A Functional Analysis of Executory Contracts

Jay Lawrence Westbrook
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* Andrews & Kurth Centennial Professor of Law, The University of Texas at Austin. This article is respectfully dedicated to Professor Vern Countryman, whose work is the standard for all of us who labor in the vineyards of commercial law. Development of the concepts in this paper has been greatly aided by conversations with Elizabeth Warren and Douglas Whaley. I am especially grateful to my colleague Douglas Laycock for his comments on earlier drafts. I am also indebted to James M. Bettis for indefatigable help with the research, as well as to David Hurst for all his assistance in recent months.
INTRODUCTION

Bankruptcy is that volume of the law that might have been written by Lewis Carroll, every conventional legal principle refracted through the prism of insolvency. In that fact lies much of its students' joy — and their frustration. In no chapter of that volume has the law become more psychedelic than in the one titled "executory contracts." The courts increasingly voice cries of confusion and frustration over the treatment of contracts in bankruptcy. Critics express growing concern about decisions that are deeply disruptive of commercial expectations, concerns awkwardly and inadequately addressed by recent con-

1. E.g., In re Booth, 19 Bankr. 53, 54-57 (Bankr. D. Utah 1982); see infra note 446.
gressional patchwork.²

Resolution of these difficulties has recently grown more pressing as more bankruptcy cases are filed with rejection of executory contracts as a primary motive.³ Although these include large and visible proceedings like the Continental Airlines case,⁴ the greater social and commercial problem lies in thousands of medium sized cases, from the soap opera actress who wants to jump to another network⁵ to the Burger King franchisee who wants to shuck its anti-competition covenant.⁶ If people continue to view bankruptcy as a device for painlessly voiding commercial contracts, then it will be transformed from a hospital for treating troubled companies into a morgue for commercial expectations. On the other hand, judicial and political over-reaction to these cases may lead to rules that cripple bankruptcy’s legitimate functions, especially the reorganization of financially troubled companies. If we are to avoid these dangers, we must completely reconstruct the fundamentals of bankruptcy contract law. My purpose in this Article is to begin that task by proposing a new and relatively simple conceptual framework to replace the bemusing complexity of current case law.

For more than a century, federal courts sitting in bankruptcy have assumed that a pre-bankruptcy contract must be “executory” in order to be assumed or rejected by a trustee in

3. See infra note 397.
5. See In re Carrere, 64 Bankr. 156, 160 (Bankr. C.D. Cal. 1986) (finding that debtor cannot reject personal services contract where major motivation is a more lucrative agreement); infra note 398.
6. See Burger King Corp. v. Rovine Corp. (In re Rovine Corp.), 6 Bankr. 661, 665 (Bankr. W.D. Tenn. 1980) (Rovine II) (holding noncompete clause of franchise agreement rejectable as part of executory contract).
bankruptcy. Because assumption and rejection are merely bankruptcy terms for performance or breach by the trustee, one can say that the courts have required a finding of “executoriness” in a contract before the trustee is permitted to perform or breach it. In the mid-1970s, in two articles in the *Minnesota Law Review*, Professor Countryman took a great muddle of confused and often wrong decisions and made them coherent by developing his famous “material breach” test for determining if a contract satisfied the courts’ requirement of executoriness. This test has greatly improved the results in the courts. Yet severe problems remain and their number is increasing.

I believe we are now ready to build upon Professor Countryman’s brilliant accomplishment and to take the necessary further step: abolishing the requirement of executoriness altogether. That is, I suggest that no such threshold finding should be necessary to assume or reject a bankruptcy contract. Instead, I will argue that the estate, as successor to the debtor’s pre-bankruptcy contracts, is in exactly the same position as any other contract party under nonbankruptcy law, with just three exceptions: a) pro rata payment of a usually small percentage of the breach of contract claims against the debtor; b) denial of specific performance against the estate of purely contractual covenants; and c) the effect of the avoiding powers. Although the demonstration requires some extensive analysis, the result will greatly simplify the problem.

I call my approach “functional,” because it proceeds by working through the problem from first principles. This re-
form, which is well within the competence of the courts to adopt under the present Code, will not change existing bankruptcy policies with respect to contracts. On the contrary, it will help ensure that they are better understood and more consistently applied.

I. THE PROBLEM

[Definitions like the material breach test] are helpful, but do not resolve this problem. The key, it seems, to deciphering the meaning of the executory contract rejection provisions, is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish.\[14\]

A. THE FUNDAMENTALS OF BANKRUPTCY CONTRACTS

The question addressed in the bankruptcy courts under the rubric "executory contracts" is the treatment of contracts to which the debtor was a party prior to bankruptcy. Each pre-bankruptcy contract represents a bundle of rights belonging to the estate (the obligations of the other party to the contract) and potential claims against the estate (the obligations of the debtor under the contract). The trustee has the choice of "assuming" a pre-bankruptcy contract or "rejecting" it. These are merely bankruptcy terms for performance or breach.\[15\] If the trustee assumes a contract, the estate is bound to perform it and the Other Party is required to perform as well.\[16\] If the trustee rejects the contract, the estate has breached and is liable for a damage claim by the Other Party, while the Other Party ordinarily is excused from further performance under normal contract principles.\[17\] The trustee is given broad discretion to assume or reject, whichever course will maximize the value of the bankruptcy estate and minimize

\[14\] In re Jolly, 574 F.2d at 351.
\[15\] 11 U.S.C. §§ 365(a), 365(g); 502(g) (1988). But see Andrew, Executory Contracts in Bankruptcy: Understanding “Rejection,” 59 U. COLO. L. REV. 845, 883-84 (1988) (finding labelling of rejection as “breach” unfortunate). Strictly speaking, assumption and rejection represent the decision to perform or breach. See infra Section II. G.
\[16\] Henceforth, for ease of reference, the nonbankrupt party to a pre-bankruptcy contract shall be referred to as the “Other Party.”
claims against it.\textsuperscript{19}

If the trustee rejects the contract, the damage claim is calculated under state contract law, but is treated as a pre-petition debt, just like the debtor's pre-petition rent or printing bill, even though the actual breach caused by rejection necessarily takes place after the bankruptcy petition is filed and the trustee appointed.\textsuperscript{20} By contrast, when a contract is assumed, the estate's obligations are treated as post-petition administration claims, just like the trustee's fees or amounts owed post-petition providers of insurance and storage for the estate's property.\textsuperscript{21} Because administration claims are paid first, they usually are paid in full.\textsuperscript{22}

This apparently simple problem has given rise to one of the most confused and difficult areas of modern bankruptcy law, especially in Chapter 11 reorganizations. The reason is that the trustee's decision to assume or reject can have some fairly remarkable consequences. For example, the trustee can speculate on the rise or fall of a market and assume or reject a pre-existing contract for the purchase or sale of goods depending on the way the market has gone since the contract was made. The trustee as seller in a fluctuating market will assume the contract if the market falls (forcing the Other Party to buy at a price over market) or reject the contract if the market rises (selling to some other buyer at a market price higher than the contract price).\textsuperscript{23} Where else in the law do we permit a seller with a firm contract of sale to speculate at the buyer's expense, often to the seller's great profit? These results suggest that the trustee somehow is not bound to the contract, yet can bind the Other Party, a consequence that seems almost magical to the legal mind. Such magic irresistibly suggests some congressional grant of a special bankruptcy "power" to ignore the normal rules of commerce for the benefit of the estate. Because these

\textsuperscript{19} Collier 15th, supra note 17, \S 365.03 (discussing trustee's discretion under the "business judgment" rule).

\textsuperscript{20} 11 U.S.C. \S 502(g) (1988).

\textsuperscript{21} Id. \S\S 365(g)(2)(A), 503(b), 507(a)(1).

\textsuperscript{22} See, e.g., In re Pearson, 90 Bankr. 638, 642 (Bankr. D. N.J. 1988) (giving priority to balance of defaulted car loan as administrative expense). There are exceptions, for example, in cases involving super-priorities, but they do not affect the validity of the proposition in most cases. 11 U.S.C. \S\S 507(b), 364(c) (1988).

effects have not been analyzed or understood in a systematic way, they have remained apparently magical.

B. RECENT HISTORY

1. Context

A systematic explanation of the treatment of bankruptcy contracts requires an understanding of the operation of the material breach test. The operation of the test is better understood in the context of the recent intellectual history of bankruptcy law.24

Bankruptcy is relatively young law. Our legal ancestors achieved a workable bankruptcy statute less than a century ago, after a hundred years of struggle to comply with the Constitution's mandate.25 The statute that emerged in 1898 was itself short and undetailed.26 The most dramatic advances in American bankruptcy law since then, the codification of the "chapter" or "payout" proceedings,27 were enacted under the pressures of the Great Depression. They were pragmatically brilliant, making ours the most sophisticated bankruptcy laws in the world, but they were accomplished with little theoretical understanding of reorganization and little appreciation of how the new types of proceedings related to the liquidation procedures we had developed from the British precedents and statutes.28

24. For two views of the long-term development of executory contract law, see Andrew, supra note 15, at 856-81; Countryman (pt. 1), supra note 7, at 440-50.

25. U.S. CONST. art. I, § 8, cl. 4; see also Sullivan, Warren & Westbrook, Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data, 1983 Wis. L. Rev. 1091, 1098-1100. Although the Constitution does not require Congress to adopt national bankruptcy laws, Congress in the 19th century clearly considered the authority to do so as creating a duty. See C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY 8 (1935).


28. Some modern theorists are just beginning to grapple with building a conceptual foundation for reorganization policies. See Jackson & Scott, On The Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain, 75 VA. L. REV. 155, 158-78 (1989). Of course, even the statute of 1898 contained American innovations, especially the New World version of the discharge, a fundamentally new creation in its breadth and moral concept. See, e.g., J. DALHUISEN, DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY § 1.07[1], at 2-132.2 to .4 (1986).
As a consequence, by the 1960s bankruptcy law consisted of a thin statutory skeleton surrounded by an enormous corpus of caselaw. Even though bankruptcy was in theory a statutory subject, it had by then arrived at a position not unlike contract law in the late nineteenth century, largely governed by a mass of confusing and often incoherent precedent. Fortunately, a group of scholars arose in the 1960s who played a role analogous to the great compilers of the common law like Williston and Corbin. The most notable were Professors Kennedy and Countryman. These scholars organized and rationalized the mass of cases into coherent doctrine, and made possible the remarkable development represented by the Bankruptcy Rules and ultimately the 1978 Bankruptcy Code (Code or Bankruptcy Code).

In this heroic age of bankruptcy scholarship, Professor Countryman's *Minnesota Law Review* articles were representative of the best of this work. The precedents governing bankruptcy contracts had become a nightmare of confusion and inconsistency by the mid-1970s. Professor Countryman took this doctrine as he found it in the cases and made sense of it. The material breach test that he developed in those articles had the effect of correctly resolving a large number of the cases in which the courts had followed confusion into error.

2. Traditional Approaches

Professor Countryman used a pragmatic approach rather than the traditional, conceptual approach to bankruptcy contracts. Before and after Countryman, scholars and judges have proposed various conceptual understandings of the treatment in

29. See, e.g., V. COUNTRYMAN, CASES AND MATERIALS ON DEBTOR AND CREDITOR passim (1964).
30. Id.
34. See supra note 7.
35. There was confusion in the statutory reflections of the case law as well. See generally Andrew, supra note 15, at 874-75 nn.120-29 (outlining caselaw background to predecessor of § 365).
bankruptcy of contracts outstanding on the filing date of the bankruptcy petition. These efforts have not been satisfactory.

One traditional view derives from the fact that executory contracts are "property of the estate" under section 541(a) of the Code. This view treats such contracts just like the two left shoes the trustee finds in the office cloakroom, to be sold if possible or abandoned if without value.\(^{36}\) This analysis will not do, however, because the trustee cannot merely sell or abandon a contract; the estate must pay for the rights it confers or pay damages for abandoning it, burdens that do not attach to the shoes.\(^{37}\)

Another view is that the executory contract is automatically breached by bankruptcy, an implied anticipatory repudiation, and that the trustee "cures" by assumption or declines to cure by rejection.\(^{38}\) Insofar as this analysis makes the state law of anticipatory repudiation relevant to the problem, Professor Countryman demonstrated that it is pernicious.\(^{39}\) Treating this analysis as federal doctrine avoids his criticisms, but suggests development of some special, post-hoc federal contract law that is unnecessary and pernicious in its own way.\(^{40}\)

Yet a third view is the "new entity" theory. This analysis posits that the estate is a "new entity" that is not a party to the pre-petition contract and is therefore free to assume or reject it.\(^{41}\) This approach has a certain conceptual charm, but the courts often show an instinctive wariness about it, an unarticulated anxiety.\(^{42}\) The judicial instinct is likely correct because the notion of a "new entity" not bound by the contract conflicts with the trustee's duty to pay damages for rejecting the contract.\(^{43}\) Because payment of damages for nonperformance of a

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36. See Collier 15th, supra note 17, ¶ 365.01, at 365-8; E. Warren & J. Westbrook, supra note 23, at 509; Countryman (pt. 1), supra note 7, at 440.

37. See Collier 15th, supra note 17, ¶ 365.01, at 365-12.

38. See Central Trust Co. v. Chicago Auditorium Ass'n, 240 U.S. 581, 592 (1916) (finding that Other Party could sue for breach when debtor became bankrupt and trustee had not assumed contract).


40. But see E. Warren & J. Westbrook, supra note 23, at 509.

41. See, e.g., Shopmen's Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698, 704 & n.14 (2d Cir. 1975) (finding post-bankruptcy debtor is new entity no longer bound by labor agreement).

42. See In re Unishops, Inc., 543 F.2d 1017, 1019 (2d Cir. 1976) (refusing to apply "new entity" theory beyond labor agreements); see also NLRB v. Bildisco, 465 U.S. 513, 527-29 (1984) (finding debtor in possession not "new entity," but has option to reject labor agreement).

contract is the very relief a breaching party normally suffers, an obligation to pay damages is, by definition, proof that the party is bound by that contract. By the same token, the power to assume the contract, even over the Other Party's objection, is hardly consistent with the notion of a separate entity that is not a party to the contract. If the new-entity approach avoids these shoals by saying the new entity is bound by, and is the beneficiary of, the contract as a successor, then the estate's position is indistinguishable from that of the original party, the debtor, and the analysis explains nothing.

The "material breach" test filled this conceptual void. With outré results unexplained, the test served as a talisman. It also permitted the courts to manipulate a concept essentially without content in order to produce what seemed to be the correct result in a particular case. Unfortunately, because bankruptcy policy is so often counter-intuitive, at least to nonbankruptcy judges, the courts fairly often got these cases wrong.

3. The Material Breach Test

Professor Countryman took a very nontraditional, pragmatic approach in the Minnesota Law Review articles. He focused upon the problem as it was actually articulated in the courts: the existence of a pre-bankruptcy contract that could be characterized as executory. From this perspective he developed what has become the standard test for an executory contract:

[A] contract 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.

Only a contract that satisfied this test could be assumed by the estate.

The material breach analysis properly resolves many cases and is widely cited in the courts. Although I will not claim to

44. See id. But see Andrew, supra note 15, at 878.
45. Countryman (pt. 1), supra note 7; Countryman (pt. 2), supra note 7.
46. Countryman (pt. 1), supra note 7, at 460.
47. Id. at 461.
48. E.g., Mitchell v. Streets (In re Streets & Beard Farm Partnership), 882 F.2d 233, 235 (7th Cir. 1989); Lubrizol Enters. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1045-46 (4th Cir. 1985), cert. denied sub nom. Lubrizol Enters. v. Canfield, 475 U.S. 1057 (1986); Benevides v. Alexander, 670 F.2d 885, 887 (9th Cir. 1982); In re Knutson (Northwest Airlines v. Klinger), 563 F.2d 916, 917 (8th Cir. 1977) (per curiam); In re Stein and Day, Inc., 81 Bankr. 263, 266 (Bankr. S.D.N.Y. 1988); In re
have done a before-and-after, case-by-case comparison, it is clear to me that the test has greatly reduced the number of judicial errors in treating contracts in bankruptcy and has greatly clarified everyone's understanding of the issues. This achievement was recognized when the 1978 Code codified the caselaw of executory contracts. The legislative history of section 365, "Executory Contracts," cited the material breach test as an example of the general understanding of the concept, although the drafters stopped short of actually incorporating the test into the Code.

The test was a godsend to judges perplexed by the strange results they found in bankruptcy contract cases. Rarely in legal history has a legal test suggested by a scholar been so quickly and widely adopted by the courts. Several courts of appeal adopted the test and many of the judges using it are expert in bankruptcy matters. Any theory based on a wholly different approach than Countryman's had best explain why the material breach test was so helpful to these courts. By the same token, an understanding of the reasons for the great success of this test will enable us to grasp its limitations, the reasons it does not work in important categories of contemporary cases.

The test has been enormously helpful for three reasons. First, it prevents assumption of a contract unless the Other Party owes a material performance. As we will see, it is very rare that assumption would be desirable for the estate unless the Other Party owes further performance of a valuable sort. Therefore, this test avoids assumption of contracts when assumption would not be beneficial to the estate.

