

LoFaro & Reiser, L.L.P.
55 Hudson Street
Hackensack, New Jersey
07601
Tel: (201) 498-0400
Fax: (201) 498-0016
E-Mail: lr.law@verizon.net
Web Site:
www.njlawconnect.com

EXECUTORY CONTRACTS/UNEXPIRED LEASES

- A. Introductory Statement.** An executory contract or unexpired lease may have a significant impact on the rights of a creditor in a bankruptcy. Bankruptcy law may permit a debtor or trustee to take advantage of the benefit of a contract by performance, or to avoid liability by rejecting it. *See* Section 365 of the Bankruptcy Code.
- B. Executory Contract Defined.** The Bankruptcy Code does not offer a definition for "Executory Contract". Courts have interpreted "Executory Contract" to be a contract where there remains substantial performance yet to be completed by both the debtor and the nondebtor party at the time the bankruptcy is filed. However, it may also be interpreted to include a situation where there remains substantial performance yet to be completed by only one of the parties, or as a contract that may benefit the estate of the debtor "from performance or breach".
- C. Examples of Executory Contracts.** Leases, collective bargaining agreements, employment contracts and supplier contracts are typical executory contracts.
- D. Unexpired Lease.**

With approval of the court, a Trustee or debtor-in-possession may assume or reject any unexpired lease of the debtor.

- 1) True Lease Versus Security Agreement.** The lease must be a "true lease" to be assumed, assigned, or rejected. A true lease may be a lease which reserves title to the property to the lessor, and the property does not become the property of the lessee at the end of its term for little or no value. A transaction involving a lease that permits the leased property to become the property of the lessee at the end of a lease term for little or no value may be treated as a "security agreement" instead of as a true lease.

An example of a true lease may be a lease to commercial real property. An example of a lease which may be determined to be a

security transaction might be an equipment lease which requires no or nominal payment at the end of the lease term to acquire title and ownership of the equipment.

E. Assumption, Assignment, and Rejection: The debtor may "assume, and assume and assign, or reject" executory contracts and leases. This is generally done by filing a motion with the court and giving notice of a hearing, and may be included in a confirmed plan under Chapter 11, 12, or 13.

1) **Assumption.** If an executory contract is "assumed" during the administrative or post-petition period then the other party to the contract becomes an administrative creditor granted priority payments over most pre-petition creditors ("administrative priority").

2) **Rejection.** The debtor may "reject" the contract, give up its benefits, and the other party becomes a pre-petition unsecured creditor for any contractual damages. If the rejected contract is a non-residential lease, the "rejected" landlord's claim cannot exceed the greater of: (i) one years rent, or (ii) fifteen percent of the remaining term of the lease, but not to exceed three years. This can be used as an effective tool in landlord negotiations, particularly where unsecured creditors receive a small percentage of the dollar amount of their claim.

3) **Assumption and Assignment.** The debtor may "assume and assign" an executory contract, usually upon a sale of the company or a portion of its: stores, machinery and equipment, etc. However, to assume and assign, the executory contract can have no pre-petition or post-petition arrearages and the assignee's credit must be pre-approved by the other party to the contract.

F. Time for Debtor to Act. Executory contract creditors would prefer to quickly know whether the debtor will assume, assume and assign or reject their contract.

1) **Non-residential Leases and Executory Contracts.** Generally, the debtor can wait until confirmation of a plan of reorganization to assume, assume and assign or reject executory contracts, unless they are for non-residential real estate. In a case under Chapter 11, 12, or 13, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan. However, the court, on the request of any party to such contract or lease, may order the trustee to determine within a

specified period of time whether to assume or reject such contract or lease. See Section 365 (d) of the Bankruptcy Code.

- 2) **Non-residential Real Property Lease.** A non-residential real property lease must be assumed or rejected within sixty days of filing the petition ("assumption period"). The bankruptcy court usually will extend the assumption period for good cause, over the objection of the lessor. However, any extension must be obtained prior to the end of the initial sixty days, or any extended, assumption period.
- 3) **Chapter 7 Cases.** In a case under Chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected. See Section 365 (d) of the Bankruptcy Code.

G. If Contract Or Lease Is In Default.

If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee cures the default, compensates the other party for actual pecuniary loss, and provides adequate assurance of future performance under such contract or lease. See Section 365 (b) of the Bankruptcy Code.

H. Exceptions. There are however, exceptions. The trustee or Debtor may not assume or assign:

- 1) Personal service contract
- 2) Contract to loan money or issue securities.
- 3) Non-residential lease which was terminated before the filing of a bankruptcy. See Section 365(c) of the Bankruptcy Code

Disclaimer: This article is provided for informational purposes only, and is not intended to provide specific legal advice to any particular situation. This article also is not intended to create any attorney-client relationship between the law firm of LoFaro & Reiser, L.L.P. and any user of this web site.