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Rejection of Collective Bargaining Agreements in Bankruptcy Proceedings (Shopmen's Local 455 v. Kevin Steel Products, Inc.; Brotherhood of Railway Employees v. REA Express, Inc.)

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BANKRUPTCY LAW

REJECTION OF COLLECTIVE BARGAINING AGREEMENTS IN BANKRUPTCY PROCEEDINGS

Shopmen's Local 455 v. Kevin Steel Products, Inc.
Brotherhood of Railway Employees v. REA Express, Inc.

Section 313(1) of the Bankruptcy Act[1] authorizes a court conducting a Chapter XI arrangement proceeding[2] to permit the debtor to reject an executory contract[3] upon notice to the other parties to the contract. Problems arise, however, if the executory contract contains an agreement to bargain collectively with a labor union since the rejection of such an agreement appears to clash with federal labor legislation[4] protecting collective bargaining agreements.[5] Focusing on this controversy, in *Shopmen's Local 455 v. Kevin Steel Products, Inc.*,[6] and *Brotherhood of Railway Employees v. REA Express, Inc.*,[7] the Second Circuit ruled that collective bar-

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[1] 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 . . . .

Bankruptcy Act § 313(1), 11 U.S.C. § 713(1) (1970).

[2] A Chapter XI arrangement is "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms." *Id.* § 306(1), 11 U.S.C. § 706(1). This proceeding "is designed to furnish a broad form of debtor relief proceedings with respect to unsecured debts." 9 H. REMINGTON, BANKRUPTCY LAW § 3564, at 198-99 (6th ed. 1955). The Chapter XI arrangement provisions were incorporated into the Bankruptcy Act in 1938. Chandler Act of 1938, ch. 575, 52 Stat. 840 (codified at 11 U.S.C. §§ 701 *et seq.* (1970)).

Chapters I through VII of the Bankruptcy Act deal with straight bankruptcy, which involves the liquidation of the debtor. Chapters VIII through XV, on the other hand, contemplate rehabilitation of the debtor. *See* 1 W. COLLIER, BANKRUPTCY ¶ 0.01 (14th ed. 1974) [hereinafter cited as COLLIER].

[3] The Act itself does not define "executory contract." One authority, however, has explained that the type of contract contemplated is one

under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973) (footnote omitted). For a further discussion of the meaning of "executory contract" see 8 COLLIER, *supra* note 2, ¶ 3.15[3].

[4] *See* notes 29-30 & 33-34 and accompanying text *infra*.

[5] A collective bargaining agreement is an "[a]greement between an employer and a labor union which regulates terms and conditions of employment." BLACK'S LAW DICTIONARY 329 (4th rev. ed. 1968). As the Supreme Court has noted, "[a] collective bargaining agreement is not an ordinary contract for the purchase of goods and services, nor is it governed by the same old common-law concepts which control such private contracts." Transportation-Communication Union v. Union Pac. R.R., 385 U.S. 157, 160-61, (1966) (citations omitted).

[6] 519 F.2d 698 (2d Cir. 1975), *rev'g and remanding* 381 F. Supp. 336 (S.D.N.Y. 1974).

[7] 523 F.2d 164 (2d Cir.), *cert. denied*, 96 S. Ct. 451 (1975), *aff'g and remanding* Civil No. 75-B-253 (S.D.N.Y., May 19, 1975).

gaining agreements may be rejected as executory contracts within the purview of section 313(1).[8]