Second, the "material breach" language focuses the courts' attention on questions of state law. It is there, in state contract
and remedies law, that the hard issues of bankruptcy contracts usually are found.\textsuperscript{54} The material breach test does not work consistently in this way, but it nonetheless is a great advance over what went before it, because it often causes the courts to analyze the state law questions that are at the heart of a bankruptcy contract problem.\textsuperscript{55}

Finally, and most importantly, the material breach test often serves as a proxy for “finality” in a contractual transaction. The analysis that follows will show that “finality” in this context often means transfer to the Other Party of what can loosely be called a “property right” — an interest arising under nonbankruptcy law that cannot be reclaimed by a bankrupt debtor unless the transfer of that interest can be avoided under one of the avoiding powers.\textsuperscript{56} When the debtor prior to bankruptcy has transferred such an unavoidable interest to the Other Party, the estate will be unable to undo that transfer and get back that property. Often that pre-petition transfer by the debtor will have completed the debtor’s material performance. In that situation, the material performance test can indirectly identify the existence of an interest in property that the estate cannot reclaim.\textsuperscript{57}

As with every intellectual advance, however, the clarifying light of Professor Countryman’s test revealed a new set of problems. The very power and utility of the Countryman approach has prompted its application to more and more problems where it is unable to give intuitively correct results, even as the host of errors it prevents have largely disappeared from the reporters. Many academics, judges, and lawyers are left, I believe, with the maddening feeling that Countryman has brought the final answer to the very tips of their tongues, but no farther.

The consequence is that the \textit{Minnesota Law Review} articles both permit and require us to re-examine the threshold requirement that a contract be determined “executory” before it is subject to “assumption” or “rejection.” After more than a decade of experience in the courts, we can now stand on the

\textsuperscript{54} E.g., Streets, 882 F.2d at 235.
\textsuperscript{56} See infra Section II. C.
shouders of Countryman and see over the wall of “executoriness.” When we do so, we can see that the wall should be torn down.

C. The Current Difficulties

Ironically, the most obvious and striking errors in the recent cases have arisen from the greatest benefit of the material breach test, the indirect identification of cases in which the Other Party has acquired a nonrejectable property interest. If the debtor had completely performed, the test made the contract nonexecutory and the transaction therefore irreversible, a generally correct result. Unfortunately, this effect of the test leads many courts to infer that executoriness must be found in a contract or it cannot be rejected. The consequence is a contract neither assumable nor rejectable, leaving it in a legal limbo. The absurdity of that idea has been less damaging, however, than the next step taken by a number of courts, positing that obligations owed to the Other Party can be rejected right out of existence. The final, and most serious, complex of errors in this line are the cases that suggest that rejection can void property interests created pre-petition by state law, even though they are not avoidable under the statutory avoiding powers. This last blunder brings the material breach test full

58. See infra Sections II. C., IV. B.
60. E.g., In re KMMCO, 40 Bankr. 976, 977 (E.D. Mich. 1984); In re Giesing, 96 Bankr. 229, 231 (Bankr. W.D. Mo. 1989); see also Andrew, supra note 15, at 886.
61. E.g., Lubrizol Enters. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1048 (4th Cir. 1985), cert. denied sub nom. Lubrizol Enters. v. Canfield, 475 U.S. 1057 (1986). This mistake has been stood on its head by cases suggesting that the trustee is somehow bound by — that is, bound to perform — contracts because they are nonexecutory. Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1153 (3d Cir. 1989). This bizarre idea may be a reaction to cases that have tried to use § 365 as an avoiding power. That is, the court in Hays may simply be trying to say that the trustee cannot undo a contract that is “final” by rejecting it. Although the intention is good, the effect is the same as coerced assumption based not on any reliance or other equities, but on the executoriness of the contract. The result in Hays, enforcement of an arbitration clause in a contract, may well be correct, but the analysis lays up trouble for the future in the Third Circuit. I made my own suggestions for a correct analysis of bankruptcy treatment of arbitration clauses in an article in this review a few years
circle, compounding the very error that it at first prevented.

Three examples should suffice to illustrate these problems. I will describe them briefly here, reserving a full discussion for the section following the theoretical analysis.62 The first example is a leading Fourth Circuit case, In re Richmond Finishers.63 The Richmond court permitted a technology licensor to rescind a license under the guise of rejecting an executory contract.64 This case seems to suggest that inventors might routinely use Chapter 11 to void licenses whenever a better deal comes along. The result is so deeply disruptive of commercial expectations and needs that Congress has adopted an amendment to the Code to limit the applicability of the executory contract “power” with respect to certain intellectual property contracts.65

I will attempt to demonstrate that such an over reaction was not justified, that the case was simply an example of “executoriness” leading a court to a wrong result. More generally, I hope to bury the use of the Richmond analysis for other sorts of contracts. Otherwise it will threaten commercial expectations in many other instances, including trademark contracts, which are not covered by the new amendment.66

A second area of great difficulty involves covenants not to compete. The leading example is In re Rovine.67 In Rovine, the court found that a franchise contract with an anti-competition covenant was executory and therefore the Chapter 11 debtor could reject it and compete freely with the franchisor (Burger King).68 Although the case may have been correctly

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62. See infra Section IV.
63. Richmond, 756 F.2d at 1043.
64. Id. at 1048.
66. Id.
68. Rovine II, 6 Bankr. at 666.
decided, its rationale is consistent with enabling franchisees to shrug off their franchise obligations as easily as inventors could revoke licenses under the *Richmond* decision. Other courts have gotten the result wrong, as well as the analysis. Once again, the “executoriness” doctrine has diverted the courts from the real issues before them, and the consequence has been to cloud important commercial expectations.

A third example is a recent spate of cases involving land-sale contracts. Two types of cases are common. In the first type, the debtor enters bankruptcy with a valuable option to purchase real estate, but no remaining obligation to the Other Party to the contract (the option price having been paid). Some courts have denied the debtor’s other creditors the benefit of the option, because the lack of material performance remaining on the debtor’s side made the contract not executory and therefore nonassumable.

A second sub-genre of land-sale cases poses an issue of characterization: is a contract for sale of land really a disguised security device? Instead of focusing on this state-law question,

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70. *E.g.*, Hardee’s Food Sys. v. KBAR, Inc. (*In re* KBAR, Inc.), 96 Bankr. 158, 159-60 (Bankr. C.D. Ill. 1988) (holding that Hardee’s franchise terminated pre-bankruptcy; contract not executory and covenant enforced); *In re* Hawes, 73 Bankr. 584, 586 (Bankr. E.D. Wis. 1987) (finding that employer could enforce covenant not to compete against former employee because employment contract was not executory; employment relationship ended when employee ceased performing duties); *In re* Noco, Inc., 76 Bankr. 839, 843 (Bankr. N.D. Fla. 1987) (alternative ground) (holding that franchise agreement was not an executory contract and debtor franchisees were not entitled to reject covenant not to compete contained in agreement where, franchise agreement was near expiration, debtor had breached it, debtor had reaped all the benefits under the agreement, franchisor had met its obligations, and only remaining obligation was debtor’s not to compete); Carstens Health Indus. v. Cooper (*In re* Cooper), 47 Bankr. 842, 844 (Bankr. W.D. Mo. 1985) (holding that where creditor-employer had no performance obligations, employment contract was not executory and debtor-employee’s non-competition requirement could not be rejected); Immugen, Inc. v. Sapse (*In re* Sapse), 31 Bankr. 914, 915 (Bankr. S.D. Fla. 1983) (finding contract for sale of business nonexecutory, covenant not to compete enforceable, and jurisdiction to prohibit debtor conduct that would diminish the value of stock belonging to the estate); *see also* Central Control Alarm Corp. v. Black (*In re* Central Watch), 22 Bankr. 561, 565 (Bankr. E.D. Wis. 1982) (finding executory employment contract containing noncompete covenant still enforceable against former officer after debtor-corporation’s Chapter 11 plan was confirmed).

71. *See infra* notes 370-73.
a number of courts have resolved the cases in terms of the bankruptcy doctrine of "executoriness." The result is an almost random assortment of right and wrong outcomes. More seriously, in the long run, the confusion engendered by the "executoriness" concept produced an important opinion by a leading jurist that seems to put many real estate sellers at risk of a fundamental post-hoc change in the bargain they made, a result that threatens an important and legitimate type of real estate transaction.

A number of scholars are concerned about these problems. While this article was in draft, a first-rate article appeared identifying many of the problems that I address and suggesting some of the same distinctions I think would be helpful. The reader familiar with Michael Andrew's article will be better prepared to understand this one and may already be disposed to abandon the dark glass of "executoriness" through which we have too long seen bankruptcy contract problems. On the other hand, I fear that parts of his analysis invite us to develop a new metaphysics of executory contracts to replace the old, rather than penetrating entirely through the problem to a straightforward understanding of bankruptcy contracts as governed by the same principles and rules as the rest of bankruptcy law. To that end, I propose to reexamine the role of contracts in bankruptcy from the ground up. After doing that, and discussing some of the leading cases from a new perspective, I will note how the Andrew analysis, excellent as it is, may create some new and unnecessary obscurities.

II. FUNCTIONAL ANALYSIS

Professor Gilmore taught us:

It is a fairly reliable rule of thumb that, when courts with some regularity begin to assign patently absurd reasons for their decisions, the decisions themselves are sound and the underlying rule of law has fallen out of touch with reality.
Whenever an area of law has become conceptually and doctrinally confused, it is always helpful to return to first principles. I concede that law reviews these days are too full of desert-island theorizing — stick-figure actors isolated from reality and provided only a banana and a demand curve.77 Nonetheless, a return to simple basics is an essential prerequisite before we turn to the reality of exemplary cases.

The executoriness requirement is a limitation on assumption or rejection that is not found in the Code. Section 36578 constrains assumption in three ways. It forbids assumption when assignment is not permitted by applicable nonbankruptcy law.79 If a contract is assumable, it requires the curing of most defaults, as well as provision of assurances about future performance.80 Those are the only limitations imposed by the Code. The executoriness requirement has been poured into the word “executory” in section 365(a) by a century of caselaw.81

It is obvious that a contract must be executory to be assumed or rejected, if the term is used in its ordinary sense to mean merely that aspects of the contract were not fully performed or satisfied on Bankruptcy Day. But if executoriness had such a simple meaning, the requirement would be trivial. The trustee need not, and could not, assume or reject a contract fully performed a year before bankruptcy — nor would anyone dream of doing so. Speaking of a “nonexecutory” contract in that sense is like discussing a sunset after dark.82

The courts intend a more complex meaning in the term “executory.” They hold many contracts to be nonexecutory, and therefore not subject to either assumption or rejection, even though the contracts were not fully performed or satisfied prior to bankruptcy. Yet they have never articulated an intelligible distinction between unperformed contracts that are executory and those that are nonexecutory.

This section presents a functional analysis of the proper treatment of bankruptcy contracts without reference to the

77. See generally Sullivan, Warren & Westbrook, Laws, Models, and Real People: Choice of Chapter in Personal Bankruptcy, 13 LAW & SOC. INQUIRY 661, 673 (1988) (suggesting that theories of legal change are often based on the abstract models of armchair theorists who fail to determine the strengths and limitations of such models).
79. Id. § 365(c)(1).
80. Id. §§ 365(b), 365(f).
81. See supra note 24.
82. We ignore, for the moment, the effect of the avoiding powers. See infra Section IV. E.
caselaw requirement of "executoriness." I argue that general
principles of bankruptcy explain why bankruptcy contracts are
sometimes treated differently than contracts outside of bank-
ruptcy. The treatment of contracts in bankruptcy is merely a
subset of those general bankruptcy principles. Looking only to
these general principles, it is possible to demonstrate all the ba-
sic propositions that govern a proper understanding of bank-
ruptcy contract law.

This discussion observes the following convention: "right"
will mean the debtor's right, and "obligation" will mean the
debtor's obligation, unless the context reveals a different inten-
tion. This convention is necessary because all contractual
rights are obligations and conversely, so it is important to re-
member which is which, from which perspective, at any point
in the analysis. The double-sided, asymmetrical nature of exec-
utory contract analysis in bankruptcy is the principal reason it
is so difficult and confusing, a point that will become evident as
we proceed.

Section A begins by examining the factors that make the
trustee's treatment of pre-bankruptcy contracts a unique prob-
lem. The trustee's routine duties are to maximize the value
of the property the estate has inherited from the pre-petition
debtor and to minimize the pre-petition claims against the es-
tate. Contracts are unique because they consist of both prop-
erty and claims, the debtor's rights under a contract and the
debtor's obligations. Furthermore, the rights and obligations
often are interdependent, with enjoyment of a particular right
dependent upon performance of a particular obligation. As a
result, the trustee's determination of the most profitable course
for the estate is much more complicated than for other types of
property and claims.

Section A then discusses the basic proposition that the
trustee inherits from the pre-bankruptcy debtor a contract cre-
ated by nonbankruptcy law. The statutory option to "assume
or reject" means exactly what the Code says it means: the op-
tion to perform or breach the contract, the same option every
contract party has under nonbankruptcy law. It follows that
the trustee is prima facie in the same position as any nonban-
kruptcy contract party, except when specific bankruptcy princi-

83. See infra text accompanying notes 94-102.
84. Id.
85. See infra text accompanying notes 103-05.
ples and rules require a different result. The section uses a simple sales contract to illustrate the trustee's financial calculations in deciding whether to assume or reject under nonbankruptcy law.87

The last part of Section A introduces the principle that generates all of the exceptions to the general proposition that the trustee is in the same position as any other contract party. That principle is equality of distribution.88 Equality among unsecured creditors means that the Other Party to a bankruptcy contract, like all other unsecured creditors, is not entitled to full performance or payment of its claims against the debtor. Instead, it ordinarily must be content with a tiny fraction of those claims, proverbially ten cents on the dollar.89 The first concrete consequence of the equality principle is that the trustee can breach (reject) a contract profitably far more often than can other contract parties because the trustee pays only a fraction of contract damages rather than the full amount of the Other Party's breach loss.90 From that simple proposition flows most of the economic "magic" associated with bankruptcy contract doctrine.

Section B explores the second consequence of the equality principle, the fact that the Other Party ordinarily cannot get specific performance of a contractual covenant, even if state law would grant that relief.91 The reason is that specific performance is full, 100% performance and therefore would violate the equality principle by giving the Other Party far more from the estate than is given to the other unsecured creditors.

Section C identifies the principal exception to the denial of specific performance against the estate. The most important and pervasive exception to the equality principle throughout

87. See infra text accompanying notes 115-18.
88. See infra notes 120-26 and accompanying text. Other principles may be important in particular cases, but the equality principle is the key point. Cases that implicate other special incidents of bankruptcy, like acceleration of debts, often are entangled with procedural questions under § 365. See, e.g., In re Unishops, Inc., 543 F.2d 1017, 1019 (2d Cir. 1976) (per curiam) (finding that contract of guarantee not executory and therefore not assumed). I look forward to discussing them in another paper.
90. See infra text accompanying notes 128-32.
91. See infra text accompanying notes 133-35.
bankruptcy law is the enforcement of state-law interests in specific assets of the estate, what may loosely be called a “property right” and what I call an “Interest in the Thing Itself” (ITI). 92 The most common example of a creditor who enjoys the dramatically unequal advantages given by such rights is the holder of a security interest. The “specific asset” or ITI exception to the equality principle applies to an ITI created by a bankruptcy contract, as it does elsewhere in bankruptcy, allowing an Other Party with such an interest to compel its enforcement. To that extent, the Other Party can obtain specific performance against the estate. 93 The Other Party thus cannot get specific performance of contractual covenants that are merely general, unsecured claims against the debtor, but can get specific performance of a “property right” or ITI.

Section D then goes step by step through a simple sales contract, with the Debtor as Buyer and the Debtor as Seller. Among other things, this example illustrates the asymmetrical effect of the bankruptcy remedies rules.

Section E addresses the exception to the exception, the constraints upon the Other Party’s power to enforce a contractually created ITI. Because enforcement of ITIs is such a large exception to the equality principle, that principle necessarily limits enforcement of ITIs under various circumstances. Those limitations are found in the avoiding powers, rather than in any bankruptcy-contract principle, but they often operate in the context of a supposed ITI created by a bankruptcy contract. Applying those powers in the usual way, the trustee may avoid an ITI created by a contract. If so, then the remainder of the analysis of the contract follows the principles already discussed where the Other Party has only general, unsecured claims against the estate.

Section F completes the functional analysis of bankruptcy contracts by explaining the role of the discharge. Just as the equality principle controls the treatment of the Other Party’s rights against the estate, the fresh-start principle ordinarily eliminates or greatly restricts the Other Party’s rights against a post-bankruptcy debtor, whether an individual or a newly reorganized corporation. This section concludes by explaining how the Other Party is protected from unfair tactics by other bankruptcy principles, notably the cramdown rules.

Finally, Section G addresses the semantic confusion engen-

92. See infra text accompanying notes 138-43.
93. See infra text accompanying notes 154-58.
dered by the phrase “assume or reject,” establishing the distinction between performing or breaching, as opposed to deciding to perform or breach.

A. THE BASICS

1. What Makes Contracts Unique in Bankruptcy?

Contracts present unique problems in bankruptcy. The reason is that every contract consists of both rights, which become property of the estate under section 541,94 and obligations, which become claims under section 502.95 Furthermore, these rights and obligations often are interdependent, so that realization of a right is dependent upon performance of an obligation. These characteristics of a contract make the trustee’s calculation of benefit and cost to the estate far more complicated than for other property and other claims. Realizing on a drill press, say, is straightforward: if it will bring more than the cost of sale, sell it. Otherwise, abandon it. Realizing on a contract right can be more complicated, because the right is often dependent on an obligation, so that the estate must perform the obligation in order to be entitled to realize on the right.96 The estate’s performance thus becomes part of the “cost of sale” of the contract right and the expense of performing the obligation may exceed the proceeds of realization on the right. This interdependence can be identified by the material breach test, which is one reason it is so helpful.

