13</sup> which provides the devices and substantive law that permit effective reorganization. One of the most important of these devices is the power to reject executory contracts.<sup>14</sup>

Congress recognized from the outset that the uniform bankruptcy laws, including the power to reject executory contracts, impaired contractual rights. The congressional debates over the enactment of the Bankruptcy Act of 1800 are replete with statements and arguments concerning the power of Congress to impair such rights.<sup>15</sup> Nonetheless, Congress concluded that it possessed the power to pass such legislation.<sup>16</sup>

Indeed, the Supreme Court has consistently upheld bankruptcy laws that have the effect of impairing contractual rights. In 1902, the Court in *Hanover National Bank v. Moyses*<sup>17</sup> stated that "[t]he subject

12. See *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1197 (1984).

13. 11 U.S.C. §§ 101-151,326 (1982). These sections include the Bankruptcy Code, the substantive law of bankruptcy.

14. 11 U.S.C. § 365(a) (1982) provides that, with certain exceptions, a trustee or debtor-in-possession, "subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." Rejection of executory contracts is a traditional bankruptcy power. See *Chandler Act*, ch. 575, § 70(b), 52 Stat. 840, 880-81 (1938) (superseded by 11 U.S.C. § 365 (1982)).

15. See C. Warren, *supra* note 1, at 30, 158-59. In 1840, Henry Clay stated that "[t]he right of the [nation] to the use of the unimpaired faculties of its citizens as producers, as consumers, and as defenders of the Commonwealth, is paramount to any rights or relations which can be created between citizen and citizen." *Id.* at 159. One year later, Congressman William P. Fessenden of Maine stated in connection with the Bankruptcy Act of 1841:

The power of Government to pass laws affecting the obligation of contracts is derived from the nature of the Government itself. . . . It is a necessary power; for it is by no means difficult to imagine a condition of things in which the safety and well being of the Nation would imperatively demand its exercise. Take the case, for example, in which a whole community becomes insolvent by some stupendous accident, or by some magnificent but fallacious scheme, such as other countries have seen and felt at no distant day. Can it be pretended that a power to apply a remedy to a disorder that is paralyzing and destroying the body politic exists nowhere? Such an idea is a libel upon the very name of Government.

*Id.* at 158.

16. See *id.* at 14, 19.

17. 186 U.S. 181 (1902).

of 'bankruptcies' includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property."<sup>18</sup> Thus, "[t]he grant to Congress involves the power to impair the obligation of contracts."<sup>19</sup> More recent examples include *United States v. Security Industrial Bank*,<sup>20</sup> which dealt with the voiding of non-purchase money interests relating to consumer debtor cases, and *NLRB v. Bildisco & Bildisco*,<sup>21</sup> which upheld the rejection of collective bargaining agreements.

A primary benefit of the business reorganization process is the freezing or suspension of creditor remedies and debtor obligations by the filing of a chapter 11 petition, which affords the time to determine and resolve problems in management, operations and finance. Most business reorganizations involve over-expanded and over-extended businesses whose ability to operate profitably has been eradicated by increased costs, changing markets, natural disasters or any of a host of other problems. Chapter 11 is remedial legislation. It sometimes requires radical surgery to save the core business and the jobs it provides.

Historically, many reorganization cases have been filed to obtain relief from burdensome executory contracts such as long-term real property leases, equipment leases, and supply agreements.<sup>22</sup> Until the mid-1970's, however, the power to reject collective bargaining agreements was used sparingly because it was not practical and would not further the goals of business reorganization.<sup>23</sup> During most of that time, the labor movement was strong and vibrant, and most bankruptcy reorganization cases involved non-public corporations located in major industrial centers with highly visible organized labor movements. Attempts to reject collective bargaining agreements in that context invariably would have been exercises in futility. The businesses involved could not obtain substitute labor and could not sustain themselves during the course of a strike; thus, while the statutory power existed, in practical terms it was illusory.

The world has changed dramatically. Membership in unions is declining,<sup>24</sup> and in many areas of the country, alternative sources of

18. *Id.* at 188.

19. *Id.*

20. 103 S. Ct. 407 (1982).

21. 104 S. Ct. 1188 (1984).