In *Kevin Steel,* the debtor-in-possession,[9] Kevin Steel, was a steel fabricator and erector. In June of 1973, one of its unions filed a charge with the National Labor Relations Board (NLRB) alleging that the company had violated the National Labor Relations Act (NLRA)[10] by refusing to sign a new collective bargaining agreement after the former one had expired.[11] The administrative law judge ruled that Kevin Steel had committed the alleged violations, and in March 1974 the NLRB ordered the employer to execute a new bargaining agreement with the union.[12] At the time these labor issues were being litigated, Kevin Steel petitioned the bankruptcy court for an arrangement under Chapter XI and later requested permission to reject the collective bargaining agreement in question as an "onerous executory contract."[13] In March 1974 the bankruptcy court, over strong union objections, permitted Kevin Steel, as a debtor-in-possession, to reject the challenged agreement,[14] but the union obtained a reversal of this determination in the district court.[15] Kevin Steel's appeal from that decision was subsequently consolidated before the Second Circuit with the NLRB's petition for enforcement of its order.[16] Judge Feinberg, writing for a unanimous panel,[17] held that section 313(1) gives the bankruptcy court the power to permit, in its discretion, the rejection of collective bargaining agreements.[18] Accordingly, the

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[8] *Kevin Steel,* 519 F.2d at 706; *REA Express,* 523 F.2d at 169.

[9] A debtor-in-possession is a debtor who continues in possession of his property where no receiver or trustee is appointed in bankruptcy. Bankruptcy Act § 342, 11 U.S.C. § 742 (1970); *see In re* Hammond Standish & Co., 126 F. Supp. 353, 355 (E.D. Mich. 1954). Subject to the court's control, the debtor-in-possession has the power to continue managing the business for a period of time fixed by the court and must report back to the court at designated intervals. Bankruptcy Act § 343, 11 U.S.C. § 743 (1970).

[10] 29 U.S.C. §§ 151 *et seq.* (1970), *as amended,* (Supp. IV, 1974).

[11] 519 F.2d at 700. The union contended that Kevin Steel had refused to sign a new collective bargaining agreement in violation of NLRA § 8(a)(5), 29 U.S.C. § 158(a)(5) (1970), *quoted in* note 29 *infra.* In addition, it was alleged that Kevin Steel had offered an employee inducement to leave the union and had laid off and terminated the employment of union members in violation of NLRA § 8(a)(1), (3), 29 U.S.C. § 158(a)(1), (3) (1970).

[12] *See* 519 F.2d at 700-01.

[13] *Id.* at 700.

[14] *See id.*

[15] The district court ruled that a collective bargaining agreement could not be considered an executory contract subject to rejection under § 313(1). 381 F. Supp. at 338.

[16] At the same time that the employer appealed from the district court's decision, the NLRB petitioned the Second Circuit for enforcement of its order that Kevin Steel sign a collective bargaining agreement and reinstate with compensation the discharged employees. The parties' joint motion for consolidation was granted by the Second Circuit. *See* 519 F.2d at 701.

[17] Joining Judge Feinberg were Judges Oakes and Van Graafeiland.

[18] 519 F.2d at 706.

Second Circuit remanded the case to the district court to determine whether the bankruptcy judge had properly exercised his discretion.[19]

In *REA Express,* decided only a month after *Kevin Steel,*[20] the debtor, REA Express, a surface and air transport carrier, was a party to collective bargaining agreements with two unions.[21] REA filed a Chapter XI petition and, like Kevin Steel, was permitted to continue its business operations as a debtor-in-possession.[22] Thereafter REA, claiming it could not continue operations unless its costs were significantly reduced, moved for an order authorizing its rejection of the two collective bargaining agreements as "onerous and burdensome."[23] The bankruptcy court held that such a rejection was not within the scope of Chapter XI,[24] but the district court reversed, finding no evidence of any limitation on the type of executory contract that a debtor-in-possession may reject under section 313(1).[25] The Second Circuit, following its reasoning in *Kevin Steel,* held that a collective bargaining agreement subject to the Railway Labor Act (RLA)[26] was an executory contract which could, with the court's permission, be rejected under section 313(1). Judge Mansfield, writing for a unanimous panel,[27] remanded the case to the district court for a determination as to whether the collective bargaining agreements ought to be rejected as onerous and burdensome executory contracts.[28]

In evaluating the central issue in each of the two cases, the Second Circuit first considered the arguments presented by the unions. In *Kevin Steel,* Shopmen's Local 455 contended that

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[19] *Id.* at 706-07.

[20] *See* 523 F.2d at 166.