Consider the example of a pre-petition contract with only two remaining elements: the estate’s right to the payment of $500, and its obligation to pick onions growing on real property belonging to the estate and deliver the onions to the Other Party.97 The debtor’s pre-petition contractual right becomes part of the estate under section 541.98 Absent a procedural bobble by the Other Party, its obligation attaches to the estate

96. See T. JACKSON, supra note 74, at 106. For the important point that the debtor in possession under Chapter 11 might have to consider ongoing economic relationships in determining whether to accept or reject, see Epling, Preconfirmation or Preclosing Payment of Prepetition Claims in Bankruptcy, 94 Com. L.J. 187, 193-94 (1989).
97. See infra Section II. D. 2. (discussing the case of the Debtor as Seller, Uncompleted Contract).
under section 502.99

Confronted with these contractual rights and obligations, what should a trustee in bankruptcy do in light of the provisions of the Code and the policies underlying them? In general, the trustee is required to realize maximum value from property of the estate. The trustee, or the debtor in possession (DIP),100 also is required to minimize claims when appropriate; for example, by objecting to those that are invalid or overblown. It must do the same for contractual rights and obligations. It does these things on behalf of a group of persons, the unsecured creditors, who are not parties to the contract in question.101 These persons have no moral or legal obligation to the Other Party and generally cannot be blamed for any pre-petition misconduct or imprudence of the debtor.

In our example, the trustee has inherited one contract right (the right to receive $500) and one contract obligation (the obligation to pick and deliver the onions). Its duty is to realize the value of the right to payment, if it can do so at a cost of less than $500. It also has the duty to minimize the obligation, if possible, by buying the onions more cheaply elsewhere or by breaching and paying damages, if that would cost less than performance. The process of dealing with the contract right is in principle no different from selling off a piece of the debtor's equipment, if the cost of sale is less than the proceeds to be obtained. Treatment of the contract obligation is the same as trying to mitigate damages on a claim, as, for example, a pre-petition tort claim, if the mitigation would increase the net dis-

99. *Id.* § 502. This discussion assumes an unsecured transaction, the most common contract situation. Some of the effects of security interests are discussed *infra* notes 380-86 and accompanying text.

100. I will refer to the Chapter 11 Debtor in Possession, 11 U.S.C. § 1107 (1988), as the “DIP.” Most of the discussion in this first section will be in the context of a Chapter 7 liquidation, but once the basic principles are established we will find some of the most interesting problems in the Chapter 11 context. In Chapters 7 and 13, the trustee is a she or he, but in Chapter 11 the DIP is usually an “it,” that is, a corporation or other artificial entity. I will use “it” for trustee and DIP throughout.

101. The trustee also may act on behalf of the debtor and other parties with an interest in the estate, especially in rehabilitation cases. See generally Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 777 n.3 (1987) (arguing that bankruptcy is an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among several different actors). As among creditors, the beneficiaries of the trustee's efforts often will be the unsecured creditors with priorities, rather than general unsecured creditors. See Herbert & Pacitti, *supra* note 89, at 313-15. But these refinements may be ignored for present purposes.
2. Nonbankruptcy Law

In the process of maximizing the benefit of the contractual rights the trustee has inherited, and minimizing the burdens of the contractual obligations, the trustee must begin with the central fact that these rights and obligations are completely defined by nonbankruptcy law, usually state contract law. The contract rights are not even tangible property. They are utterly constructs of a state legal regime that requires us to perform many of our promises much of the time. The rights and obligations by definition were created before bankruptcy law began to operate as to this debtor. In general, therefore, these rights and obligations — and the benefits and burdens they bring to the estate — in all respects are governed by state contract law.

One corollary is of special importance in some cases: state law determines what bundle of contractual rights and obligations are to be considered together as a single contract (single contract or contract).

102. The trustee might decide to pay the medical bills of an indigent tort victim, for example, if the result would be to lessen the estate's liability. But see Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1988) (reversing order to pay for Dalkon Shield claimants' treatment before confirming debtor's plan of reorganization).

103. Unless the context clearly requires otherwise, reference to "state law," means applicable nonbankruptcy law, whether state, federal, or foreign.

104. See Butner v. United States, 440 U.S. 48, 57 (1979) (holding that the Bankruptcy Act generally follows state law in determining property rights in the estate's assets). This general proposition, however, does not imply that bankruptcy policies should be narrowly understood, so that state law results should almost never be changed in bankruptcy. See Nimmer, Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions, 36 Emory L.J. 1009, passim (1987); Warren, supra note 101, passim. But see Baird & Jackson, Corporate Reorganization and the Treatment of Divorce Ownership Interests, 51 U. Chi. L. Rev. 97, 100 (1984).

105. Because state contract law often makes the rights and obligations contained in a single contract dependent upon each other, the grouping of rights and obligations into separate contracts is often important in understanding them. No bankruptcy principle changes the state-law grouping rules. Thus, the trustee must deal with pre-petition contractual rights and obligations in those bundles called single contracts, as they are defined by state law or other nonbankruptcy law. E.g., In re Cutters, Inc., 104 Bankr. 886, 889 (Bankr. M.D. Tenn. 1989) (finding contract for sale of business severable; covenant not to compete part of nonexecutory segment); In re Gardinier, Inc., 50 Bankr. 491, 493-94 (Bankr. M.D. Fla. 1985) (holding broker's right to commission severable from land-sale contract and not executory); rev'd, 831 F.2d 974, (11th Cir. 1987), cert. denied sub nom. Byrd v. Gardinier, Inc., 109 S. Ct. 140 (1988); see Westbrook, supra note 61, at 623-24 & nn.112-16 (discussing cases holding that nonbankruptcy law makes arbitration clauses severable contracts, permitting...
This is an appropriate place to emphasize that section 365, and any supposed special rules governing "executory" contracts, have nothing to do with the entry of pre-bankruptcy contracts into the estate. One thing that always confuses students about executory contracts is that section 365(a) (granting the "power" to assume or reject) starts with the contract already in the estate. As already noted, it comes in under sections 541 (rights) and 502 (obligations). Indeed, section 541 contains the key provision that ensures that contractual rights become property of the estate despite efforts to restrict their assignability. So the contract attaches to the estate without any reference to section 365 and exactly as it existed at state law at the moment of bankruptcy.

Even the trustee's "power" to assume or reject in section 365(a) is not a special rule of bankruptcy law. This option means merely that the trustee may (must) perform or breach any single contract. We know that is what it means because the Code itself says just that. Yet state law gives this option to every party to every contract. Posner or Holmes would say this principle is unequivocal; others might limit it on moral grounds. Putting to one side the moral question, to which we will return, state contract law permits a party to choose between performing or breaching and paying damages, at least when an award of damages can fairly and sensibly compensate their assumption or rejection separate from main contract). This proposition is related to the rule that the trustee must assume a contract as a whole, cum onere. Thompson v. Texas Mexican Ry. Co., 328 U.S. 134, 141 (1946); Countryman (pt. 2), supra note 7, at 535; 2 COLLIER 15th, supra note 17, ¶ 365.01; see infra note 272.

106. See supra notes 98-99 and accompanying text.


108. See generally Butner, 440 U.S. at 57 (holding that state law determines the property rights in the bankruptcy estate's assets).

109. E.g., Societe Nationale Algerienne pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation des Hydrocarbures v. Distrigas Corp., 80 Bankr. 606, 609 (D. Mass. 1987). But see Andrew, supra note 15, at 883-84. Assumption and rejection are just slightly different from performance or breach, a point discussed in Section II. G.


111. R. Posner, Economic Analysis of Law 106 (3d ed. 1986); O. Holmes, The Common Law 301 (1923); Holmes, The Path of the Law, 10 Harv. L. Rev. 457, 462 (1897). But see Laycock, The Death of the Irreparable Injury Rule, 103 Harv. L. Rev. 687 (1990). Although Laycock is utterly persuasive that specific relief is routinely available where necessary, he also finds that it is nonetheless rarely granted. See infra note 172.

112. See infra text accompanying notes 224-25.
the Other Party. The debtor had that option and so does the trustee.

Thus a trustee must look to state contract law in the first instance to evaluate the contractual rights and obligations connected to the estate. The contractual rights are property of the estate and, as with any property, the trustee will realize on them or abandon them. The trustee will abandon property if the costs of realizing upon it exceed its value, so that it has no net value (Net Value).

In our pending example, suppose the debtor-seller had delivered the onions before bankruptcy, leaving nothing but the estate's inherited right to payment of $500 by the Other Party. Unless the cost of suit exceeded $500, the trustee would simply enforce the right and get the money. By the same token, if the Other Party buyer had paid the $500 before bankruptcy but the onions had not been delivered (the estate inherited an obligation but no remaining right), the trustee would have the simple choice of performing the obligation, picking and delivering the onions, or paying damages for nonperformance, like any other party to a contract. The trustee will pick the cheaper alternative. We will discuss in a moment the unique impact of bankruptcy law in this situation, but to this point the trustee's job is just simple contract law and elementary business judgment.

The trustee's analysis is unchanged when the estate contains both a right and an obligation from a single contract, as long as the two are independent. In our example, if the $500 right to payment arose from some earlier performance under the original contract and is enforceable under contract law regardless of whether the trustee delivers the onions, then the trustee's decision-making process is the same.

113. We postpone the specific performance problem for now. See infra Section II. B.

114. See T. Jackson, supra note 74, at 108. Given Dean Jackson's central premise, that bankruptcy law rarely should change state law results (a view I do not share), it is congenial for him to find that bankruptcy contracts should be considered as primarily governed by state law. Id. He also sees, correctly, that the executory status of a contract does not matter for rejection. Id. at 109. Dean Jackson has some real insights into the executory contract problem, but his preoccupation with his central premise causes him to devote much of the rest of his discussion to criticizing § 365 for permitting deviation from state law rules, rather than pursuing the executory contract problem.

115. Throughout this introductory discussion, I ignore for clarity's sake the effect of the avoiding powers on bankruptcy contracts. See infra Section II. E.

116. See infra Section II. A. 3.
The trustee's analysis often is more complicated, because state contract law might make the right and the obligation interdependent. In the example we are using, state law may well say that the right to receipt of the $500 depends upon performance of the obligation to deliver the onions. In that case, the trustee, like any other contract party, must net the benefit of the $500 payment against the cost of picking and delivering the onions and then compare that Net Value against the cost of paying damages for nondelivery. Again, the process is the same as netting the cost of sale of a piece of equipment against the likely sale price. The trustee's duty to creditors will be to choose the most profitable alternative, thus maximizing the estate. The difference is merely that state contract law makes the right depend on the obligation and therefore makes the calculation more complicated.

3. The Limitation of Remedies In Bankruptcy

Now we introduce the special effect of bankruptcy principles for the first time. Whether a contract's rights and obligations are independent or dependent, the trustee's calculations of benefit and cost will differ greatly from the ordinary contract party because of remedies rules unique to bankruptcy. Bankruptcy law most often changes state law rules to alter remedies, and the treatment of contracts in bankruptcy is no exception.

The principle that modifies the trustee's position, making it much more favorable than that of the pre-petition debtor, is equality of distribution. That principle requires that all creditors be treated equally, subject to a number of important exceptions. It apparently is the most universal of all insolvency principles throughout the world.

From the equality principle comes the rule of pro rata distribution to pre-petition unsecured creditors. The pro rata rule requires that unsecured creditors share proportionately in dis-
tributions, with the result that almost never are they paid in full. Their claims are calculated in full under state law, as we have just discussed, but their actual relief, the payment of the claims, can be thought of as being in little tiny Bankruptcy Dollars, which may be worth only ten cents in U.S. dollars.

In sharp contrast, if the trustee assumes a contract, then it is converted into an estate obligation, a post-petition obligation, and the Other Party becomes entitled to full performance or payment as an administration claim. Because administration claims are paid first in any distribution, they are usually paid in full, 100 cent U.S. dollars.

The resulting change in the trustee’s Net Value calculation produces much of the “magic” of executory contract doctrine in bankruptcy. When the trustee calculates the cost of breaching an obligation, it figures the breach claim in full U.S. dollars under state law, but it must calculate real, net costs in light of paying that claim in Bankruptcy Dollars, that is, paying only a percentage of the claim as calculated under nonbankruptcy law in real U.S. dollars. Conversely, when the trustee calculates the cost of performance, it must figure that cost in 100 cent U.S. dollars, because it must pay for performance as an administration claim. Finally, any amounts to be paid to the trustee by the Other Party also will be in full U.S. dollars. Because bankruptcy is another world, it is appropriate to adapt the international convention from this point forward, referring to 100 cent dollars as “U.S. $” and the distribution cost of the claim in bankruptcy as “B.D. $”.

These rules change the calculation dramatically. In the onion contract example, let us assume the cost of picking and delivering the onions to the Other Party is U.S. $550. Let us further assume that the price of onions in the marketplace is the same, U.S. $550. Therefore the transaction represents a U.S. $50 loss, because only U.S. $500 will be paid. The breach-claim expense under contract law also should be U.S. $50. Because I am a law professor, I can assume those pleasant fanta-

122. Id. § 502.
123. See supra notes 103-05 and accompanying text.
126. Id. § 507(a)(1).
127. An exception is possible in the usual case when the Other Party is insolvent, or when its intransigence makes collection very expensive relative to return.
ties, a perfect market and no transaction costs, so that it will cost the Other Party U.S. $550 to “cover,” and that party will recover U.S. $50 from the breaching party who refused to pick. Perfect symmetry, at least in the halls of academe. The Net Value of assumption is the financial benefit of the Other Party’s performance, less the cost of performance of the contract, plus the further benefit of assumption that comes from the fact that the estate does not have to pay the Other Party for the breach of contract claim that would arise from rejection.128

For a nonbankruptcy contract party, the Net Value of performance theoretically is zero in this example. Consequently, a nonbankrupt party has no reason to perform or not to perform on an amoral, one-shot basis. The calculation is very different for the estate that inherits such a contract, because the breach-claim will be paid in Bankruptcy Dollars, while the performance cost will be paid in full U.S. dollars as a cost of administration. Assuming a 10% distribution, the loss from assumption and performance would be U.S. $50 (U.S. $500 contract price less U.S. $550 cost of performance), while the amount saved by eliminating the Other Party’s breach claim would be only U.S. $5 (B.D. $50 = U.S. $5), because that claim would be paid in Bankruptcy Dollars. Thus the Net Value of assumption for the estate, unlike the nonbankrupt contract party, is U.S. $-45.129 To state the point affirmatively, the cost of breach is U.S. $5 while the net cost of performance is U.S. $45. Breaching and paying is cheaper than performing, even in theory, so it is clear the estate should choose to breach-and-pay.130 Thus, the trustee often will breach-and-pay when any other contract party in the same position will perform.131 The dramatic loss of position of the Other Party flows directly from the fundamen-

128. If the reader will forgive a formula:
   Net Value, Assumption = (VOP - CP) + OPC.
   Net Value, Assumption = (U.S. $500 - U.S. $550) + $50 = 0, where VOP is the value of the Other Party’s performance, CP is the cost of performance by the estate, and OPC is the saving the estate enjoys from assumption because it does not have to pay the Other Party’s damage claim for breach of contract.

129. Net Value, Assumption = (VOP - CP) + OPC.

130. For the trustee, we have to rewrite the formula. The trustee’s formula is as follows, where B.D. stands for Bankruptcy Dollars:
   Net Value, Assumption = (U.S. $VOP - U.S. $CP) + B.D. $OPC.

131. But see infra text accompanying notes 132, 278.
tal bankruptcy rule that all unsecured creditors are paid pro rata and the fundamental bankruptcy fact that such payments often are a tiny percentage of the amount owed under state law.

The effect of paying claims in Bankruptcy Dollars is even more clear when the breach claim exceeds the marginal loss from performance. If the Other Party's breach claim in this example had been $100, then a normal contract party would have a substantial incentive to perform, because saving a $100 damage claim would have more than offset the $50 loss on performance of the contract. Not so for the trustee, who saves U.S. $50 by avoiding the cost of performance, net of the benefit of the contract price, but pays only U.S. $10 (B.D. $100) for breach. The trustee's Net Value for assumption is still negative, U.S. $-40, and breach-and-pay remains the best economic decision. The Other Party's damage claim must be unusually great, or the distribution on account of unsecured damage claims must be unusually large, to make assumption of an unprofitable contract economically sound.\textsuperscript{132}

To summarize, the estate generally should assume only profitable contracts of the debtor, because the severe undercompensation of unsecured creditors in bankruptcy will make it worthwhile to reject (breach) all unprofitable contracts. The rare exceptions most often arise with unusually large breach claims or unusually substantial dividends to unsecured creditors.

B. SPECIFIC PERFORMANCE

Before we can work all the way through even a simple goods contract, we must discuss two additional bankruptcy principles, 1) bankruptcy denial of specific performance against the estate; and 2) bankruptcy enforcement of nonbankruptcy remedies in specific assets.

Professor Countryman, in the \textit{Minnesota Law Review} articles, identified the rule that specific performance is not available against the bankruptcy trustee.\textsuperscript{133} The reason behind the

\textsuperscript{132} See infra text accompanying note 278. The usual Net Value analysis also might change when the Other Party has a large setoff claim. \textit{Id}.