22. See, e.g., *In re United Cigar Stores Co.*, 89 F.2d 3, 5-6 (2d Cir. 1937) (lease); *In re Cheney Bros.*, 12 F. Supp. 605, 607 (D. Conn. 1935) (same).

23. See *Truck Drivers Local Union No. 807 v. Bohack Corp.*, 541 F.2d 312, 319-20 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978); *In re Overseas Nat'l Airways, Inc.*, 238 F. Supp. 359, 361-62 (E.D.N.Y. 1965); *In re Klaber Bros., Inc.*, 173 F. Supp. 83, 85 (S.D.N.Y. 1959). See *infra* notes 26-27.

24. See *The de-unionisation of America*, *The Economist*, Oct. 29, 1983, at 71.

labor are available.<sup>25</sup> A strike no longer means the termination of a business.<sup>26</sup> Consequently, the rejection of collective bargaining agreements has become a more viable option in reorganization proceedings.

## II. COLLECTIVE BARGAINING AGREEMENTS UNDER THE BANKRUPTCY CODE

### A. *Standard for Approving Rejection*

A collective bargaining agreement is an executory contract subject to rejection, or court-approved breach of contract,<sup>27</sup> in accordance with section 365 of the Bankruptcy Code (Code).<sup>28</sup> Section 365 contains no language requiring that interests of other creditors and parties in interest be sacrificed in favor of the preservation of collective bargaining agreements or the preferred treatment of employees.<sup>29</sup> Indeed, when Congress determined that certain types of contracts, such as shopping center leases, should be accorded different treatment, it had no difficulty in enacting special requirements under the Code to evidence that difference.<sup>30</sup>

Under the "business judgment" test traditionally applied to requests for rejection of executory contracts, a debtor must show only that rejection will benefit the estate.<sup>31</sup> Despite the absence of any specific statutory language, courts generally have applied a stricter standard to rejection of collective bargaining agreements than to rejection of other executory contracts in an effort to accommodate national labor policies and promote the efficacy of the collective bargaining process.<sup>32</sup>

25. See *Givebacks at Eastern and Greyhound*, Dun's Business Month, Jan. 1984, at 24, col. 3 (striking Greyhound drivers replaced by non-union workers).

26. See *id.*

27. See *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1194 (1984).

28. 11 U.S.C. § 365(a) (1982). A "claim arising from the rejection under section 365 of this title . . . , of an executory contract . . . shall be allowed . . . or disallowed . . . the same as if such claim had arisen before the date of the filing of the petition." *Id.* § 502(g).

29. See *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188, 1194-95 (1984); *In re Brada Miller Freight Sys.*, 702 F.2d 890, 896-97 (11th Cir. 1983).

30. See 11 U.S.C. § 365(b)(3) (1982). Despite the existence and ability of Congress to legislate special requirements, a national bankruptcy law should not be emasculated by the inclusion of such special interest legislation. Such legislation invariably reduces the effectiveness of a statute by granting preferential treatment to some group to the detriment of other parties in interest.

31. See *Group of Institutional Investors v. Chicago, M., St. P. & Pac. R.R.*, 318 U.S. 523, 549-50 (1943); 2 *Collier on Bankruptcy* ¶ 365.03, at 365-14 to 365-16 (15th ed. 1984).

32. See, e.g., *In re Brada Miller Freight Sys.*, 702 F.2d 890, 897-98 (11th Cir. 1983); *Brotherhood of Ry., Airline & S.S. Clerks v. REA Express, Inc.*, 523 F.2d 164, 168 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975); *Shopmen's Local Union No. 455 v.*

The seminal case elucidating the different and more stringent standards applicable to the rejection of collective bargaining agreements is *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.*<sup>33</sup> The Second Circuit held that rejection of a collective bargaining agreement under the former Bankruptcy Act required determinations that (1) the agreement is onerous and burdensome and (2) the competing equities favor the rejection of the collective bargaining agreement.<sup>34</sup> One month after *Kevin Steel Products*, the Second Circuit in *Brotherhood of Railway, Airline & Steamship Clerks v. REA Express, Inc.*<sup>35</sup> enunciated an even more demanding test for the rejection of a collective bargaining agreement: Rejection should not be authorized unless it is established that in the absence of such rejection the debtor "will collapse and the employees will no longer have their jobs."<sup>36</sup> Although it is unlikely that the Second Circuit meant to substantively change the judge-made standards of *Kevin Steel Products*, the courts subsequently applied a stricter two-step analysis derived from *REA Express*.<sup>37</sup>

The first step of this analysis required the determination that the collective bargaining agreement was onerous and burdensome to the debtor and would cause the collapse of the debtor's business. The debtor's objectives of improving its competitive position and matching the lower labor costs of competitors were not sufficient grounds for approval of rejection.<sup>38</sup> The debtor, under this analysis, had to establish that the alternative to rejection was liquidation.