[21] The two unions in collective bargaining relationships with REA were the Brotherhood of Railway, Airline and Steamship Clerks and the International Association of Machinists and Aerospace Workers.

[22] 523 F.2d at 167.

[23] *Id.* REA's motion for an order authorizing rejection of the collective bargaining agreements was made on March 24, 1975. One agreement was not due to expire until December 31, 1975, the other until June 1, 1976. The Second Circuit summarized the reasons for REA's complaint that the collective bargaining agreements were onerous and burdensome as follows:

> (1) their supplemental unemployment and consolidation provisions would completely forestall the debtor, which is insolvent, from adopting and implementing a reorganization plan that would enable it to survive, and (2) the debtor cannot meet the full wage scales provided for in the agreements.

Id.

[24] *See id.*

[25] Civil No. 75-B-253 at 2.

[26] 45 U.S.C. §§ 151 *et seq.* (1970).

[27] Joining Judge Mansfield were Judge Mulligan and Justice Clark, retired, sitting by designation.

[28] 523 F.2d at 172.

application of section 313(1) to collective bargaining agreements would contradict sections 8(a)(5) and 8(d) of the NLRA. Section 8(a)(5) makes it an unfair labor practice for an employer to refuse to bargain collectively with his employees' representative.[29] Section 8(d) prohibits the termination or modification of a collective bargaining agreement without compliance with the rigorous procedures outlined in that section.[30] The union further maintained that granting the bankruptcy court authority to permit rejection of collective bargaining agreements would seriously undermine essential NLRA policies.[31]

In *REA Express,* the Brotherhood of Railway Employees and the International Association of Machinists raised analogous arguments with respect to the RLA.[32] Section 2 of that Act forbids a carrier to change working conditions of employees in any way except as prescribed in the collective bargaining agreement itself or in section 6 of the Act.[33] Section 6 sets forth a protracted proce-

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[29] Section 8(a)(5) of the NLRA provides:

It shall be an unfair labor practice for an employer—

. . . .

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 159(a) of this title.

29 U.S.C. § 158(a)(5) (1970).

[30] Section 8(d) provides, in pertinent part, that no party to a collective bargaining agreement shall terminate or modify it unless he:

(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 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 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:

. . . [T]he duties so imposed 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.

29 U.S.C. § 158(d) (Supp. IV, 1974), *amending* 29 U.S.C. § 158(d) (1970).

[31] The union alleged that judicial sanction of Kevin Steel's construction of § 313(1) would enable an employer to "accomplish indirectly what it could not do directly without violating the Labor Act, namely, the unilateral termination of a labor agreement during its term." 519 F.2d at 702. Moreover, allowing employers to reject collective bargaining agreements, the union argued, would impair industrial peace, one of the central purposes of the NLRA, since employees would be forced to resort to strikes as the only means for protecting their interests. *Id.* at 703.

[32] *See* 523 F.2d at 168.

[33] Section 2 provides in part:

No carrier, its officers, or agents shall change the rates of pay, rules, or working conditions of its employees, as a class, as embodied in agreements except in the manner prescribed in such agreements or in section 156 of this title.

45 U.S.C. § 152 (1970).

dure for amending the collective bargaining agreement, requiring, *inter alia,* at least 30 days' written notice of any proposed change.[34] The unions argued that since REA was a carrier, the bankruptcy court could not permit rejection of its executory contracts without adhering to these provisions.[35]

Although the Second Circuit rejected the unions' arguments in both cases, it did so only after careful assessment of a number of factors: the practical functions of a bankruptcy proceeding;[36] the particular language employed in the Bankruptcy Act;[37] and the available case law.[38] In both instances the court emphasized the bankrupt's special status as a debtor-in-possession. The Second Circuit reasoned that a debtor-in-possession, as a newly created entity very different from the prebankruptcy debtor, is not a party to any prebankruptcy labor agreement between the debtor and a union.[39] Indeed, the power conferred by section 313(1) to reject executory contracts was thought to be predicated on the very fact that the new entity has its own rights and duties subject to the control of the bankruptcy court. Accordingly, the Second Circuit concluded that absent a specific assumption of the old agreement, the new entity is not bound by any terms of a collective bargaining agreement contracted by the debtor prior to bankruptcy.[40]