\textsuperscript{133} See Countryman (pt. 1), \textit{supra} note 7, at 465-66, 471; Westbrook, \textit{supra} note 61, at 619 n.94 and authorities there cited. \textit{But see Proyectos Electrónicos, S.A. v. Alper}, 37 Bankr. 931, 933-34 (E.D. Pa. 1983). The effect of the \textit{Proyectos} decision, which ignored the Code (other than the automatic stay) and bankruptcy caselaw, was to award the goods to the buyer if, and only if, the goods were actually or constructively delivered. This is not really specific perfor-
rule is the principle of equality of distribution. Specific performance is in effect 100% “payment;” that is, performance in full. Giving that remedy to one pre-petition unsecured creditor, the Other Party, would seriously violate the equality principle as to all other unsecured creditors, leaving them with a far smaller distribution. 134 This proposition, denial of specific performance against the trustee, is crucial to analyzing some of the most important types of bankruptcy contract cases. It is not an important part of the concept of executorness, however, even though Professor Countryman identified it for us. For the same reasons, the equitable remedy of rescission should not be available against the trustee, 135 although rescission damages may be.

The Other Party is not often prejudiced by this treatment, even if the reason for granting specific relief under state law is that damages are hard to calculate. 136 The reason is that bankruptcy law provides a special remedy for the Other Party whose damages are hard to ascertain. Section 502(c) gives the bankruptcy court very broad power to “estimate” claims, without the constraints of state law doctrines about speculative damages. 137 Thus, the bankruptcy court probably could give a
fainter compensatory damage claim in this situation than could a state court limited by constraints not applicable in bankruptcy.

Even in a case in which the bankruptcy court’s estimate might give the Other Party a damage claim that is undercompensatory, denial of specific relief is the fairest result. Because bankruptcy almost always yields very low recoveries for all creditors, the Other Party’s understated claim probably will result in a distribution closer to equality with the other creditors than would granting specific performance. That is, 100% performance for the Other Party will be more unequal than pro rata payment of an understated claim.

C. AN INTEREST IN THE THING ITSELF

In general, bankruptcy law enforces what may loosely be called “property rights” existing under nonbankruptcy law. More precisely, bankruptcy will enforce nonbankruptcy remedies on behalf of an Other Party if they are remedies entitling the Other Party to dominion over a specific asset, unless the Other Party’s interest is subject to avoidance under the bankruptcy avoiding powers. This “property” principle is central to bankruptcy law because it is by far the most important exception to the principle of equality of distribution. The rule derived from the property principle, payment in full to the Other Party of the proceeds of sale of such an asset, is the most im-


138. See F. MACDONALD, NOVUS ORDO SECLORUM 10-11 (1985). By dominion, I mean, roughly, use and/or the right to alienate and/or the right to use and/or alienate the proceeds of use or alienation. (This footnote is dedicated, with affection but without apology, to those who despise the “and/or” formulation.)

important exception to the rule of pro rata payment. A commonplace example is the treatment of security interests.\textsuperscript{140} This rule operates as to interests created by bankruptcy contracts as it does elsewhere in bankruptcy, resulting in a major exception to the rule that specific performance is not granted against the estate.

An interest in a specific asset that entitles the owner of the interest to the asset itself, or to priority payment of the proceeds of its sale,\textsuperscript{143} is largely congruent with what is called a property interest. I call it an "Interest in the Thing Itself" (ITI) to emphasize that I want to avoid addressing global issues about the definition of that ubiquitous concept, "property." We use the concept of "property" in many ways for many purposes and its general definition is beyond the scope of this effort.\textsuperscript{142} Calling such an interest an ITI focuses attention in the right place for bankruptcy purposes, on the remedies available to the Other Party, and deflects the historical and emotional freight that accompany the word "property."\textsuperscript{143} So, an ITI is an interest under nonbankruptcy law that entitles its beneficiary to dominion over a specific asset or to priority in the proceeds of the sale of that asset.

Nothing in this discussion purports to explain why or when nonbankruptcy law confers upon a party the right to these remedies, thus creating an ITI. I am content to leave that to nonbankruptcy law and nonbankruptcy scholars, just as the Code does. The only relevant point here is that bankruptcy law enforces ITIs created under nonbankruptcy law.\textsuperscript{144}

It is curious that the Code is never very explicit about the rights of an owner of an ITI.\textsuperscript{145} The fact that bankruptcy law enforces the nonbankruptcy remedies available to the holder of

\begin{itemize}
  \item[140.] See id. §§ 506, 725.
  \item[141.] Sometimes, the owner gets the proceeds less costs of sale. Id. § 506(c).
  \item[142.] See generally Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 HARV. L. REV. 1165, 1202-13 (1967). In that article, Professor Michelman greatly contributes to our understanding of the concept of "property" in perhaps its broadest context, expropriation. For the even more difficult problem of defining "property" in the context of transnational expropriation, see generally H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS 487-95 (2d ed. 1976).
  \item[143.] Andrew argues against distinguishing between property rights and contract rights in bankruptcy contract analysis primarily because of his concern that state-law labels should not decide cases, a concern I share. See Andrew, supra note 15, at 924.
  \item[144.] See supra notes 138-40 and accompanying text.
  \item[145.] For example, the Code never explicitly states that the holder of a valid security interest is entitled to receive all of the proceeds from sale of col-
\end{itemize}
such an interest must be derived in major part as a negative inference from the definition of "property of the estate" in section 541 of the Code. From the fact that the Code permits nonbankruptcy law to define the "property" interests of the debtor at the moment of bankruptcy, it follows that the interests of an Other Party in such property is also defined by nonbankruptcy law: all the world that is not the debtor's belongs to someone else. As to any asset in which section 541 gives the estate an interest, any other interest in that property belongs to somebody else. A similar definition can be derived from section 547 for preference purposes. The white area on a Rorschach defines the dark area and is defined by it, and much the same thing is at work in the Bankruptcy Code's definition of property of the estate and its inferential definition of the property of an Other Party. In this negative, inferential way, the Code defines the enforceable ITI of an Other Party.

The Code further refines the definition of the Other Party's property by reference to the avoiding powers. The Code denies an interest to the Other Party and gives it to the estate if the interest would not survive transfer to a transferee under defined circumstances, or if the Other Party got the interest under defined circumstances during a defined period lateral until paid in full. That fact must be inferred from several provisions, especially §§ 506, 541(a), 552(b), 724(b)(1).

146. 11 U.S.C. § 541(a) (1988). It is often said that "property of the estate" is a bankruptcy law concept to be defined by the federal courts. E.g., Segal v. Rochelle, 382 U.S. 375, 379-80 (1966); see 4 COLLIe 15th, supra note 17, § 541.02(1) (stating that federal law determines what constitutes property within the meaning of § 541). That proposition is no doubt true in the sense that bankruptcy courts are empowered to look past nonbankruptcy labels in determining whether an interest is property of the estate. But the existence of a bundle of remedies in favor of a party is the consequence of preexisting nonbankruptcy law, even if the characterization of those remedies as "property" for bankruptcy purposes is ultimately a question of bankruptcy law. Because the bankruptcy characterization of an interest as "property" turns on the characteristics of the remedies available to enforce that interest, nonbankruptcy law determines what interests are eligible to be "property" under bankruptcy law. United States v. Security Indus. Bank, 459 U.S. 70, 78 (1982). See T. JACKSON, supra note 74, at 93-94; see also 4 COLLIe 15th, supra note 17, § 541.02(1). Of course, Congress can decide to limit or expand the remedies available in bankruptcy to holders of various nonbankruptcy interests, but it generally has not exercised that power.


before bankruptcy.\textsuperscript{150} If the Other Party's claimed interest — its bundle of remedies — survives the avoiding powers, then it is an ITI for bankruptcy purposes.

Modern analysts want to avoid resolving important bankruptcy questions by relying on the distinction between "property rights" and "contract rights."\textsuperscript{151} They have an instinct that the distinction could lead to a quagmire of abstract debate, and that instinct is sound. Yet we cannot avoid the fundamental fact that bankruptcy issues turn on the important distinction between the bundle of remedies usually called "property rights" and the bundle called "contract rights." As much as we may resist, no other distinction will work. To paraphrase what Churchill said of democracy, the property-contract distinction is the worst possible, except for all the others.\textsuperscript{152}

The approach suggested here avoids the pitfalls inherent in the property-contract distinction by focusing concretely on the specific remedies available to enforce a particular sort of nonbankruptcy interest, so that the bankruptcy analyst can look for the remedies that define an interest under nonbankruptcy law rather than for a label or an abstract concept.\textsuperscript{153}

With this understanding in hand, it is accurate to say that bankruptcy courts will enforce a nonbankruptcy ITI, a large exception to the principle of equality of distribution and the rule of pro rata payment. That fact is crucial to understanding bankruptcy contracts because, as we have seen, the treatment of bankruptcy contracts is governed by the limitations on the Other Party's remedies imposed by the equality principle and the pro rata rule.\textsuperscript{154} The enforcement of ITIs is the key exception to those limitations.

A functionalist looks at the concrete operation of remedies as the key to the bankruptcy contract problem, so the special treatment of an ITI is central to understanding the operation of

\textsuperscript{150} Id. §§ 547, 548.
\textsuperscript{151} See, e.g., Andrew, supra note 15, at 924.
\textsuperscript{152} Oxford Dictionary of Quotations 150 (3d ed. 1979) (House of Commons, November 11, 1947). Part of the reason we resist relying on this distinction is that it is not justifiable as a matter of principle. See infra note 158. Yet it is pervasive in our law, especially our debtor-creditor law. See United States v. Security Indus. Bank, 459 U.S. 70, 74-75 (1982) (distinguishing Congress' power to modify a secured creditor's property rights from its authority over contract rights). Because it is pervasive, it is the only distinction that maintains the necessary symmetry between bankruptcy contract doctrine and the avoiding powers. See infra note 363.
\textsuperscript{153} See infra note 341.
\textsuperscript{154} See supra text accompanying notes 120-21, 133-35.
the rule barring specific performance against the estate. When an Other Party enjoys an ITI under nonbankruptcy law, injunctive relief will vindicate its rights against a bankruptcy trustee, but in the absence of an ITI the trustee is immune from such relief for the reasons discussed previously. Because the relief sought is very similar, a functionalist must understand why it is available in one case and not the other.

The recognition and enforcement of an ITI, as defined, provides the clarifying distinction. For example, an order lifting the bankruptcy stay and requiring the estate to turn over property to a secured party for sale is enforcement of an ITI, while an order enforcing a covenant against competition or an arbitration clause is not an enforcement of an ITI, because the latter rights are general claims, not rights to specific assets. Injunctive enforcement of the latter would violate the equality principle without justification, while enforcement of the former falls squarely within the exception to that principle for a nonbankruptcy ITI. Similarly, a right to specific performance of a land contract may constitute an ITI for this purpose and may be enforceable in bankruptcy notwithstanding the rule against specific performance against the estate, a point discussed below.

155. I make this assertion in the context of property and contract rights, ignoring tort and public law rights of various kinds not under discussion here.

156. Creating three categories of relief, of which two would be enforceable and one not enforceable, is a second possible distinction. The additional category would arise in cases with no ITI, and it might produce enforcement of certain nonbankruptcy specific performance rights even absent an ITI. It would draw a line between an interest that yields a right to payment under nonbankruptcy law and one that yields only a right to specific relief. In my view, this last category would be empty, or nearly so. See infra note 215.

157. In some sense, the distinction is between rights in rem and in personam. The latter rights usually are enforced by negative remedies — for example, injunctions against competition or stay of a lawsuit pending arbitration — but not always. As with any other distinction, it is possible by heroic obfuscation to confuse the two types of rights, but in most cases the distinction is clear to one who wishes to understand. For an illuminating discussion of the logical relationship between in personam and in rem rights, see Macneil, Efficient Breach of Contract: Circles in the Sky, 68 VA. L. Rev. 947, 963-65 (1982) (discussing when property rights change ownership in transaction). To a substantial extent, the distinction between a general claim and an interest in specific property is congruent with the distinction between enforcing a debt against the debtor's property and against the debtor's liberty. Since the abolition of imprisonment for debt, state law permits enforcement against liberty only in rare circumstances, notably for domestic support orders and covenants against competition. The former policy has been accepted by Congress in the form of an exception to discharge. 11 U.S.C. § 523(a)(5) (1988).

158. See infra text accompanying notes 187-88. There is no grand principle
One further clarification may be helpful. It is characteristic of nonbankruptcy law that a party's interests mature in the course of a transaction. Rights that consist of merely general remedies become, at some point, ITIs. Thus it is possible to think of the attainment of an ITI by a party to a transaction as marking a point of finality in that transaction, a point after which it is not reversible. Hinging the analysis on "finality" is a mistake because it invites the same sort of abstract, conceptual discourse that lurks in the labels "property" and "contract." But people often feel intuitively that "finality" or "irreversibility" under nonbankruptcy law is important to bankruptcy treatment of contracts, and thus it is useful to see that this intuition is closely linked to the transformation of a general claim into an ITI under nonbankruptcy law.

A final point should be made here, even though it lies outside the main line of the argument. I am not suggesting, as Dean Jackson does, that Congress cannot, or should not, alter nonbankruptcy remedies as to an ITI. Congress clearly has the power to do so, especially prospectively. It may appropriately exercise that power in any way that seems helpful to the commercial life of the nation. It may decide that certain ITIs should not be enforceable in bankruptcy, or should be limited in enforcement, in the interest of rehabilitating a failing business or spreading the risks of business liquidation. It has done precisely that with respect to one ITI, a seller's limited right of reclamation under Article 2 of the Uniform Commercial Code. Congress decided to make the reclamation right enforceable in bankruptcy, but only to a limited extent. Congress has considerable power to alter property rights prospectively and can do so to some extent even retrospectively. See United States v. Security Indus. Bank, 459 U.S. 70, 79-82 (1982) (stating that Congress may retroactively impair contractual obligations); see also Rogers, The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause, 96 HARV. L. REV. 973, 974, 1013-30 (1983) (arguing that fifth amendment does not significantly constrain bankruptcy power).

159. See T. JACKSON, supra note 74, at 21-27.


161. See U.S. CONST. art. I, § 8, cl. 4.


164. See infra note 173.
gress can appropriately impose such limitations on any nonbankruptcy ITI. Because it generally has not done so, most ITIs are enforceable in bankruptcy.

With these propositions on the table, it is now possible to work all the way through the treatment of a simple contract for the sale of goods when it enters bankruptcy. The effort will illustrate why bankruptcy contract problems are so complicated. The principal reason is the problem's lack of symmetry.

The “executoriness” doctrine presumes symmetry. A contract is executory or it is not, regardless of the side on which we find the debtor-estate. The operative bankruptcy relief rules, however, are utterly asymmetrical, favoring the estate (the other unsecureds) over the Other Party. Thus, we must always examine a given type of contract from both perspectives, debtor as “or” and debtor as “ee,” before we understand how that contract should be treated in bankruptcy. Each permutation of even a simple contract has two different answers, depending on whether the estate is on one side of the contract or the other. The simple onion sale contract that we used as an example creates more than a hundred permutations.\textsuperscript{165} Lest the reader despair, I hasten to add that the great majority of the cases are easy ones. The cases that are not easy are relatively rare, although some of them are important.

One of the most interesting parts of the analysis is the role of the avoiding powers in bankruptcy contract cases. More than half of the permutations in these cases result from the avoiding powers. In the interest of clarity, I am going to discuss each case without reference to the avoiding powers and then address the effects of those powers and their role in the confusion surrounding bankruptcy contracts.

D. Step-By-Step Analysis

1. Debtor As Buyer

We start with a contract in which the pre-petition debtor was the buyer of onions for a fixed price of $100 for 100 bushels.

\textsuperscript{165} If we were to chart the permutations of bankruptcy contracts, the chart itself would be symmetrical; that is, it would apply to both Debtor as Buyer and Debtor as Seller, but the results would be very different, depending on whether the Debtor was buying or selling. Whether assumption or rejection is the sensible course will routinely turn on whether the Debtor is Buyer or Seller because of the operation of the bankruptcy rules limiting the remedies of the Other Party.
The Completed Contract. In the first instance, the seller delivered the onions to the debtor-buyer pre-bankruptcy, and the debtor-buyer paid in cash on delivery. The traditional approach is that no executory contract exists. Ignoring any question of warranties the functional view is that the estate inherited no contractual obligation and no contractual right under this contract, and therefore nothing need be done about the contract as such. (The trustee will, of course, want to sell the onions — and promptly too.)

The Half-Completed Contract — Debtor's Performance Remains. Here the onions were delivered to the debtor-buyer, but the debtor had not paid prior to bankruptcy. The current approach says the contract is not “executory” because the Other Party, the seller, owes no remaining material performance. Thus, the debtor-buyer could not assume or reject. The functional approach is that the estate has no remaining contractual right from this contract, so in the great majority of cases the estate receives no benefit from assumption, which would have no effect in the usual case except to elevate the Other Party's claim to a priority claim entitled to 100% payment. Absent assumption, the contractual obligation, payment of $100 calculated under state law, is the Other Party's allowed claim, and it is payable in tiny Bankruptcy Dollars. Assumption is unthinkable and rejection (breach-and-pay) inevitable.