The second step of the analysis required a "balancing of the equities," a subjective exercise not susceptible to precise quantification or

Kevin Steel Prods., Inc., 519 F.2d 698, 707 (2d Cir. 1975). For two differing interpretations of the development of judicial standards for approval of rejection of collective bargaining agreements, see Bordewieck & Countryman, *The Rejection of Collective Bargaining Agreements by Chapter 11 Debtors*, 57 Am. Bank. L.J. 293, 332 (1983) (bankruptcy court should not approve rejection if it appears that debtor might reorganize successfully without rejection) and Pulliam, *The Rejection of Collective Bargaining Agreements Under 365 of the Bankruptcy Code*, 58 Am. Bank. L.J. 1, 39-41 (1984) (business judgment standard for rejection of executory contracts should apply to collective bargaining agreements because it provides speed, flexibility and predictability).

33. 519 F.2d 698 (2d Cir. 1975).

34. *Id.* at 707 (citing *In re Overseas Nat'l Airways, Inc.*, 238 F. Supp. 359, 361-62 (E.D.N.Y. 1965).

35. 523 F.2d 164 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975).

36. *Id.* at 172.

37. See *In re Alan Wood Steel Co.*, 449 F. Supp. 165, 169 (E.D. Pa. 1978); Note, *The Labor-Bankruptcy Conflict: Rejection of a Debtor's Collective Bargaining Agreement*, 80 Mich. L. Rev. 134, 149 (1981).

38. *In re Connecticut Celery Co.*, 23 Collier Bankr. Cas. (MB) 68, 77 (Bankr. D. Conn. 1980).

qualification. Courts considered such factors as: (1) the good or bad faith of the debtor *and* the union in their negotiations and prior dealings with each other; (2) management's termination of unprofitable operations; (3) the spreading of the pain of the reorganization process among all interested groups, including reductions in compensation of management and non-union groups, if appropriate; (4) the impact of liquidation on the debtor and its employees; (5) the potential consequences of a strike for the debtor; (6) the adequacy of relief from rejection for employees and other claimants, taking into consideration the elimination of contractual fringe benefits such as seniority and pension rights and the impact that such claims may have on the debtor's ability to reorganize; and (7) the proportion of employees covered by the collective bargaining agreement.<sup>39</sup> The weight to be given to each of the foregoing factors or such other factors that a court decided were pertinent was a matter of discretion. As a result, predicting the outcomes was very difficult.

In 1982, the wisdom of *REA Express* and its progeny was challenged by a decision of the Court of Appeals for the Third Circuit in *In re Bildisco*.<sup>40</sup> Construing section 365 of the Bankruptcy Code, the Third Circuit specifically rejected the *REA Express* standard for rejection of a collective bargaining agreement and proclaimed that the more reasonable standard to be applied was aptly set forth in *Kevin Steel Products*.<sup>41</sup>

The court criticized *REA Express* on two specific grounds. First, it noted the difficulty of predicting the success of a reorganization case in its early stages.<sup>42</sup> Second, it considered the preservation of jobs to be a more important consideration than the enforced continuation of a collective bargaining agreement.<sup>43</sup> The decision of the Third Circuit reflects a greater deference to the business judgment of management and a desire to establish standards that do not subordinate the interests of non-labor creditors and other parties in interest to those of labor groups.<sup>44</sup>

The Third Circuit's decision in *In re Bildisco* turned the tide of court decisions from the rigid application of the *REA Express* standards. The departure from *REA Express* was refined by the Eleventh Circuit in *In re Brada Miller Freight System*,<sup>45</sup> in which the court

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39. See *In re Brada Miller Freight Sys.*, 702 F.2d 890, 899-900 (11th Cir. 1983); *In re Braniff Airways, Inc.*, 25 Bankr. 216, 218-19 (Bankr. N.D. Tex. 1982) (mem.).