In *Kevin Steel* the court also rejected the union's contention that Congress, due to the unique nature of labor agreements, intended to exclude collective bargaining agreements from section 313(1).[41] The court agreed with the union's premise that a collective bargaining agreement differs from an ordinary contract in several respects.[42] Such an agreement, which has been referred to as a "generalized code to govern a myriad of cases which the

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[34] *Id.* § 156. Section 6 prescribes a procedure for changing rates of pay, employee rules, and working conditions. It provides for a minimum of 30 days' written notice of any such change and an involved procedure for resolving differences between the parties. During the time of such attempted resolution of the controversy, no changes may be unilaterally effected by the carrier. 523 F.2d at 168.

[35] 523 F.2d at 168.

[36] *See* text accompanying notes 39-40 *infra.*

[37] *See* text accompanying notes 48-54 *infra.*

[38] *See* notes 55-67 and accompanying text *infra.* Other decisions, not directly on point, but cited by the court, include *In re* Capital Serv., Inc., 136 F. Supp. 430, 437-38 (S.D. Cal. 1955); *In re* American R.R. of P.R., 110 F. Supp. 45, 46 (D.P.R. 1952), *aff'd per curiam,* 202 F.2d 149 (1st Cir. 1953); *In re* Public Ledger, Inc., 63 F. Supp. 1008, 1014 (E.D. Pa. 1945), *rev'd in part,* 161 F.2d 762 (3d Cir. 1947); and *In re* Mamie Conti Gowns, 12 F. Supp. 478, 479-80 (S.D.N.Y. 1935).

[39] *Kevin Steel,* 519 F.2d at 704; *REA Express,* 523 F.2d at 170.

[40] *Kevin Steel,* 519 F.2d at 704; *REA Express,* 523 F.2d at 170.

[41] 519 F.2d at 703.

[42] *Id.* at 705.

draftsmen cannot wholly anticipate,"[43] typically "covers the whole employment relationship."[44] Often, the agreement is not a voluntary contractual relationship,[45] but an "outline of the common law of a particular plant or industry."[46] Nevertheless, the *Kevin Steel* court concluded that absent specific evidence to the contrary, uniqueness alone is not a valid basis for exclusion under section 313(1).[47]

Since legislative history offers no indication of Congress' intended definition of executory contracts,[48] the Second Circuit focused its attention on the Bankruptcy Act itself.[49] The court found it particularly noteworthy that while section 313(1) makes no exception for collective bargaining agreements, section 77(n) specifically protects "railroad employees" from having their wages or working conditions changed in any way except as outlined in the RLA.[50] This distinction, the Second Circuit contended, demonstrates that Congress, had it so intended, could have removed labor agreements from the scope of section 313(1).[51] The court found the unions' assertion that the absence of any such limitation from section 313(1) was attributable to "legislative oversight" especially unpersuasive in light of the numerous opportunities Congress had to cure such a deficiency.[52] In view of the clear legislative intent and case law supporting the specific exclusion of railroads from the general operation of bankruptcy law,[53] in the court's opinion there

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[43] United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578 (1960), *citing* Shulman, *Reason, Contract, and the Law in Labor Relations,* 68 HARV. L. REV. 999, 1004-05 (1955). For a further discussion of the nature of collective bargaining agreements, see Chamberlain, *Collective Bargaining and the Concept of Contract,* 48 COLUM. L. REV. 829 (1948).

[44] United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 579 (1960) (footnote omitted).

[45] *Id.* at 580; John Wiley & Sons v. Livingston, 376 U.S. 543, 550 (1964).

[46] NLRB v. Burns Int'l Security Servs., Inc., 406 U.S. 272, 285 (1972), *citing* John Wiley & Sons v. Livingston, 376 U.S. 543, 550 (1964). For a discussion of both *Burns* and *Wiley,* see Note, *The Bargaining Obligations of Successor Employers,* 88 HARV. L. REV. 759 (1975).