One point that seems obvious here will be less obvious in more complicated contexts. The remedy almost never available to the Other Party is reclaiming the onions. Although bankruptcy law might block enforcement of a reclamation remedy, it is usually not available under applicable contract law anyway. This aspect of state law, which can be understood as determining the “finality” of past performance at some point during the life of a contract, is a matter of limitation of remedies. Article 2 of the Uniform Commercial Code almost never entitles an unsecured seller to recover delivered goods because of a subsequent failure to pay the purchase price. In almost all cases, the seller under Article 2 has merely a claim for dam-

166. We assume a one-step transaction, with no pre-existing contract.
167. See supra note 46 and accompanying text (quoting Countryman's test for executory contracts).
168. See infra Section III. C.
169. Id.
170. But see infra note 266 and accompanying text (discussing impact of warranties).
171. See infra note 173.
ages, not an entitlement to return of the goods themselves.\textsuperscript{172} If state law did grant this relief, a variety of rescission, bankruptcy's special relief rules might not permit this relief against a trustee.\textsuperscript{173} In sales of goods under Article 2, however, and in many other state contract law contexts, state law standing alone usually denies any remedy in the property itself — that is, state law does not give the seller an ITI. It goes without saying that bankruptcy gives no greater rights to the Other Party and therefore the Other Party cannot get the onions back.

The Half-Completed Contract — Other Party's Performance Remains. This time the debtor-buyer has paid, but the Other Party has not delivered the onions by the time of bankruptcy. If the Other Party refuses to deliver the trustee will be entitled to “cover” and sue for damages in full U.S. dollars, or in the unusual case get specific performance — delivery of the onions — depending on state contract law under all the circumstances.

\textsuperscript{172} U.C.C. §§ 2-702 to -710 (1987); Pacific Express, Inc. v. Teknekron Infowitch Corp. (In re Pacific Express, Inc.), 780 F.2d 1482, 1487 (9th Cir. 1986). The seller of course, can reserve a security interest enforceable under Article 9, but it is then in the same position as any lender or other creditor in taking a security interest. Aside from a secured position, there are only narrow and unusual circumstances where a seller can get back the goods themselves, principally in U.C.C. § 2-702(2). See Note, Bankruptcy and Article Two of the Uniform Commercial Code: The Right to Recover the Goods Upon Insolvency, 79 HARV. L. REV. 598, 609 (1966). Recent scholarship suggests that specific relief is more readily available than was traditionally thought, but that such relief remains relatively rare. See Laycock, supra note 111, passim. Furthermore, specific relief ordinarily is refused under state law if the defendant is insolvent.

As long as specific relief is rarely granted, we can do rough justice by assuming that it represents a state-law property right of some importance, especially if it survives "strong-arm" attack under § 544(a). If specific relief became routine, however, it would lose its efficacy as a talisman of state policy. In that case, bankruptcy policy, especially the equality principle, might require a more selective and difficult analysis to determine when state-law specific relief should be treated as enforceable in bankruptcy.

\textsuperscript{173} The U.C.C. allows reclamation under certain narrow circumstances. U.C.C. § 2-702. See Note, supra note 172, at 609. Prior to the Code, this state law remedy was attacked in bankruptcy with some success. In re Good Deal Supermarkets, Inc., 384 F. Supp. 887, 887 (D.N.J. 1974). \textit{Contra} Alfred M. Lewis, Inc. v. Holzman (In re Telemart Enters., Inc.), 524 F.2d 761, 765-66 (9th Cir. 1975). In the 1978 Code, Congress granted a right of reclamation to sellers, although a narrower remedy than is available under the U.C.C. 11 U.S.C. § 546(c) (1988); see Flav-O-Rich, Inc. v. Rawson Food Serv. Inc. (In re Rawson Food Serv., Inc.), 846 F.2d 1343, 1348 (11th Cir. 1988) (holding that seller must show debtor's control over goods to reclaim them under § 546(c)). The bankruptcy attacks on § 2-702 were generally based on the power to avoid statutory liens, now 11 U.S.C. § 545 (1988).
The contract is not executory under the executoriness analysis because no performance is due from the debtor. Because that conclusion means the trustee cannot assume, we are left to wonder how the trustee can proceed to do what obviously should be done, enforce the delivery obligation. In practice, it appears that the trustee nonetheless enforces, although with no theoretical foundation in executoriness doctrine. The functionalist says there is only an enforceable contract right, a right not dependent on any contract obligation. Therefore, the trustee almost certainly should assume and enforce the contract against the Other Party.

The Uncompleted Contract. Now the onions are undelivered and the debtor-buyer has not paid. Currently, the contract is executory, and the trustee may assume or reject. Ignoring the avoiding powers issues, this case is similar to the simple onion problem discussed earlier except the debtor is a buyer in this case and thus movements in the market produce opposite effects, because the estate is now on the other side of the transaction. If the market has gone up, the estate-buyer will assume and get either the onions or the difference in price as damages. That result is the same as outside bankruptcy. The estate has simply taken advantage of the good bargain (as it turned out) made by the pre-petition debtor.

If the market has gone down, however, the bankruptcy relief rules change the result dramatically, as in the earlier example. The nonbankrupt debtor would have been stuck with a bad bargain. Things are very different for the trustee. With the market down to, say, $80, the trustee will reject the contract. If the estate is still in the onion business, it will buy at the lower market price. If not, it will just forget about onions. Either way, the trustee will face the same $20 claim from the seller of the onions under state law. But the trustee will pay only a small percentage of that claim, because it will pay in Bankruptcy Dollars. The trustee will avoid paying the U.S. $100 contract price to the seller and instead will pay only U.S. $2 (B.D. $20 at 10%) for its breach. The symmetry of contract law remedies is broken and the trustee, unlike a nonban-

174. U.C.C. §§ 2-711 to -717 (1987); see Note, supra note 172, at 600-01.
175. Countryman (pt. 1), supra note 7, at 458-59.
176. See supra notes 97-102, 115-17 and accompanying text.
177. See supra notes 121-32 and accompanying text.
178. See supra notes 122-24 and accompanying text.
Bankruptcy buyer, can profit from breach. By breach it avoids a loss of U.S. $20 in exchange for a payment of U.S. $2. Of course, the trustee loses the right to delivery of the onions, but since the market is down, the contract price for the onions makes the contract unprofitable.\(^{179}\)

Note, however, that the Other Party seller here, because it has not delivered, ends up with the onions themselves and therefore will often be much better off than the Other Party seller that has delivered before bankruptcy. Absent an unusual circumstance, the loss of most of the purchase price is a much greater loss to the Other Party seller than the mere loss of the benefit of the bargain. Take two Other Party sellers, one who has delivered and one who has not. The contract price for the onions was $100, but the market price is now $80. The undelivered seller resells at $80 and has only $20 in damages. The delivered seller, unable to get the onions back under either Article 2 or bankruptcy law,\(^{180}\) is out the full $100 — it delivered the onions and got nothing. When each gets, say, 10% of its claim as a bankruptcy dividend, the undelivered seller loses U.S. $18 (U.S. $20 — B.D. $20 = U.S. $18), while the delivered seller loses U.S. $90 (U.S. $100 — B.D. $100 = U.S. $90).

So far the example is not challenging, but these simple cases illustrate the central role of contract law in juxtaposition with the limited, but very powerful, capacity of bankruptcy law to change the ultimate result because of the rule of pro rata payment.

These results might seem harsh to these Other Parties, but only if the position of all the other unsecured creditors is ignored. They too will get only 10% (or some amount less than 100%) of what they are owed. The onion seller who had not delivered on that date is better off than the one who did deliver, but both get only a small percentage of their state law breach claims, just like the telephone company, the landlord, and all the rest. Furthermore, the difference between the treatment of the delivered and the undelivered seller is not arbitrary. The former delivered on credit prior to bankruptcy — deliberately accepted a credit risk — while the latter did not accept this

\(^{179}\) These magic effects are increased by the trustee’s procedural power to postpone rejection after bankruptcy. It can continue to watch the market and, by rejecting, produce a breach-claim that relates back to the date of bankruptcy. 11 U.S.C. §§ 365(d), 365(g), § 502(g) (1988). In this Article I largely ignore the important impact of various procedural rules in § 365.

\(^{180}\) See supra notes 171-73 and accompanying text.
2. Debtor as Seller

Now the pre-petition debtor becomes the seller of onions.

*The Completed Contract.* This case works out the same as when the debtor is the buyer.\(^{182}\)

*The Half-Completed Contract — Other Party’s Performance Remains.* The debtor-seller delivered the onions pre-bankruptcy and the trustee merely awaits payment from the Other Party. Ignoring warranties, the estate has no contract obligation, only an enforceable right not dependent upon further performance by the debtor-seller. The trustee sues and gets payment in full U.S. dollars. The contract is nonexecutory, because the debtor-seller has no more material performance, but that makes no difference.

*The Half-Completed Contract — Debtor’s Performance Remains.* In this example, the Other Party buyer paid before bankruptcy, but the debtor-seller did not deliver the onions. The estate contains a contractual obligation, but no contractual right arising from the same contract. The lack of a contractual right almost certainly means no Net Value from assumption, so assumption is usually unthinkable.\(^{183}\) The Other Party buyer has the right to “cover” and to claim a) the purchase price already paid, and b) any damages from having paid a higher market price.\(^{184}\) That claim will be calculated under state law, but will be paid in Bankruptcy Dollars. The buyer suffers along with all the other unsecured creditors, because of the pro rata payment rule.\(^{185}\) The Other Party cannot get the onions in the usual case, because a buyer who has not received delivery is not

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\(^{181}\) The undelivered seller accepted a credit risk only to the extent of the benefit of its bargain under the contract.

\(^{182}\) See supra text accompanying note 166.

\(^{183}\) Sometimes the difference in damages between performance and breach is so great that the estate can achieve Net Value in performance even without a contractual right to earn by performance. See infra note 278 and accompanying text.

\(^{184}\) U.C.C. §§ 2-711 to -715 (1987). As with sellers, the U.C.C. grants a reclamation remedy to the Other Party buyer, but it is so narrow that it is very rarely available, in or out of bankruptcy. *Id.* § 2-502; see supra note 173. The buyer retains a possibility of specific performance under unusual circumstances. U.C.C. § 2-716 (1987). Even when available, such a remedy would often face an avoiding power attack. See infra text accompanying note 200.

\(^{185}\) In this situation, the Other Party could have an ITI if the sale contract gave it a security interest in the onions, and that security interest was properly perfected and otherwise unavoidable. See Pacific Express, Inc. v. Teknekron Infoswitch Corp. (*In re Pacific Express, Inc.*), 780 F.2d 1482, 1486
ordinarily entitled to the onions themselves under nonbankruptcy law\textsuperscript{186} and therefore has no ITI.

This instance, the buyer paying the debtor-seller in advance, is the appropriate point to introduce the large exception to the foregoing analysis for cases where nonbankruptcy law gives the Other Party an ITI. The commonplace example is a simple land contract case, just like our prior example, with land replacing onions. The Other Party buyer may well have an ITI under state law in the form of a right to specific performance by conveyance of the land.\textsuperscript{187} If it does not, then it has no specific performance right in bankruptcy. If it does, then that equitable right will be enforceable in bankruptcy, unless it is avoidable under one of the avoiding powers. It is a right functionally indistinguishable from all the other ITIs enforceable in bankruptcy as exceptions to the equality principle — security interests, co-tenancies, and all the rest. It must be enforced unless it can be avoided.

This sort of case is very controversial. Professor Countryman stated that the buyer's rights under such a contract could be defeated, while Andrew asserts that they are fully enforceable unless avoidable.\textsuperscript{188} In this instance Andrew is right. Part of the confusion surrounding this discussion arises from the fact that such ITIs — a right to specific performance of a land contract — frequently are avoidable under one of the avoiding powers and therefore Professor Countryman's result is frequently the right one. We have postponed the avoiding power discussion to the next section.

*The Uncompleted Contract.* The onions are neither delivered nor paid for. This case was analyzed earlier in this section.\textsuperscript{189} The trustee-seller will be free to assume or reject, depending on the market. If the trustee rejects, the Other Party will have only an unsecured claim for damages and will be paid in Bankruptcy Dollars.

As with the last example, the outcome and analysis is fundamentally different if the Other Party has an ITI. Again substituting land for onions, the Other Party buyer likely has a

\begin{itemize}
\item[\textsuperscript{186}] U.C.C. §§ 2-711 to -716 (1987).
\item[\textsuperscript{187}] Andrew, *supra* note 15, at 909 (citing Clark v. Snelling, 205 F. 240 (1st Cir. 1913)).
\item[\textsuperscript{188}] Countryman (pt. 1), *supra* note 7, at 464-65; Andrew, *supra* note 15, at 907-11.
\item[\textsuperscript{189}] See *supra* notes 128-32 and accompanying text.
\end{itemize}
right to conveyance of the land, a right to specific performance under nonbankruptcy law, even if it has not paid prior to bankruptcy. In that case, the right to the land is an enforceable ITI in bankruptcy, unless it is subject to avoidance under the avoiding powers.

To summarize, the treatment of bankruptcy contracts is not a function of special bankruptcy rules about executory contracts, but rather a straightforward consequence of the bankruptcy policies limiting the Other Party's remedies in a way that realizes on good pre-petition bargains and minimizes bad ones, all for the benefit of unsecured creditors generally. Nonbankruptcy law often fails to give the Other Party an ITI and therefore relegates it to the poor plight of unsecured creditors generally, an entirely appropriate result and only inequitable in the sense that life is unfair.

The analysis becomes complex in these cases when nonbankruptcy law is unclear about the Other Party's right to an ITI. The complexity introduced by an ITI lies in determining if state law does treat the Other Party's interest as an ITI (for example, state law considers onions somehow unique under the circumstances) and, if so, determining if the ITI could survive the trustee's avoiding powers. We now turn to the role of the avoiding powers in bankruptcy contracts.

E. IMPACT OF THE AVOIDING POWERS

A thorough re-analysis of bankruptcy contract problems is not possible without considering the impact of the avoiding powers. They complete the yin and yang of the equality principle and the property principle in bankruptcy contracts.\(^{190}\) Although the enforcement of ITIs is an important exception to the equality principle in bankruptcy contracts, as elsewhere in bankruptcy, equality re-emerges as a limitation on the property principle through the operation of the avoiding powers.

Those powers, and the policies they serve, are inextricably interwoven with the contract issues in many of the cases. The most notable example may be the *Richmond* case, as we will see.\(^{191}\) Merely noting the relevance of the avoiding powers is insufficient because their putative applicability frequently leads to error in bankruptcy cases when the court uses "executory contract" analysis to resolve a problem implicating the avoiding

\(^{190}\) See supra notes 137-40 and accompanying text.

\(^{191}\) See infra Section IV. B.
powers. At the same time, this Article is not a review of the whole of the law of the strong-arm clause, preferences, and fraudulent conveyances. I compromise by setting forth the general impact of the avoiding powers and giving some exemplary analysis.

The starting point is the proposition that in every bankruptcy contract case where the debtor, as buyer or seller, performed prior to bankruptcy, the debtor’s performance (payment or delivery) may be avoidable under the strong-arm clause or as a preference or a fraudulent conveyance.

A common type of case is exemplified by the onion contract, where the debtor as seller delivered before bankruptcy. Under Article 2, the seller has no right to get the onions back and neither does the estate of the debtor-seller as a matter of bankruptcy contract law. However, the estate may be able to show that the delivery was a preference. If, for example, the Other Party paid for the onions in advance and then the debtor delivered them, the delivery may have been a preference and the estate may be able to recover the onions or their value under sections 547 and 550. The delivery was a preference if the trustee can prove the seven elements of section 547(b),

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193. Id. § 547.
194. Id. § 548.
198. § 547. Preferences...
(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made
   (A) on or within 90 days before the date of the filing of the petition; or
   (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if
   (A) the case were a case under chapter 7 of this title;
   (B) the transfer had not been made; and
   (C) such creditor received payment of such debt to the extent provided by the provisions of this title.
Subsection (b)(5) requires a showing that the delivery made the Other
including delivery within ninety days of bankruptcy and insolvency on the delivery date. If the court holds the delivery was a preference, the estate avoids the transfer and gets back the onions; then it rejects and pays damages for breach of contract in Bankruptcy Dollars.

The impact of the avoiding powers in contract cases is not limited to the debtor's pre-bankruptcy performance. They may operate with respect to the very promise that the debtor made in the contract, if that promise created an ITI under nonbankruptcy law. As before, if we change the subject matter of the last example from onions to real estate, the debtor's mere promise to convey likely created an ITI, a right to specific performance conveying the land. But that ITI may be avoidable. For example, suppose the debtor's agreement to convey the land in the pre-bankruptcy contract was in satisfaction and release of an unsecured debt previously owed to the buyer. In that case, the transfer of the "equitable right to conveyance," the creation of the ITI, was a preference and is avoidable, assuming the other elements of section 547 are satisfied. Because the antecedent debt can be paid much more cheaply in post-rejection Bankruptcy Dollars, the trustee avoids the right under section 547, rejects the contract, and resells the land for many full U.S. dollars.

As we will see, this example is very close to Party better off. That is easily satisfied in the example in the text because, absent delivery, the Other Party buyer has no onions and is just another unsecured creditor. Finding a preference thus depends on the other six elements. I speak of seven elements in § 547(b), although there are only five numbered elements, by counting two that are tucked within the introductory language to § 547(b): 1) a transfer; 2) of an interest of the debtor in property. 199. For preferences, insolvency is presumed during the 90 day period. Id. § 547(f).

200. That is, following avoidance the debt revives, the trustee rejects and resells, and the trustee pays the debt in Bankruptcy Dollars. See infra note 212.