40. 682 F.2d 72 (3d Cir. 1982), *aff'd sub nom.* NLRB v. Bildisco & Bildisco, 104 S. Ct. 1188 (1984).

41. *Id.* at 79.

42. *Id.* at 80.

43. *Id.*

44. *Id.* at 75-76.

45. 702 F.2d 890 (11th Cir. 1983).

elaborated on the "balancing of the equities" standard.<sup>46</sup> Subsequent cases, particularly at the bankruptcy court level, although not indiscriminately approving rejection, have relied on the rationales of the Third and Eleventh Circuits in considering requests for the approval of rejection of collective bargaining agreements under section 365 of the Bankruptcy Code.<sup>47</sup>

While the lower courts were struggling with the conflict between the highly restrictive standard set by the Second Circuit and the more relaxed standard set by the Third and Eleventh Circuits, the Supreme Court was considering the issue in the context of the Third Circuit's decision in *In re Bildisco*. In *NLRB v. Bildisco & Bildisco (Bildisco)*,<sup>48</sup> the Court was presented with two issues: (1) the proper standard for permitting the rejection of a collective bargaining agreement, and (2) the ability of a trustee or debtor-in-possession to unilaterally modify the terms and conditions of a collective bargaining agreement prior to court approval of rejection *and* in spite of the provisions of the National Labor Relations Act (NLRA) governing such modification.<sup>49</sup>

The Court unanimously affirmed the decision of the Third Circuit regarding the proper standard for rejection of collective bargaining agreements.<sup>50</sup> Justice Rehnquist, writing for the Court, recognized that "there is no indication in § 365 . . . that rejection of collective-bargaining agreements should be governed by a standard different from that governing other executory contracts."<sup>51</sup> Nevertheless, Justice Rehnquist noted that every court of appeals that had considered this issue had concluded that a more stringent standard should be applied to rejection of collective bargaining agreements than to other executory contracts.<sup>52</sup> Thus, the Court agreed that the "special nature" of collective bargaining agreements requires that a "somewhat stricter standard" govern their rejection.<sup>53</sup>

As to the critical choice between the "forced liquidation" test of *REA Express* and the "onerous and burdensome" test of *In re Bildisco*, the Supreme Court adopted the latter, stating that the agreement

46. *Id.* at 899-900. See *supra* text accompanying note 33.

47. See, e.g., *In re Rath Packing Co.*, 11 Bankr. Ct. Dec. (CRR) 498, 503 (Bankr. N.D. Iowa Jan. 12, 1984); *In re Commercial Motor Freight, Inc.*, 27 Bankr. 293, 297 (Bankr. S.D. Ind. 1983).

48. *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188 (1984).

49. *Id.* at 1191.

50. *Id.* at 1201.

51. *Id.* at 1195.

52. *Id.*; see *In re Brada Miller Freight Sys.*, 702 F.2d 890, 897-98 (11th Cir. 1983); *In re Bildisco*, 682 F.2d 72, 79 (3d Cir. 1982), *aff'd sub nom.* *NLRB v. Bildisco & Bildisco*, 104 S. Ct. 1188 (1984); *Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc.*, 519 F.2d 698, 706-07 (2d Cir. 1975).

53. 104 S. Ct. at 1195.

must burden the estate and the balance of the equities must favor rejection.<sup>54</sup> The court concluded that the *REA Express* test was “fundamentally at odds with the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code,” and unjustifiably subordinated the “multiple, competing considerations underlying a Chapter 11 reorganization” to consideration of the collective bargaining agreement.<sup>55</sup>

With respect to balancing the equities, the bankruptcy courts must consider the interests of all affected parties—the debtor, creditors and employees—but the focus of the inquiry should be on the “ultimate goal of Chapter 11” to rehabilitate the debtor.<sup>56</sup> The Court noted that “the Bankruptcy Court must consider not only the degree of hardship faced by each party, but also any qualitative differences between the types of hardship each may face.”<sup>57</sup> It specified the following equitable considerations: “the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors’ claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees.”<sup>58</sup> The Court further noted 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.”<sup>59</sup> Thus, the beneficiaries of a collective bargaining agreement, like other claimants in a chapter 11 case, must make sacrifices to achieve a successful reorganization.