[47] 519 F.2d at 704-05.

[48] *See* S. REP. No. 1916, 75th Cong., 3d Sess. 12 (1938).

[49] *Kevin Steel,* 519 F.2d at 703. An examination of the Proposed Bankruptcy Act of 1973 is also helpful in this regard. *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 137, 93d Cong., 1st Sess. pt. 12 (1973). Section 4-602 of the Proposed Act, which corresponds to the present § 313(1), covers the rejection of executory contracts. A commentator's note to the section states that the term "executory contract" is undefined, but "its general meaning in the Bankruptcy Act is well understood." *Id.* at 155. It can be inferred from this statement that inasmuch as no exception for collective bargaining agreements exists under the present § 313(1), no such exception is contemplated by the Proposed Act.

[50] *See* 11 U.S.C. § 205(n) (1970).

[51] *Kevin Steel,* 519 F.2d at 704; *REA Express,* 523 F.2d at 169.

[52] *Kevin Steel,* 519 F.2d at 705.

[53] *Id., citing* International Ass'n of Machinists v. Central Airlines, Inc., 372 U.S. 682,

was no reason to assume that the exemption of railroad employees was meant to exclude *all* employees from the Bankruptcy Act's operation.[54]

As the Second Circuit recognized, there appear to be no appellate decisions precisely on point.[55] The court's analysis is consonant, however, with district court precedent concerning section 313(1) as well as analogous provisions of the Bankruptcy Act. For example, in *Carpenter's Local 2746 v. Turney Wood Products, Inc.*,[56] a straight bankruptcy proceeding, the court permitted the rejection of a collective bargaining agreement as an executory contract under section 70(b) of the Act.[57] The *Turney* court concluded that Congress would surely have provided an exception for collective bargaining agreements had it desired one.[58] Similarly, in In re *Business Supplies Corporation of America*,[59] an unfulfilled collective bargaining agreement was held to be an executory contract since the court reasoned that it would be contrary to the purpose of Chapter XI to read an exception into section 313(1) where none existed.[60]

Other authorities are also in unison with the Second Circuit's decision that for purposes of the Bankruptcy Act's section 313(1) a

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687-89 (1963) (discussion of particular economic problems confronting railroad industry); *see* H.R. REP. No. 1897, 72d Cong., 2d Sess. (1933). Section 77 of the Bankruptcy Act, 11 U.S.C. § 205 (1970), was enacted in 1933 when many railroads, suffering from generally adverse economic conditions, were confronted with the necessity to reorganize. It was designed to avoid the expense and waste involved in the administration of equity receiverships. *See* Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479, 496-98 (1974); Note, *Regional Rail Reorganization Act of 1973: Was Congress on the Right Track?*, 49 ST. JOHN'S L. REV. 98, 102 n.30 (1974).

[54] *Kevin Steel*, 519 F.2d at 705. As the court noted in *In re* Business Supplies Corp. of America, 72 CCH Lab. Cas. 27,978 (S.D.N.Y. 1973),

> Congress' expression in 11 U.S.C. § 205 demonstrated its solicitude for railway workers based on its concern for continued health of the interstate railway system of the country. . . . But Congress expressed nō such solicitude for other workers in the ordinary garden variety reorganization proceeding whether in Chapter X or in Chapter XI.

Id. at 27,978-79.

[55] *See* 519 F.2d at 703-04, where the *Kevin Steel* court expressed its views as to why the precise issue here involved has been litigated so infrequently.

[56] 289 F. Supp. 143 (W.D. Ark. 1968) (mem.), *discussed in* Comment, *Collective Bargaining and Bankruptcy*, 42 S. CAL. L. REV. 477, 479-80 (1969) [hereinafter cited as *Collective Bargaining*].

[57] 289 F. Supp. at 149. Section 70(b) was applicable in *Turney* because the business was being liquidated. This section provides in pertinent part:

> The trustee shall assume or reject an executory contract . . . within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later . . . . Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected . . . .

11 U.S.C. § 110(b) (1970).

[58] 289 F. Supp. at 149.