Bankruptcy law is remarkably silent about the process of unraveling an avoided transaction. It does not spell out the collateral consequences that follow from avoidance of a transfer, although it is clear that revival of the Other Party's original claim must be one of them. 11 U.S.C. § 502(h) (1988). In the simple case, an unsecured creditor who was paid its $10 debt a week before bankruptcy has no claim on Bankruptcy Day, but surely gets a $10 general claim after the trustee avoids the transfer and obtains return of the $10. County of Sacramento v. Hackney (In re Hackney), 93 Bankr. 213, 219 (Bankr. N.D. Cal. 1989) (holding that after preference avoidance by trustee, debt re-arises and regains its nondischargeable status). In more complex transactions, restoration of the status quo is a murkier proposition, beyond the scope of the present discussion.
the facts in Richmond.201

Thus either the debtor’s pre-petition performance, or the contractual promise itself, may constitute an ITI and may be avoidable.

In some cases the analysis becomes more complex. One fairly typical instance requires a double preference analysis because the transaction includes a sequence of two related transfers — the Chinese Box problem.202 This sort of problem can arise in a bankruptcy contract analysis as it can anywhere else in preference law.

Take the land-sale example again, where the case presents the following sequence of pre-petition events under the contract: a) the debtor’s promise in the contract created an obligation to convey that constituted a state-law ITI; b) the debtor performed the promise prior to bankruptcy by conveying. In that situation there are two transfers subject to possible avoidance: the ITI-creating promise and the conveyance. The voidability of the second transfer, the conveyance, will turn on the voidability of the first transfer, the promise to convey. Let us assume that the second transfer, the conveyance of the land, clearly included all the elements of a preference (the advance payment being the antecedent debt), except for the hypothetical posed by section 547(b)(5): was the Other Party better off because of the transfer represented by the conveyance?

The answer to that question depends upon the avoidability

201. Lubrizol Enters. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.), 756 F.2d 1043 (4th Cir. 1985) (Richmond IV), cert. denied sub nom. Lubrizol Enters. v. Canfield, 475 U.S. 1057 (1986), discussed infra notes 319-68 and accompanying text. A more common attack on a land sale contract might be under the “strong-arm” clause, 11 U.S.C. § 544(a)(3) (1988). If a bona fide purchaser (b.f.p.) would defeat the Other Party’s specific-performance ITI (e.g., because it is unrecorded and the buyer is not in possession), then so can the estate, and the Other Party has no ITI in bankruptcy. Chbat v. Tleel (In re Tleel), 876 F.2d 769, 772 (9th Cir. 1989) (holding trustee as b.f.p. had priority interest in real estate where adverse claimant was not in possession of the property and had no recorded interest). The estate rejects and repays the purchase price in Bankruptcy Dollars.

In the rare instance of a specific performance right in personal property, as under U.C.C. § 2-716 (1987), the Other Party’s specific-performance ITI would not likely survive avoiding power attack. 11 U.S.C. § 544 (1988); see U.C.C. §§ 2-402 & comments, 2-403 & comments (1987); see also Note, supra note 172, at 599-603.

of the earlier transfer, the specifically enforceable promise to convey. If the promise to convey would have been unavoidable in bankruptcy, and therefore would have been enforceable, then the Other Party is no better off because of the conveyance before bankruptcy. If the conveyance had not been made, the Other Party could have obtained specific enforcement of the promise to convey in bankruptcy court, and therefore would have gotten the land anyway. In that case, the requirements of section 547(b)(5) would not be satisfied and the pre-bankruptcy conveyance would not be a preference. Thus the avoidability of the conveyance as a preference turns upon the avoidability of the first transfer, the promise to convey.

The ITI (the right to conveyance) created by the promise might have been subject to avoidance under any of the avoiding powers. For example, the sales contract might have been unrecorded and therefore subject to defeat by a bona fide purchaser under state law. If so, the trustee could avoid it under section 544(a)(3) and the promise to convey would not have been enforceable in bankruptcy. In that case, the pre-bankruptcy conveyance made the Other Party much better off than it would have been absent the conveyance, section 547(b)(5) is satisfied, and the conveyance of the land is avoidable as a preference. Once the trustee avoids the conveyance and gets the land back, the analysis proceeds just as in any non-ITI situation. The trustee rejects, sells the land for full value, and repays the purchase price to the Other Party in Bankruptcy Dollars.

These preference examples are illustrative of a number of situations in bankruptcy contract problems where the debtor's pre-bankruptcy promise or performance may be avoidable. On the other hand, it is worth an aside to note that often times a putatively avoidable contractual promise or performance is saved from avoidance. Pre-bankruptcy performance often constitutes a preference under section 547(b) that is not avoidable because it is sheltered by an exception to avoidance in section 547(c). In particular, section 547(c)(2), the ordinary course exception, often protects routine pre-bankruptcy performance.

The avoiding powers operate in bankruptcy contract situations to produce one more remarkable result. In every bankruptcy contract case, regardless of the state of performance of the contract at the time of bankruptcy, the Other Party's claim is subject to reduction if the obligation giving rise to the claim is avoidable as a fraudulent conveyance. 203 This analysis ap-

203. See, e.g., Rubin v. Manufacturers Hanover Trust, 661 F.2d 979, 993 (2d
plies whether the Other Party's claim existed at the time of bankruptcy or arises subsequently as a result of rejection, avoidance, or some combination of the two. One result is that the estate sometimes may be able to reclaim the debtor's performance and avoid the Other Party's claim, at least in part.

Again consider our example of the onion contract with the debtor as seller, but add that the contract price was ridiculously low. Suppose that the onions were worth $500 when the original contract was made, but the contract price was only $100. Assuming the debtor's insolvency at that time, the obligation to sell the onions at that low price is avoidable as a fraudulent conveyance because the price was not "reasonably equivalent value." In that case, not only will the debtor recover the onions as a preference, but the Other Party will have a claim only for the amount it actually paid prior to bankruptcy, rather than for the full benefit of its bargain. Its actual recovery, of course, will be lower still, because it is payable in Bankruptcy Dollars.

F. DISCHARGE

Discharge is almost never the subject of discussions of executory contracts, yet its effect in changing state contract law results is every bit as important as the principles already discussed. One source of the lack of understanding of this point is confusion from which even knowledgeable people sometimes suffer, the confusion created by that modern phenomenon, the

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205. 11 U.S.C. § 548(c) (1988); UNIF. FRAUDULENT TRANSFER ACT §§ 5(a), 8(b), 7A U.L.A. 657, 662 (1984). If the contract price was $100, the onions were really worth $500, Other Party buyer paid $100 in advance, and then the debtor-seller delivered, all pre-bankruptcy, then the debtor recovers the onions themselves as a preference and avoids the contractual obligation to sell the onions for $100 as a fraudulent conveyance, because the price was too low. The Other Party is left only with its right, assuming its good faith, to recover the $100 it actually paid. 11 U.S.C. § 548(a)(2), (c) (1988).

206. But see Andrew, supra note 15, at 927 n.288.
Debtor In Possession (familiarly, the “DIP”).

The DIP looks and acts a lot like the pre-petition debtor, yet the Code places the DIP in the position of a trustee. As a result, it is easy to confuse the two perspectives: that of the trustee maximizing the estate and that of the debtor (DIP) enjoying the benefits of discharge. This confusion affects many bankruptcy analyses, but none more so than that of bankruptcy contracts. Its effect is found in many of the most troubling and difficult recent cases, especially those involving covenants not to compete and franchises and licenses.

An academic assumption that discharge is only important for natural-person debtors, not for corporations, exacerbates the confusion. That assumption is accurate for Chapter 7, but not for Chapter 11, where the discharge of pre-petition debt is central to every plan of reorganization, whether the debtor is a natural person or a legal entity like a corporation or partnership.

Covenants against competition are good examples of the operation of discharge in bankruptcy contract cases, as the later discussion of Rovine will illustrate. Let us consider the simple example of a salesman, Harry, who has a contract of employment with the Acme Company to sell its goods on commission. The contract contains a reasonable covenant against competition, enforceable for a reasonable time after termination of employment, and the covenant would be enforceable by injunction under state law. Note, however, that it is not an ITI, an interest in any of Harry’s specific assets.

Harry does a good job of selling, but a bad job of handling his personal affairs. He greets with naive enthusiasm every credit card application and every letter advising that “We have $2,000 waiting for YOU!” This attitude leads inexorably to a Chapter 7 bankruptcy. After bankruptcy, Harry is offered a much better job with a competitor of Acme. (To keep the example simple, no customer lists or trade secrets are involved.)

207. See supra note 100.
209. See infra Section IV. A.
211. See infra notes 281-318 and accompanying text.
Assuming Harry has not defrauded anyone, he will walk away from all his debts to Sears, the electric company, and his brother-in-law, by virtue of the discharge.\textsuperscript{212} He also will escape the anti-competition obligation, so his fresh start will include his new job.\textsuperscript{213} Some observers might be distressed that he can escape the obligation to Acme, just as Sears and the rest may be upset about Harry dodging his obligations to them. The key point here is that it is the discharge that costs all of them, including Acme, the right to enforce their unsecured contract claims, not some exotic bankruptcy rule about "executory" contracts.

Before we leave Harry, a caveat is necessary. Not everyone agrees that he can be discharged from this particular obligation, the covenant against competition. Some say that Acme's negative injunctive right is not a "claim" and therefore not a dischargeable "debt."\textsuperscript{214} If that were correct, the covenant would not be discharged and Harry would be bound by it even after bankruptcy. I believe few, if any, equitable remedies should be excluded from the definition of "claim" and therefore from discharge, but that is an argument for another day.\textsuperscript{215}

\begin{small}
\textsuperscript{213} Id.
\textsuperscript{214} See, e.g., Carstens Health Indus. v. Cooper (\textit{In re Cooper}), 47 Bankr. 842, 845 (Bankr. W.D. Mo. 1985) (holding that equitable right not a claim and therefore specifically enforceable). \textit{But see}, e.g., Silk Plants, Etc. Franchise Sys. v. Register (\textit{In re Register}), 95 Bankr. 73, 75 (Bankr. M.D. Tenn.) (holding that right to enforcement of noncompetition covenant is a claim and dischargeable), aff'd, 100 Bankr. 360 (M.D. Tenn. 1989). See generally Julis, \textit{Classifying Rights and Interests Under the Bankruptcy Code}, 55 AM. BANKR. L.J. 223, 232-46 (1981) (discussing the definition of "claim" and noting classification difficulties); Andrew, supra note 15, at 921 n.268 (same).
\textsuperscript{215} Julis argues that the adoption of the "right to payment" language in § 101(4)(b), which narrowed the definition in earlier versions, signaled a congressional intent to exclude a fairly wide range of equitable claims. Julis, supra note 214, at 236. The language is still very broad, however, and a broad reading seems compelled by the overall congressional policy of eliminating "provability" of claims and including virtually all of the debtor's obligations. See \textit{House Report}, supra note 50, at 180, 309, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6140-41, 6266.

My own view is that because the Code grants such expansive power to the bankruptcy courts to estimate claims, 11 U.S.C. § 502(c) (1988), the damage remedy (the "right to payment") almost always will be available in bankruptcy, even when it might not have been at state law. Note that the question here is not the irreparable injury rule, which holds that equitable remedies are unavailable if legal remedies will adequately repair the harm. See Laycock, supra note 111, manuscript at 2, 4 (discrediting the rule by demonstrating that equitable remedies are routinely available when courts find legal damages inadequate). Rather it is a federal standard of a "right to payment." For these reasons, I think the availability of a "right to payment" must take into account
\end{small}
tant thing here is that the right to discharge is the correct place to tussle over this issue, rather than it being the offshoot of some special rule about bankruptcy contracts.

Meantime, back in bankruptcy court, Harry's Chapter 7 trustee will be allowing claims from these same creditors. Acme's claim will be harder to figure than most; that difficulty in calculation is one of the principal reasons that anti-competition covenants are enforced specifically under state law. In bankruptcy court Acme has a much better chance to prove a monetary loss than it has under state law, because the Code gives the bankruptcy court special powers for estimating claims. On the other hand, if the salesman's bankruptcy is like most individual bankruptcy cases, the unsecured creditors will receive little or nothing in any case.

Acme's claim arose when the trustee rejected the debtor's contract with Acme. Even if the contract was assumable, the greater power of the bankruptcy court to provide a reasonably adequate estimation, especially in light of the fact that equitable relief almost always produces more inequality among legally equal creditors than does estimation and pro rata payment. The result might be that the statutory category defined as an equitable claim without a "right to payment" will be an empty or nearly empty set, to be treated as a mere congressional caveat against the unforeseen.

On the other hand, there are policy reasons for injunctions that transcend inadequacy of legal remedy. See Laycock, supra note 111, manuscript at 79-80. When such policies apply to the rights of a nonbankrupt party, it could be argued that they might on rare occasions override the bankruptcy policies of discharge and equality of distribution. See Nimmer, Executory Contracts in Bankruptcy: Protecting the Fundamental Terms of the Bargain, 54 U. COLO. L. REV. 507, 512-13 (1983). I for one do not believe that a case can be made for enforcing contract remedies on that basis, as opposed to public policies involving, for example, the environment. Putting to one side normative views as applied to bankrupt individuals, an interpretation that would expand the category of "unprovable" and nondischargeable equitable claims would be devastating to many business reorganizations. Such an interpretation also would have the ironic effect of leaving the Other Party with no enforceable claims versus the assets in bankruptcy.

Some recent cases have found no right to payment when a state judgment for specific performance was obtained before bankruptcy. In re Roxse Homes, Inc., 74 Bankr. 810, 818 (Bankr. D. Mass. 1987), aff'd, 83 Bankr. 185 (D. Mass.), aff'd, 860 F.2d 1072 (1st Cir. 1988); Rusinski v. Prionic (In re Prionic), 70 Bankr. 596, 601 (Bankr. W.D. Penn. 1987). This is a special category of cases, which presumably rests on the well-settled general rule that a pre-bankruptcy final judgment is controlling in bankruptcy. E.g., Chattanooga Memorial Park v. Still (In re Jolly), 574 F.2d 349, 351 (6th Cir.), cert. denied, 439 U.S. 929 (1978); see Westbrook, supra note 61, at 639 & n.176.

217. See T. SULLIVAN, E. WARREN, & J. WESTBROOK, supra note 89, 201-31; Hervert & Pacitti, supra note 89, at 316.
218. The contract may not have been assumable because it may have been
trustee would reject it because assumption has no effect except to elevate Acme's claim to an administrative claim. On the other side, in most cases Acme would not want specific enforcement of the anti-competition covenant against the estate. Thus, the trustee will reject and pay an estimated breach claim in Bankruptcy Dollars from the available assets, if any.219

The executoriness analyst confronted with this case will be lost in a psychedelic hall of mirrors, filled with conceptual agony over the existence vel non of an executory contract. The functionalist will long since have departed, whistling, for a weekend at the beach.

The key point about this sort of case is that any felt inequity is solely a function of the discharge. Acme's loss is economic and can be calculated in damages, however imprecisely. The bankruptcy court probably can do a fair job with that calculation. Acme's rights should not be completely satisfied when Sears and the rest suffer great loss. Indeed, it would be ironic if Acme got, in effect, full payment because its claim could not be calculated, while those with clearly defined losses were left in the cold.220

The same basic analysis applies to a Chapter 11 debtor, as we will see in the later discussion of the Rovine case.221 To the extent that some observers feel a risk of inequity in cases like these, focusing on discharge also serves to illuminate the proper approach to preventing abuse of bankruptcy in such cases, primarily through objection to discharge222 and cramdown.223 These questions are also addressed in the discussion of Rovine.224

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219. The damage claim will be estimated based on Harry's likely harm to Acme in his post-discharge sales activities, but as a pre-petition claimant Acme will only share in the available pre-petition assets. 11 U.S.C. §§ 365(g)(1), 502(g) (1988).

220. If Harry committed fraud, of course, he would not get the discharge. 11 U.S.C. § 523(a)(2)(A) (1988). Even without fraud, some might argue that the "substantial abuse" doctrine should be used to force him to pay. Id. § 707(b) (1988). But if so, it should benefit all unsecured creditors, not just Acme.

221. See infra Section IV. A.


223. Id. § 1129(b).
G. ASSUMPTION AND REJECTION: DECIDING TO PERFORM OR BREACH

Before concluding the discussion of the functional approach to bankruptcy contracts, we should consider a rhetorical problem. Although scholars and practitioners generally agree that assumption means performance and rejection means breach, that usage conceals a semantic hitch. This hitch contributes to the confusion in discussing bankruptcy contracts.

Assumption is not performance, it is the decision to perform. Rejection is not breach, but the decision to breach. Performance or breach follow the court’s approval of the trustee’s decision.224 Thus, when the trustee asks approval of assumption, it is asking for approval of performance, but assumption is the decision, not the performance itself.

I belabor the semantic point because I think the Code reflects the “moral” difficulty that came up in the initial, theoretical discussion of assumption and rejection.225 Whether Posner and Holmes like it or not, promise-breaking has a moral dimension. That dimension explains, in part, various procedural contract rules that put burdens on the breacher, the wrongdoer, the person who started all this fuss and made a lawsuit necessary.

In part, the grant in section 365 of the right of assumption and rejection may reflect the need to give the trustee the moral right to breach a contract. The trustee’s moral position is sound, because it is acting for the innocent unsecured creditors, not for the deadbeat debtor.