The Supreme Court appears to have elevated a formerly equitable consideration to the level of a prerequisite for approval of rejection. In reaching its decision, a bankruptcy court must be convinced that “reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution.”<sup>60</sup> If the debtor cannot demonstrate that (1) it has made “reasonable efforts” to modify the agreement and (2) such efforts are “not likely” to yield “prompt and satisfactory” results, the bankruptcy court will not intervene, and apparently, the request for approval of rejection would be denied.<sup>61</sup>

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54. *Id.* at 1196.

55. *Id.* at 1196; see *In re Brada Miller Freight Sys.*, 702 F.2d 890, 897 (11th Cir. 1983).

56. 104 S. Ct. at 1197.

57. *Id.*

58. *Id.* Other courts interpreting this language are likely to consider additional equities that were mentioned in cases prior to the Supreme Court’s *Bildisco* decision. See *supra* text accompanying notes 33-34.

59. 104 S. Ct. at 1197.

60. *Id.* at 1196.

61. *Id.*

### B. Rejection Prior to Court Approval

The second issue presented to the Supreme Court in *Bildisco* was whether a trustee or a debtor-in-possession is guilty of an unfair labor practice under section 8(a) or 8(d) of the NLRA<sup>62</sup> for unilaterally rejecting or modifying a collective bargaining agreement before approval of rejection by the bankruptcy court.<sup>63</sup> On this issue the Court split five to four, holding that such unilateral rejection was not an unfair labor practice.<sup>64</sup> The majority concluded that, as a matter of

62. Section 8(a) of the National Labor Relations Act, 29 U.S.C. § 158(a) (1976), provides in pertinent part:

(a) Unfair labor practices by employer

It shall be an unfair labor practice for an employer-

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section [7];

. . . . (5) to refuse to bargain collectively with the representatives of his employees . . . .

*Id.* Section 8(d) of the NLRA provides in pertinent part:

(d) Obligation to bargain collectively

For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, . . . *Provided*, That where there is in effect a collective-bargaining contract covering employees in an industry affecting commerce, the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract, unless the party desiring such termination or modification-

(1) serves a written notice upon the other party to the contract of the proposed termination or modification sixty days prior to the expiration date thereof, or in the event such contract contains no expiration date, sixty days prior to the time it is proposed to make such termination or modification;

(2) offers to meet and confer with the other party for the purpose of negotiating a new contract or a contract containing the proposed modifications;

(3) notifies the Federal Mediation and Conciliation Service within thirty days after such notice of the existence of a dispute . . . and

(4) continues in full force and effect, without resorting to strike or lock-out, 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:

The duties imposed upon employers, employees, and labor organizations by paragraphs (2) to (4) . . . shall not be construed as requiring either party to discuss or agree to any modification of the terms and conditions contained in a contract for a fixed period, if such modification is to become effective before such terms and conditions can be reopened under the provisions of the contract.

*Id.* § 158(d).

63. 104 S. Ct. at 1197.

64. *Id.* at 1201.

statutory interpretation, "the filing of the petition in bankruptcy means that the collective-bargaining agreement is no longer immediately enforceable, and may never be enforceable again."<sup>65</sup> As the Second Circuit noted in *Truck Drivers Local Union No. 807 v. Bohack Corp.*,<sup>66</sup> an executory contract is a "contract in limbo" until it is assumed or rejected.<sup>67</sup> Therefore, a trustee or a debtor-in-possession is not bound either by the mid-term modification procedures or by the "bargain to impasse" requirement set forth in section 8(d) and section 8(a)(5) of the NLRA.<sup>68</sup>

In reaching this conclusion, the majority rejected the Third Circuit's reliance on the "new entity" theory.<sup>69</sup> Some lower courts had attempted to justify approval of rejection of executory contracts on the theory that the debtor-in-possession, created upon the filing of a chapter 11 petition, is not bound by the contracts of the debtor.<sup>70</sup> The majority found this theory to be unnecessary, stating:

For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing.<sup>71</sup>

As a matter of policy, the majority decision regarding unilateral modification is consistent with the "fundamental purpose of reorganization"—"to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."<sup>72</sup> A debtor-in-possession may be seriously weakened during the period between the filing of a chapter 11 petition and approval of rejection if forced to abide by the terms of the collective bargaining agreement. A

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65. *Id.* at 1199.