[59] 72 CCH Lab. Cas. 27,978 (S.D.N.Y. 1973).

[60] *Id.*

collective bargaining agreement is to be treated as an executory contract.[61] In one of the leading treatises on bankruptcy law it is unequivocally stated that "[t]here is no restriction on the type of executory contract that may be rejected" under section 313.[62] A district court adopted this reasoning in In re *Klaber Brothers*[63] to permit the rejection of an executory collective bargaining agreement under section 313(1) as onerous and burdensome to the bankrupt's estate. The *Klaber* court noted that the language of section 313(1) placed no limitation on the type of executory contract that could be rejected.[64] Similarly, in In re *Overseas National Airways, Inc.*,[65] the court rejected the petitioner's argument that collective bargaining agreements are not executory contracts within the scope of section 313(1). Nevertheless, the court refused to permit the debtor, an air carrier, to reject the collective bargaining agreement in question since it found the company's employees to be protected by section 77(n) of the Bankruptcy Act, which prescribes an exclusive means for the disaffirmance of such agreements.[66] The court noted, however, that had the carrier not come within the section 77(n) exception, the bankruptcy court would have had the power to reject the agreement as an executory contract.[67]

The small amount of legal precedent available, therefore, strongly supports the findings of the Second Circuit in *Kevin Steel* and *REA Express*. The court of appeals was careful to note, however, that section 313(1) does not mandate rejection of executory contracts. Rather, the decision whether or not to permit rejection is solely within the discretion of the court.[68] It has been noted that an executory contract should be rejected when such action would work to the advantage of the bankrupt's estate.[69]

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[61] *See, e.g.*, Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479, 492-98 (1974); *Collective Bargaining, supra* note 56, at 478.

[62] 8 COLLIER, *supra* note 2, ¶ 3.15[1].

[63] 173 F. Supp. 83, 85 (S.D.N.Y. 1959).

[64] *Id.* at 84-85.

[65] 238 F. Supp. 359 (E.D.N.Y. 1965).

[66] *Id.* at 360. The *Overseas Airways* court construed § 77(n) to apply to any collective bargaining agreement governed by the RLA. Yet, the language of § 77(n) expressly protects only "railroad employees" from having their wages and working conditions altered by a judge or trustee acting under the Bankruptcy Act. 11 U.S.C. § 205(n) (1970). Indeed, in *REA Express* the district court held that § 77(n) applies only to railroad employees, thus excluding REA's employees from that section's protection. The court characterized the *Overseas Airways* case as "distinguishable on its facts," but also noted that even if the case had been applicable it would not have been followed. Civil No. 75-B-253 at 3.

[67] 238 F. Supp. at 360-61.

[68] *Kevin Steel*, 519 F.2d at 706-07; 8 COLLIER, *supra* note 2, ¶ 3.15[8].

[69] 8 COLLIER, *supra* note 2, ¶ 3.15[8]; *In re* Klaber Bros., 173 F. Supp. 83, 85 (S.D.N.Y. 1959).

Since the party injured by the rejection of the contract becomes a creditor with a claim for damages, whether the executory contract ought to be rejected should be decided in light of the resultant increase in the debtor's liability.[70] Nonetheless, absent bad faith on the part of the debtor-in-possession, courts generally permit the rejection of an executory contract if the detriment occasioned by performance is greater than the benefit to be gained thereby.[71] Alteration of this general rule is appropriate, however, in the case of the proposed rejection of a collective bargaining agreement because federal labor legislation is also involved. Accordingly, the Second Circuit, in remanding both *Kevin Steel* and *REA Express*, carefully set forth the factors which must be scrutinized and balanced by the court in such a case.