Of course, important procedural reasons support the spotlight on the decision to perform or breach. That decision now requires the court’s approval in all cases,226 reflecting the modern appreciation that such decisions can have fateful consequences for liquidation dividends, or the prospects for reorganization. The trustee newly appointed to liquidate a complicated estate (or sell a business as a going concern) needs time to compute the costs and benefits of assumption or rejection of each pre-petition contract and it is important to focus its attention on that duty. In Chapter 11, the DIP may know about the outstanding contracts, but in the chaos characteristic

224. This point is made evident by the fact that after assumption, the trustee may either perform the contract or assign it. Id. §§ 365(b), 365(f) (1988).
225. See supra text accompanying note 111.
of the opening days of a reorganization it is important that
court approval forces a focus on the merits of each outstanding
contract. This requirement for a decision (rather than a drift
into performance or breach), stiffened by the need for court ap-
proval, helps to ensure sound business conclusions.\(^2\) We have
seen how complex the calculation of cost and benefit can be, in-
tertwining financial and contract-law analysis, so this proce-
dural focusing device, approval of the decision to perform or
breach, is very important. The court will defer to the trustee or
the DIP under the "business judgment" rule,\(^2\) but the as-
sumption or rejection decision must be supported by facts and
reasons.\(^2\)

H. SUMMARY OF THE FUNCTIONAL APPROACH

To summarize briefly the main points of a functional analysis:

1. There is no special bankruptcy "power" to assume or re-
ject contracts. The trustee (or DIP) has the power to perform
or breach contracts, just like any other contract party under
state law, and it inherits that power from the pre-petition
debtor along with the debtor's pending contract rights and
obligations.\(^2\)

2. There should be no requirement of a threshold finding
that a contract is "executory" as a prerequisite to performance
or breach by the trustee.\(^2\) The trustee must abandon or per-
form upon each contract right in the estate and must perform or
breach each contract obligation.\(^2\) When contract law makes
certain rights and obligations interdependent, the trustee's
right to perform upon the rights will be dependent upon per-
formance of the obligations, as for any other contract party.\(^2\)

3. The only justifiable changes in contract results in bank-
ruptcy are those arising from bankruptcy's limitations on the

\(^{227}\) For the suggestion that the provision might be for the purpose of forc-
ing the trustee to a decision for the benefit of the Other Party, see Silverstein,
Rejection of Executory Contracts in Bankruptcy and Reorganization, 31 U.

\(^{228}\) Lubrizol Enters. v. Richmond Metal Finishers, Inc. (In re Richmond
Metal Finishers, Inc.), 756 F.2d 1043, 1047 (4th Cir. 1985), cert. denied sub nom.
Lubrizol Enters. v. Canfield, 475 U.S. 1057 (1986); see 2 COLIER 15th, supra
note 17, ¶ 355.03.

\(^{229}\) Richmond, 756 F.2d at 1047-48.

\(^{230}\) See supra notes 103-18 and accompanying text.

\(^{231}\) See infra Section III.

\(^{232}\) See supra notes 95-118.

\(^{233}\) See supra notes 117-18 and accompanying text.
Other Party’s remedies and from the avoiding powers.\textsuperscript{234} The principal provisions involved are the pro rata distribution rules,\textsuperscript{235} the corollary rule against specific performance or rescission against the trustee,\textsuperscript{236} the avoiding powers,\textsuperscript{237} and the bankruptcy discharge.\textsuperscript{238}

4. Any apparent inequities in the treatment of the Other Party under the bankruptcy remedy rules fall into one of two categories: a) inequities that are only apparent, because they represent the Other Party’s sharing of the losses of insolvency with the other unsecured creditors;\textsuperscript{239} and b) inequities that may arise if the debtor benefits from imposing on the Other Party, a question to be addressed under the principles of sections 523 (discharge) and 1129(b) (cramdown and absolute priority).\textsuperscript{240}

III. THE PERNICIOUS EFFECTS OF EXECUTORINESS

A. A RULE WITHOUT A REASON

Now that we have worked through the basics of a functional approach to the bankruptcy contract problem, the difficulties and anomalies of the present executoriness analysis can be addressed. Let me say flatly at the outset that there is nothing to be said for a threshold requirement of executoriness as a precondition to the assumption or rejection of bankruptcy contracts. It is a century-old wrong turning. The material breach test has considerable virtue, but only insofar as it greatly ameliorates the effects of the executoriness requirement.

The discussion just concluded makes the most fundamental case against a threshold requirement of executoriness. It is a requirement with no basis in the Code. If bankruptcy contract problems can be fully understood without reference to that requirement, it is surplusage and has no effect except confusion and obfuscation. No bankruptcy policy is served by the requirement, and executoriness is not necessary to the operation of the well understood basic rules about treatment of bankruptcy contracts.

If that requirement never restrains the trustee from pro-

\textsuperscript{234} See supra notes 119-37, 190-205 and accompanying text.
\textsuperscript{235} See supra note 119-32.
\textsuperscript{236} See supra notes 133-37 and accompanying text.
\textsuperscript{237} See supra notes 191-205 and accompanying text.
\textsuperscript{238} See supra notes 206-23 and accompanying text.
\textsuperscript{239} See supra notes 213-20 and accompanying text.
\textsuperscript{240} See infra Section IV. A. 2, 3.
ceeding according to the Net Value calculation and maximizing benefits to the estate, then it is irrelevant. If it sometimes prevents the trustee from maximizing the estate on a Net Value analysis, then it is pernicious, unless it serves some other overriding bankruptcy policy. Because there is no bankruptcy policy or notion of fairness served by the executoriness requirement, it is irrelevant or pernicious in every case. In Michael Andrew's lovely phrase, "the clothes have no emperor." Section 365 provides a number of important procedural rules, some of which have real economic impact, but executoriness is utterly unnecessary to the analysis of bankruptcy contracts.

The executoriness requirement may well have evolved as a simple series of semantic mistakes. It is natural lawyerly rhetoric to say that a contract that the trustee may assume or reject is an "executory" contract. An easy pontification in the next case, as the court cites learnedly the prior authority, is the statement, "the trustee in bankruptcy may assume an executory contract." From there it is easy for judges, lawyers, and law professors, all of whom love rules, to derive a rule, "a contract must be executory to be assumed or rejected." From any such positive statement, it is an easy misstep to the implied negative, "a contract that is not executory may not be assumed or rejected." Once the statement of the rule has been elaborated so far, it seems inescapable that there must be a subset of bankruptcy contracts that are not executory. The consequence may be the emergence of a notion that there are contracts that are somehow "in" bankruptcy, yet in some sense not "executory."

I do not seek to demonstrate that the executoriness test arose historically through a series of semantic missteps of the

242. We all understand that "procedural" rules have substantive or quasi-substantive effects, and in that sense bankruptcy rules do change the terms of pre-bankruptcy contracts in some respects. For example, the expiration of an option in a pre-bankruptcy contract may be extended 60 days by filing a bankruptcy petition. 11 U.S.C. § 108(b) (1988); see, e.g., In re G-N Partners, 48 Bankr. 462, 468 (Bankr. D. Minn. 1985) (allowing petition to be filed 36 minutes before option expired). In the service of clarity and brevity, I ignore these procedural phenomena.
244. One thinks of Cardozo's admonition that we must avoid being enslaved by our own formulations. Berkey v. Third Ave. Ry., 244 N.Y. 84, 94, 155 N.E. 58, 61 (1926).
sort I have just described, but it seems to me that the survival of such a purely formal doctrine must have some such explanation. It may be that this formal logic has prevailed precisely because the remarkable results of assumption and rejection of bankruptcy contracts are not understood, so a formal, manipulable system has considerable appeal for judges groping toward correct results.

Because executoriness has no basis in policy or fairness, it is almost infinitely manipulable. That is its central fault. I am not one of those who believes that all legal doctrine can be infinitely manipulated in plausible ways. Doctrine that can be so manipulated is almost always formalistic, unlinked to any real basis in policy and fairness. Doctrine that is rooted in policy and fairness is far less subject to manipulations that seem plausible to the knowledgeable. The fact that a threshold requirement of executoriness tacitly assumes some special bankruptcy policy that does not exist is the very reason that it is always capable of giving the right answer — or the wrong one.

The simplest and most fundamental symptom of the weakness of the executoriness requirement is the notion that some contracts cannot be rejected because they are not executory.245 Because rejection merely means breach-and-pay,246 does that statement mean that the contract must be performed? No, because the lack of executoriness means it cannot be assumed — that is, performed — either. What are we to make of a contractual obligation that can neither be performed nor breached? Shall we say it can only be paid? But pay is just what we do, in or out of bankruptcy, when we breach-and-pay (in bankruptcy terms, reject). If the concrete difference between rejection and nonrejection is zero, the test for rejectability is without point. Any doctrine that requires such logical and semantic nonsense must be unsound.247

245. Professor Countryman's position on this point was somewhat ambiguous. See Countryman (pt. 1), supra note 7, at 451-60.
246. 11 U.S.C. §§ 365(a), 365(g), 502(g) (1988); see supra note 15 and accompanying text; infra notes 403-05 and accompanying text.
247. See, e.g., In re KMMCO, 40 Bankr. 976, 978 (E.D. Mich. 1984) (holding that debtor's obligation to pay death benefits to employee's widow as long as she did not die, remarry or cohabit with a man was a non-executory contract; terms relating to widow were not contractual obligations but conditions subsequent to debtor's obligation to pay); see also Andrew, supra note 15, at 887 (noting that rejection, though unnecessary, is harmless as long as it is not applied incorrectly). For Andrew, this is the central point. See infra note 262. I am indebted to Professor Douglas Whaley for helping me to see this point clearly.
The executoriness requirement serves no policy and leads to logically absurd results. Worse still, it obscures the true issues in bankruptcy contract cases, masking the state-law issues that are usually the central difficulty, as well as other bankruptcy issues.

B. TREATING STATE LAW QUESTIONS AS MATTERS OF EXECUTORINESS

The focus of the "executoriness" requirement is on some supposed special rule of bankruptcy law, thus taking the court's attention away from the core question: the parties' rights under state contract law. The hard questions in these cases are usually there, in contract law. Once the contract law questions are answered, the application of the bankruptcy payment rules is often simple. The result is that the executoriness requirement presents a mine field of opportunities for error that functional analysis avoids.

One instance is where it is not clear whether or not an Other Party seller should be considered as having delivered the goods before bankruptcy. Resolving this question often is important because state law, Article 2 in the case of onion contracts, makes this distinction crucial for the rights of the Other Party seller, in and out of bankruptcy. The executoriness approach tempts a bankruptcy court to resolve this problem by determining the executoriness of the contract, rather than simply looking to state law for the answer. The real question is whether nonbankruptcy law gives the Other Party seller an ITI.

A common example of this sort of problem is where the onions were in transit on the date of bankruptcy. Article 2 provides rules that determine whether the onions are to be considered delivered, given the provisions of the contract and the circumstances of the case. The state courts apply these rules to determine if a seller has the rights of a seller before delivery, or the much more limited rights of a seller after delivery.

248. The state law questions are sometimes quite difficult because some circumstances that arise in bankruptcy are not likely to have arisen under state law, and therefore there may be few precedents. What precedents there are can be misleading if the state-law decision was made in a context different from the circumstances presented in the bankruptcy case. In that event, the court must try to plumb the policy basis for state law as best it can, and then apply those state policies to the bankruptcy context. See infra note 266.


250. E.g., "FOB," "CIF," and others. See id. §§ 2-319 to -320.
The problem is apt to arise when the seller attempts to stop the goods in transit or goes to court to reclaim them. The goods are on the train or stored at the dock and the issue is whether the Other Party seller can get them back or is stuck with only a damage claim to be paid in Bankruptcy Dollars.

When the onions were in transit on the date of bankruptcy, the functional analyst will look to this body of state U.C.C. law to determine if the Other Party is a delivered seller or an undelivered seller. If the seller is undelivered, then the trustee must assume the contract or forfeit any rights in the goods. If the Other Party seller delivered, then it has very limited rights and the bankruptcy payment rules will relegate it to an unsatisfying damage claim payable in Bankruptcy Dollars.

From a functional standpoint, that is that.

The mystique of executoriness tempts courts to apply a federal bankruptcy analysis of material performance due, rather than the proper U.C.C. analysis. Oftentimes, it must be said, this analysis obtains the right answer. This type of problem illustrates the most important reason that the material breach analysis is enormously helpful as compared to the intellectual anarchy that preceded it. By focusing the court’s attention on the material performance of both sides, the executoriness test overlaps the underlying state law problem, which is whether the Other Party seller managed to avoid delivering before bankruptcy — that is, whether the Other Party has an ITI.

Unfortunately, the test often leads to the wrong answer for at least two reasons. One is the mistaken notion that the mere obligation to make payment is not material performance. This notion was not put forward in Countryman’s Minnesota Law Review articles. One can imagine the reaction of a room full of business people on hearing that payment is not a material part of contract performance. Nonetheless, this idea has enjoyed

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251. This problem, of course, used to be decided under the rubric “passage of title,” prior to adoption of the U.C.C.
253. Id. § 2-702.
254. See supra notes 172-73.
256. E.g., Mitchell v. Streets (In re Streets & Beard Farm Partnership), 882 F.2d 233, 235 (7th Cir. 1989); In re Coast Trading Co., 744 F.2d 686, 692-93 (9th Cir. 1984).
257. See, e.g., Nevins, 79 Bankr. at 17.
considerable currency. Applied to our example, that notion would mean that there is no material performance due on the debtor-buyer's side (a buyer just pays) and therefore no executory contract, whether or not the Other Party delivered the goods. The executoriness test makes the answer to the central state law question irrelevant and almost guarantees error.

The second reason for mistakes is the presence of ancillary obligations, like warranties, that can yield the answer "executoriness" when the seller has delivered the onions, which usually should make assumption out of the question. The impact of ancillary obligations in producing bad results under the executoriness analysis is discussed in the next section.

Thus, the threshold requirement of "executoriness" is not merely unnecessary, but leads to error. As the continuing discussion will reveal, the executoriness requirement can almost always be manipulated to produce the correct result, but the fact that it deflects the courts from the true problems of state contract law invites — and often produces — error. As a result, bankruptcy contract law conflicts with state contract law without any good federal policy reasons to support the difference.

C. ANCILLARY OBLIGATIONS

The presence of ancillary obligations is an important aspect of executoriness analysis in many of the recent cases. It is frequently encountered in license cases and in cases involving a noncompete covenant. It is another instance of using "executoriness" analysis where state contract law is the real point,


259. A striking example of the tangle is In re Coast Trading Co., 744 F.2d 686 (9th Cir. 1984). Based on the facts stated, the court apparently got everything right as to result, but its executory contract approach to the Article 2 problem left it saying that it did not matter if the debtor assumed or rejected, because the claim would have administrative priority anyway. Id. at 693.
but it is sufficiently important to deserve a section of its own in this discussion.

An ancillary obligation (Ancillary) for this purpose is an obligation that is not the central exchange of a contract. An Ancillary may be important, its performance may be a material part of the contract, but it is not the central obligation in a particular single contract. Generally speaking, Ancillaries are important in bankruptcy contract cases when they have the characteristic of being on-going obligations, remaining when the main performance is completed on one or both sides. Performing Ancillaries often is contingent on future circumstances.

Common examples of Ancillaries for our purpose are warranties, covenants to defend intellectual property rights, noncompete covenants, and arbitration clauses. There are many others, including perpetual care of a burial plot.\textsuperscript{260}

It makes sense to start with a simple example. The subject is the onion contract again, but this time we will not ignore warranties, as we explicitly did earlier.

1. Debtor as Buyer

In the prior analysis, one case was the Debtor as Buyer, Half-Completed Contract — Debtor's Performance Remains.\textsuperscript{261} It was quite simple under any approach. The debtor-buyer had received the onions, but still owed the purchase price at the time of bankruptcy. The estate will reject because the contract contains no remaining benefit for the debtor.\textsuperscript{262} The executorness doctrine says "no executory contract," because the Other Party already delivered, and yields the same result.\textsuperscript{263}

Yet the debtor-buyer almost certainly had warranty rights. Absent a disclaimer, virtually all contracts under Article 2 of the U.C.C. contain warranties implied by law,\textsuperscript{264} and many have

\textsuperscript{260} Chattanooga Memorial Park v. Still (In re Jolly), 574 F.2d 349, 349 (6th Cir.), cert. denied, 439 U.S. 929 (1978).

\textsuperscript{261} See supra text accompanying notes 169-73.

\textsuperscript{262} In a sense, rejection is irrelevant. The trustee does not reject, but merely pays the claim. Yet the analysis seems more coherent, if we say that the trustee breaches, thus emphasizing the controlling place of nonbankruptcy law in calculating the Other Party's claim as a matter of damages for breach of contract. In this way we also ensure court control of the process. 11 U.S.C. § 365(a) (1988).

\textsuperscript{263} Albeit ignoring what happens to the claim. 11 U.S.C. §§ 365(a), 365(g), 502(g) (1988).

\textsuperscript{264} U.C.C. §§ 2-312 to -318 (1987).
express warranties. Warranties, both express and implied, are common in nongoods contracts, as well. In our prior example, the warranties in favor of the debtor-buyer probably were not important enough to be worth assuming and losing U.S. $90, so we safely ignored them.265

Now suppose some facts that are unusual, but well short of fantasy. Suppose the government discovers a deadly onion virus, rare but virulent, that poses a real risk of unsalability and of product liability claims. In the marketplace, 100 bushels of onions are now worth $100 only if backed by a strong warranty against the virus. The market will accept only a warranty given by a producer like the Other Party seller. A company in the position of our debtor-buyer (wholesaler, jobber, or whatever) can resell onions only if it can assign to the next buyer the warranty given by the Other Party seller. The market is such that with a warranty from the Other Party the onions are worth $100, but without it they are unsalable. Further assume, as before, a 10% distribution to unsecureds.