66. 541 F.2d 312 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978).

67. *Id.* at 320. If the debtor-in-possession receives benefits under any executory contract prior to its assumption or rejection, *Bildisco* requires that the debtor-in-possession must pay the reasonable value of those services. 104 S. Ct. at 1199.

68. 104 S. Ct. at 1200 & n.14.

69. See *In re Bildisco*, 682 F.2d 72, 82-83 (3d Cir. 1982), *aff'd sub nom.* NLRB v. *Bildisco & Bildisco*, 104 S. Ct. 1188 (1984).

70. See *Brotherhood of Ry., Airline & S.S. Clerks v. REA Express, Inc.*, 523 F.2d 164, 170 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975); *Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc.*, 519 F.2d 698, 704 (2d Cir. 1975); *cf. In re Brada Miller Freight Sys.*, 702 F.2d 890, 894-96 (11th Cir. 1983) (debtor-in-possession may constitute a new entity for some purposes but is indistinguishable from the pre-bankruptcy corporation with respect to obligations under the collective bargaining agreement).

71. 104 S. Ct. at 1197; see *In re Brada Miller Freight Sys.*, 702 F.2d 890, 894-96 (11th Cir. 1983).

72. 104 S. Ct. at 1197.

73. *Id.* at 1201 (Brennan, J., concurring in part and dissenting in part).

hearing on the rejection issue can take several weeks, even months. Unless the trustee can take immediate steps to shore up the operational and financial structure of the business, the goals of chapter 11 will be poorly served.

The minority opinion of Justice Brennan, joined by Justices Marshall, Blackmun and White, criticized the majority for failing, on the unilateral rejection issue, to properly accommodate the policies of the NLRA and the collective bargaining process.<sup>73</sup> Justice Brennan accused the majority of giving too much deference to the bankruptcy law. He urged that adherence to the collective bargaining agreement pending approval of rejection, subject to section 8(d) of the NLRA, "will not seriously undermine the chances for a successful reorganization."<sup>74</sup> Justice Brennan argued that "the option to violate a collective-bargaining agreement before it is rejected is scarcely vital to insuring successful reorganization,"<sup>75</sup> although such an option may in fact induce "economic warfare."<sup>76</sup>

The minority opinion fails to take into account the realities of the business world. In every instance of a chapter 11 case involving rejection of a collective bargaining agreement, either the chapter 11 petition or the application for approval of rejection has been preceded by extended litigation with the collective bargaining agent. Ordinarily the failure to obtain the requisite concessions from the union is a primary cause of the chapter 11 filing. Indeed, the labor unrest referred to by the minority is usually extant and the trustee or debtor-in-possession must decide whether it can operate the business and retain some employees or whether it should close down entirely with the attendant discharge of all employees.<sup>77</sup> The minority opinion, by focusing upon the purported issue of "premature rejection," misperceives the problem of compelled adherence to existing terms and conditions, particularly work rules, of a collective bargaining agreement.

The Supreme Court decision in *Bildisco* is not a deathblow to unions, and the significance of the case should not be exaggerated. The decision is consistent with those of every circuit but one, and *Bildisco* has not had the effect of wholesale resort to the bankruptcy

74. *Id.* at 1210.

75. *Id.* at 1209.

76. *Id.* at 1208.

77. For example, at the time Continental Air Lines filed its chapter 11 petition, the company employed approximately 12,000 people. *See* N.Y. Times, Oct. 11, 1983, at A20, col. 3. Because of Continental's ability to modify its collective bargaining agreements, it has been able to continue operations and provide employment, as of early 1984, for 6,000 people. *See* N.Y. Times, Feb. 3, 1984, at D1, col. 3. Continental hopes and expects to continue to increase the size of its labor force. *Id.*

courts by businesses for the purpose of rejecting collective bargaining agreements. Notwithstanding the cries of anguish and large-scale public relations campaigning by organized labor,<sup>78</sup> viable and well-capitalized businesses do not resort to the bankruptcy courts to resolve their labor disputes. A board of directors does not pass a resolution to file a chapter 11 petition with any sense of ecstasy. Despite the era of the liberal society, bankruptcy still bears the stigma of failure.