The Second Circuit explained that in addition to evaluating the financial situation of the debtor-in-possession, a court must give due consideration to the policies underlying labor legislation.[72] Echoing the statement of the court in *Overseas Airways*, the *Kevin Steel* panel emphasized that if a debtor rejects a collective bargaining agreement, many employees are affected in areas such as union benefits, including pension and welfare rights, and seniority.[73] According to the Second Circuit, therefore, the harm to the employees must be balanced against the Bankruptcy Act's intent to give the debtor a fresh financial start in a favorable arrangement plan.[74] The *REA Express* court concluded that

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[70] 8 COLLIER, *supra* note 2, ¶ 3.15[8]. Of course, rejection by the debtor does not, in and of itself, make the other party to the contract a creditor. For such a party to be deemed a creditor there must also be an injury as a result of the rejection. *Id.*

[71] *Collective Bargaining, supra* note 56, at 481. *In re* Mamie Conti Gowns, Inc., 12 F. Supp. 478 (S.D.N.Y. 1935), is illustrative of the consequences of bad faith on the part of the party seeking rejection. There, the court refused to permit a trustee in bankruptcy to reject a collective bargaining agreement because the employer had previously contracted with the union not to take any such action in the event of reorganization. *Id.* at 480.

[72] In *Kevin Steel* the court stated that its "concern that the important policies underlying the Labor Act be respected in decisions whether to allow rejection of collective bargaining agreements would lead [it] to a careful scrutiny of the bankruptcy court's exercise of discretion." 519 F.2d at 707. In *REA Express* the court remanded "substantially for the reasons stated in remanding *Kevin Steel*." 523 F.2d at 172.

[73] 519 F.2d at 707, *quoting In re* Overseas Nat'l Airways, Inc., 238 F. Supp. 359, 361-62 (E.D.N.Y. 1965). According to the *Overseas Airways* court:

> [T]he Bankruptcy Court, when it *has* the power to reject a collective bargaining agreement, should do so only after 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. That would leave the employees without compensation for their losses, at the same time enabling the debtor, at the expense of the employees, to consummate what may be a more favorable plan of arrangement with its other creditors.

Id. (emphasis in original).

[74] *See* note 73 *supra; Collective Bargaining, supra* note 56, at 477-81.

> in view of the serious effects which rejection has on the carrier's employees it should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs.[75]

In *Kevin Steel* and *REA Express,* the debtors-in-possession were treated as new entities not bound by collective bargaining agreements they had entered into prior to their filing of a Chapter XI petition in bankruptcy.[76] In its treatment of the debtors-in-possession, the court attempted to avoid conflict between bankruptcy policy designed "to preserve the funds of the [debtor] for distribution to creditors and to give the [debtors] a new start"[77] and labor policy encouraging "creation and enforcement of collective bargaining agreements."[78] The Second Circuit's solution — to include collective bargaining agreements within the scope of section 313(1) once it is determined that the debtor is in economic distress — treats unions and employees as creditors who must renegotiate and even relinquish some rights "in order to maintain the enterprise as a going concern so they can at least realize a substantial percentage of what they would otherwise receive."[79] By restricting the right to reject a collective bargaining agreement to those situations where rejection is necessary to enable the debtor-in-possession to remain viable, the Second Circuit has recognized that the purposes of both the Bankruptcy Act and the labor acts will be most effectively served if business operations and the attendant employment opportunities are preserved. Moreover, this reconciliation of bankruptcy and labor legislation appears to ensure equitable treatment of employers and employees alike.

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[75] 523 F.2d at 172.

[76] *See* text accompanying notes 39-40 *supra.*

[77] *Collective Bargaining, supra* note 56, at 477.

[78] *Id.* Other courts have similarly been called upon to reconcile the competing policies of bankruptcy and labor legislation. In Durand v. NLRB, 296 F. Supp. 1049, 1055 (W.D. Ark. 1969) (mem.), the court stated that when the Bankruptcy Act and the NLRA "come into contact with each other, they should, if possible, be so construed and applied as to avoid conflicts between them . . . ." In Carpenters Local 2746 v. Turney Wood Prods., Inc., 289 F. Supp. 143, 148 (W.D. Ark. 1968) (mem.), the court contended that if the two bodies of law were "read together and properly construed" there would be no conflict between federal labor legislation and the Bankruptcy Act.

[79] *REA Express,* 523 F.2d at 169.