Generally, debtors that file petitions under chapter 11 and seek to reject collective bargaining agreements are grasping for survival in a competitive business environment.<sup>79</sup> To characterize the efforts of these debtors to salvage their businesses and the jobs of employees, albeit sometimes under different compensation levels and work rules, as "union-busting" is a misnomer, and to attribute bad faith to such debtors is counterproductive. Furthermore, the federal courts are certainly capable of discerning those rare cases in which a debtor files for bankruptcy merely to escape its obligations under a collective bargaining agreement.<sup>80</sup> Indeed, the close scrutiny mandated by the

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78. See Barbash, *Inside: The Federal Judiciary*, Wash. Post, Nov. 25, 1983, at A2, col. 1.

79. See, e.g., *In re Continental Airlines Corp.*, 11 Bankr. Ct. Dec. (CRR) 623, 624 (Bankr. S.D. Tex. Jan. 17, 1984); *In re Rath Packing Co.*, 11 Bankr. Ct. Dec. (CRR) 498, 499 (Bankr. N.D. Iowa Jan. 12, 1984).

80. Under the former Bankruptcy Act, debtors filing under §§ 74, 77, 77B, Chapter IX and Chapter X had to comply with an express good faith filing requirement, and courts often read into the Bankruptcy Act a similar requirement for cases filed under Chapters XI and XII. *In re Victory Constr. Co.*, 9 Bankr. 549, 555-57 (Bankr. C.D. Cal. 1981). Section 921(c) of the Code, however, relating to petitions filed under Chapter IX (municipalities), is the only provision that expressly conditions the right to file a petition on the good faith of the debtor at the time the case is commenced. 11 U.S.C. § 921(c) (1982). Nevertheless, it has been held that good faith is an implicit prerequisite for filing a Chapter 11 petition. See *In re Northwest Recreational Activities, Inc.*, 4 Bankr. 36, 39 (Bankr. N.D. Ga. 1980) ("Good faith . . . is merged into the power of the court to protect its jurisdictional integrity from schemes of improper petitioners seeking to circumvent jurisdictional restrictions and from petitioners with demonstrable frivolous purposes absent any economic reality.").

In those cases in which courts have found bad faith surrounding the filing of a petition, the debtor has engaged in some form of misconduct or is not legitimately attempting a reorganization. See, e.g., *In re Nikron*, 27 Bankr. 773, 778 (Bankr. E.D. Mich. 1983) (debtor not engaged in any ongoing business); *In re Landmark Capital Co.*, 27 Bankr. 273, 281-82 (Bankr. D. Ariz. 1983) (purpose of filing to frustrate enforcement of power of sale provision under deed of trust). In *In re Tinti Constr. Co.*, 29 Bankr. 971 (Bankr. E.D. Wis. 1983), the debtors had moved to reject a union contract. The court refused to approve the rejection because (1) even if the contract were rejected, the business would in all likelihood fail, and (2) the debtor's sole purpose in filing was to avoid the union contract—the debtor's schedules reflected that all bills were either current or had been paid, and the only other claims were those of the union. *Id.* at 974-75.

Supreme Court in *Bildisco* ensures that the federal courts will uncover such impropriety. To charge that any Chapter 11 debtor that announces its intention of seeking approval of the rejection of its collective bargaining agreements is guilty of bad faith is to be "oblivious to the obvious."

#### CONCLUSION

If the national policy for the reorganization and rehabilitation of financially distressed debtors is to be served, the Bankruptcy Code must be given effect as enacted and in conformity with that national policy. The furtherance of this expressed national policy does not undermine the underlying policies of the labor laws. The intervention of bankruptcy, as in the case of all commercial relationships, creates a new arena for the adjustment and enforcement of rights and obligations. Indeed, it is in the interests of the nation and of labor that businesses be resuscitated, prosper and provide continued employment. It would be a grave error for Congress to yield to continuing union pressures and adopt legislation further restricting the debtor's ability to reject collective bargaining agreements, because of the resultant negative impact on the ability of distressed business entities to reorganize.

The theme of chapter 11 is consensus. The objective is the formulation of a business plan, or plan of reorganization, that will achieve consensual acceptance. Successful reorganization plans are formulated through cooperative efforts of give and take, rather than through the use of protracted and expensive litigation tactics that usually result in prejudice and injury to all concerned. Labor representatives must learn to work with management in the reorganization effort in order to save the debtor's business and the jobs that this business will provide if it is able to survive.