On these facts, assumption, which is unthinkable in the usual case, is in the best interest of the estate and the other creditors. Assumption of the contract will cost U.S. $100, payment in full as an administration claim. But assumption will also activate the warranty obligations of the Other Party, making the onions salable for U.S. $100. Payment in full to the Other Party makes the onions salable on a “break-even” basis and also eliminates the Other Party’s B.D. $100 claim by satisfying it, saving the estate U.S. $10 on a 10% distribution. Breach, on the other hand, will leave a U.S. $10 (B.D. $100) payment to the Other Party and the onions will bring nothing in the marketplace. This case is the rare example when assumption makes economic sense, when the debtor is buyer and the onions were delivered.266 The profit to the estate and the

265. See supra text following note 168.

266. This analysis presumes that the warranty right inherited by the trustee from the debtor-buyer is dependent under contract law upon performance of the payment obligation: if the trustee breaches and pays only part of the price, the Other Party seller has a complete defense to any warranty claims based upon the debtor-buyer’s breach of contract in not making full payment. On that basis, the foregoing analysis is correct.

If, on the other hand, the seller has a warranty obligation under state law despite nonpayment of the purchase price — or despite only partial payment — the trustee would not assume because the warranty obligation would be enforceable without 100% payment. The trustee would breach (reject) and enjoy the warranty obligation while paying only 10% of the payment price. State law is key because nothing in the Bankruptcy Code purports to affect the in-
other unsecureds from assumption will come from breaking even on the onions while eliminating one unsecured claim, and thus leaving more for everyone else. The value added from the increase in the value of the onions because of assumption outweighs the requirement of full payment and so assumption is more profitable than breach.²⁶⁷

This sort of situation, involving an Ancillary, can create great problems with the executoriness rule.²⁶⁸ In a given court, the preceding case (onions delivered to the debtor-buyer, price unpaid) may have come up again and again and may have been treated as a classic nonexecutory contract, producing the correct economic result in the usual case. Then a case arises like the hypothetical case just stated, where the Ancillary — the warranty — really matters financially. All the precedent seems to say that the contract is nonexecutory and therefore cannot be assumed.²⁶⁹ If so, the trustee must forgo the benefit to the estate from assumption. Instinctively finding no good reason for the unsecured creditors to lose that benefit, the court may use the warranty obligation to make the contract executory and thus permit the benefit to be had.²⁷⁰

2⁶⁷ terdependence of the obligations in any way. Once the state contract analysis is clear, the economic or functional analysis, giving effect to the bankruptcy payment rules, is relatively easy.

One problem in this whole analysis is that the circumstance of bankruptcy — rather than any bankruptcy rule that changes state contract law — often presents questions unlikely to arise under state law. See supra note 246.

2⁶⁸ Another variable that can change the trustee's functional analysis is the percentage of distribution contemplated. In the preceding case, if the distribution to unsecureds is 20%, then the profit to the estate and the other creditors from assumption is U.S. $20 because of the elimination of the Other Party's breach claim. As the percentage of distribution rises, the possibility of a profitable assumption also rises, adding to the precedent-confusion discussed infra notes 268-79 and accompanying text.


²⁷⁰ For example, one of our finest bankruptcy judges, Judge Schwartzberg, may be in trouble the next time he gets an author-publisher case just a bit different from one he recently decided. In re Stein and Day, Inc., 81 Bankr. 263, 267 (Bankr. S.D.N.Y. 1988). There the debtor-publisher had bought and published two of the Other Party author's books, with a "right of
Yet in the very next "ordinary" sale of goods case, a party may contend that the contract is executory because warranties are present. The result in the unusual case becomes a precedent for using an Ancillary, a warranty, to make such a contract executory. The trustee in the next routine case now may claim that the obligation to pay the Other Party seller can be rejected out of existence, leaving the estate owing nothing. Or the Other Party in the next case may argue that its claim should be paid in full because the warranty makes the contract executory and it should be deemed assumed on one theory or another. The history of the executoriness doctrine suggests that the court again will manipulate the doctrine to find a nonexecutory contract and thus the right result, that is, the result that permits maximization of the estate. In so doing,
however, the courts create a mass of confusing and inconsistent doctrine and sometimes make serious errors. These problems would be avoided if the court decided the issues explicitly as a matter of state contract analysis and consequent costs and benefits to the estate from performance or breach.

The warranty example provides another explanation for the fact that the executoriness doctrine is almost endlessly manipulable. Virtually any contract can be called executory if the court is willing to look for Ancillaries to serve the function of "further performance due." If the court wants a nonexecutory contract, it ignores "quiet" obligations like warranties and patent-defense covenants. If it wants an executory contract, it uses these Ancillaries to give it one and permit the desired result. Most contracts contain an Ancillary the courts can use as "further material performance," but Ancillaries, being ancillary, are also easy to ignore when courts seek a nonexecutory answer.

2. Debtor as Seller

Now consider the converse case, the *Half Completed Contract—Debtor's Performance Remains*, but this time with the Debtor as Seller. The Other Party paid for the onions, but the debtor-seller has not delivered when bankruptcy intervenes. Normally, the trustee using a functional approach simply dismisses the idea of assumption, since no contract right is gained by assuming, and it breaches and pays in Bankruptcy Dollars. If the market is still paying $100 for 100 bushels, the trustee resells for U.S. $100, the Other Party covers at a loss of U.S. $100 (having paid twice for the onions), and the trustee pays B.D. $100, or U.S. $10. Assumption means delivering the onions to a sale); *In re Camptown, Ltd.*, 96 Bankr. 352, 355 (Bankr. M.D. Fla. 1989) (finding property maintenance agreement (executory) severable from right to occupy and use land (nonexecutory)). On the other hand, when the "onions" are delivered to the debtor pre-bankruptcy and the court does not want the debtor to avoid related obligations, the contract can be declared nonseverable and the *cum onere* rule used to make the debtor perform or give up the "onions." See, e.g., *In re Case*, 91 Bankr. 102, 104 (Bankr. D. Colo. 1988) (involving debtors in possession of condominium, but seeking to reject maintenance obligations).

275. The first explanation is that it is not tied to any bankruptcy policy or concept of fairness. See supra Section III. A.

276. The ultimate Ancillary may be one the court identified in a land sale case, Hall v. Perry (*In re Cochise College Park*), 703 F.2d 1339 (9th Cir. 1983). The court appeared to hold that the fact that a mortgage remained on land already sold, with deed delivered, constituted remaining material performance because the seller-lender has to release the mortgage on full payment! *Id.* at 1349 n.5.
the Other Party, losing the U.S. $100 from the market sale and gaining only the savings of U.S. $10 in breach-claim payment to the Other Party. The Net Value of assumption is U.S. $-90 and no rational trustee would assume. 277

Once again, however, we can posit an unusual case where the Other Party has a huge damage claim in case of breach. The Other Party buyer needs the onions as part of a much larger contract with an “Ultimate Buyer.” Because the market has recently gone crazy, Ultimate Buyer wants an excuse to terminate its contract with the Other Party and nondelivery of the onions would provide a valid legal justification. For technical reasons, the Other Party cannot cover if the debtor-seller (estate) does not deliver. As a result, the Other Party stands to lose a perfectly demonstrable $10,000 profit from the larger contract. We also will suppose that the Other Party explained all this to the debtor-seller in advance, and therefore state contract law entitles the Other Party to recover those lost profits if the debtor fails to deliver the onions. Finally, we will assume that for promotional reasons the original contract required the Other Party buyer to label the onions “Debtor’s Crunchy Onions.”

Now the trustee’s calculations change. Assumption will require delivery of the onions, losing the potential U.S. $100 profit from sale in the market, but will also avoid a claim from the Other Party buyer of B.D. $10,000. Even in Bankruptcy Dollars, the payment to the Other Party at 10% will cost the estate U.S. $1,000, far more than the profit from the market sale. On these unusual facts, the trustee will want to assume and deliver, thus minimizing loss to the estate. 278

As before, the bankruptcy court may have repeatedly found this sort of contract nonexecutory in routine cases, because the Other Party owed no remaining performance. In this unusual case, the court must manipulate executoriness to save the unsecureds from a catastrophic claim by the Other Party, a claim that might preempt all the estate’s unencumbered assets. An average lawyer for the trustee will read the precedents and give up. A smart lawyer — or a smart bankruptcy judge, sua sponte — will seize upon the existence of an Ancillary, the

277. For Net Value formula, see supra notes 128-30 and accompanying text.
278. Another unusual case might arise when the Other Party still owes substantial payment and is entitled to offset a breach claim against the further payment due to the estate. Setoff amounts to 100% payment of a claim to the extent of the setoff, which is why the setoff right is treated as a secured claim in bankruptcy. 11 U.S.C. §§ 506(a), 363(a) (1988).
"crunchy" labeling obligation, as "material performance" still due on the side of the Other Party buyer, call the contract executory, and save the unsecureds. The result will be right and the lawyer or judge will feel quite clever — until the next routine case in this category comes along and one of the parties makes the same arguments. Now these arguments produce the wrong financial result, and the court and the litigants descend into a doctrinal quagmire.

This example is especially interesting because, unlike the warranty in the Debtor as Buyer example, the Ancillary here, the labeling requirement, is unrelated to the actual financial issue. The labeling problem is not important economically because the trustee could care less about having the debtor’s label on the onions. Yet the Ancillary lies there; sleeping, just awaiting a kiss from a smart lawyer to turn the frog into an executory contract. This sort of thing makes great children’s stories, but terrible law.

Even more interesting is the problem the executoriness court will have if the labeling provision is not so helpfully buried in the provisions of this contract, or if the lawyers fail to ferret it out. Without such an Ancillary, this is one of the few cases where it is quite difficult to find any “material performance” due from the Other Party. A court employing the executoriness test might be stuck with forbidding assumption and thus preventing the trustee from saving anything for the other unsecureds. There is no possible justification for that result, which also damages the Other Party.

D. EXECUTORINESS MASKING AN AVOIDING POWERS PROBLEM

Some significant cases turn on an implicit assumption that bankruptcy law somehow gives the trustee greater contract remedies than the debtor has pre-bankruptcy, in addition to its limits on the remedies of the Other Party. I think courts suppose a special bankruptcy contract power in some cases because another, real bankruptcy policy and power is lurking unidentified. The notion of a special bankruptcy contract “power,” coupled with the “magic” of some bankruptcy contract results, leads courts to hold that bankruptcy changes state contract rights in substantive ways, when courts are really responding to the other, unidentified bankruptcy principle. A striking exam-

279. See supra Section III. C. 1.
ple is Richmond, discussed after Rovine. 280

IV. EXEMPLARY CASES

A. Rovine

A good place to start discussing exemplary cases is *In re Rovine*, 281 a classic executory contract case. It is one of the cases involving a noncompete covenant. These cases do not involve an ITI, so they are perhaps the simplest type of cases that the courts find difficult and controversial. *Rovine* provides a good example of applying the principles and approaches previously discussed to a more complicated problem.

The facts in *Rovine* are relatively simple. The Rovine Corporation was a Burger King franchisee under a typical franchise contract (as far as the facts appear in the opinion). 282 It presumably received all sorts of start-up help in establishing its burger store, including complete plans for layout and proper equipment, training of personnel, and the rest ("french fries here, apple turnovers over there"). Burger King also promised to keep Rovine on the cutting edge of hamburger technology and permitted the use of its heavily advertised brand name. 283 In turn, Rovine was obligated to pay royalties to Burger King and to comply with Burger King's standards of "Burger Excellence." It also agreed to a covenant not to compete with Burger King in a stated geographical area for a stated period of years following termination of the franchise for any reason. 284 The covenant appeared to be sustainable as reasonable in time and extent under state contract law.

The burger business did not do well, so Rovine Corporation filed in Chapter 11 bankruptcy. 285 Given its financial results to date, it decided that the status of Burger King franchisee was more expensive than it was worth. Furthermore, we can assume that it already got many of the benefits of a franchisee in the pre-opening training and guidance provided by Burger King, benefits that were to be amortized by payment of royalties to Burger King over many years. The fact that a franchisee

280. See infra Section IV. B.
281. Burger King Corp. v. Rovine Corp. (*In re Rovine Corp.*), 5 Bankr. 402 (Bankr. W.D. Tenn.) (*Rovine I*), later proceeding, 6 Bankr. 661 (Bankr. W.D. Tenn. 1980) (*Rovine II*).
283. *Id.*
284. *Id.*
gets benefits early in the franchise and pays for them later is no doubt one important reason Burger King included that covenant against competition. It prevents the franchisee from getting the benefits and then dumping the franchise to avoid paying the related future royalties.

In any event, Rovine decided to go it alone, to purvey its hamburgers under its own name, foregoing Burger King’s research and development, but also avoiding the royalty obligation. Thus, in its role as DIP-trustee it rejected the Burger King contract, including the covenant not to compete, and stated an intent to sell its burgers at the same old stand under its own name. Burger King understandably objected. It made its objection under the rubric of executoryness, contending that the franchise contract was not executory and therefore was not subject to rejection. Because the contract could not be rejected, Burger King contended, the covenant against competition could not be rejected and should be enforced.

The court took the argument on these terms, as many precedents suggested it should, and concluded that the contract was executory. Much material performance obviously was due from Rovine, including royalty payments and maintenance of Burger Excellence, so the problem was to find material performance due from Burger King in order to satisfy the material breach test for executoryness. That task was not easy because Burger King already had done most of the valuable things it promised. Nonetheless, the court found some Ancillaries that did the job. It held that Burger King’s obligation to consult and to provide Rovine with the latest Burger Breakthroughs made the contract executory. Therefore, the court allowed Rovine to reject the contract and avoid the effect of the noncompete covenant.

The result seems entirely correct, at least within the four

286. Id.

287. In the first Rovine opinion, the parties focused the court’s attention on the covenant alone, not the whole franchise contract. Id. In the second round, Burger King also contended that it had no “claim” for violation of its competition covenant because it had no right to payment under 11 U.S.C. § 101(4) (1988). Rovine II, 6 Bankr. at 663. In effect, Burger King asserted that its rights were enforceable only by injunction, and therefore it could not be compensated by payment of damages. See supra notes 214-15 and accompanying text.

288. Rovine II, 6 Bankr. at 666.

289. Id.

290. Id.
corners of bankruptcy contract policy. It was painful for Burger King, no doubt, and in a sense unfair. But pain and unfairness are the lot of unsecured creditors in bankruptcy and Burger King, as the Other Party, was suffering along with everyone else.

1. The Executoriness Analysis

Although the result in *Rovine* was almost certainly correct as to the release of the noncompete covenant, the inquiry that led to the result seems curiously off the point. The extent of Burger King's additional obligations should not determine the debtor's right to reject. Should Burger King's counsel now advise the company to eliminate all post-opening services to new franchisees? Should a court confronting such a revised contract conclude that Burger King's reduction of its consideration entitles it to enforce the noncompete covenant? The further performance due from the Other Party and that party's right to enforce residual covenants are not logically connected. Any connection may cut the other way: a party that agrees to continue performing as part of an ongoing relationship should have a greater right to insist on performance of the debtor's promises. The rejectability of the competition covenant should not turn on Burger King's continuing obligation to keep the debtor informed of the latest developments in quarter-pounders.

The Burger King obligations were Ancillaries, unrelated to the underlying economics of the case, yet they had to be found "material" under state contract law if the contract was to be held executory and rejectable. Because it would be easy to find them nonmaterial under contract law, this analysis could produce the wrong result in two different ways. Binding state-law precedent holding similar obligations to be nonmaterial might force a bankruptcy court to find the contract nonexecutory and nonrejectable, even in a case where the court realized that rejection was the right economic answer. The second sort of mistake can arise where there is no state-court precedent, so that the bankruptcy court can plausibly find the Ancillaries material or nonmaterial. In this situation, the court's attention is

291. The larger question of fairness in this case is discussed *infra* Section IV. A. 3.


293. See *supra* Section III. C.
focused on the wrong issue, the central legal point can be manipulated in either direction, and there is every likelihood the court will get the wrong answer. In both situations, the risk of error comes from the fact that the materiality of the Ancillaries is merely incidental.

Burger King’s “consultation” obligation seems extremely tenuous and hard to enforce. I sincerely doubt that Rovine could terminate the contract because Burger King “hardly ever calls anymore.” The future-technology promise was fairly vague and of speculative value as well. I am skeptical that failure to communicate promptly the latest secret sauce would entitle Rovine to terminate the contract. But the real point is that a court could come out either way, without committing an obvious mistake.

Because these Ancillaries could be considered nonmaterial, a state court decision might have squarely held, on very similar facts, that breach of any of these Ancillaries did not justify termination by Rovine. If the bankruptcy court takes the law seriously (as courts fairly often do), it must hold the contract nonexecutory and defeat the maximizing of the estate. That result would be wrong, in practice and in principle.

294. A more subtle Ancillary in *Rovine* is the ongoing right to use the Burger King name. The court did not give much attention to this issue in the “executoriness” analysis, but it seems the most valuable of the remaining benefits of the franchise contract. On the other hand, it is a curiously passive and negative sort of continuing material performance for an “executoriness” analysis. Burger King must not seek an injunction against Rovine (or the estate) for using the Burger King name absent a breach of the franchise contract. As long as the contract is not breached by Rovine, Burger King is obligated to so “perform.” This sort of negative performance is the ultimate sleeping Ancillary, to be ignored or invoked as manipulation requires. This kind of Ancillary may be very important in some of the license cases. A negative Ancillary of this sort can make virtually all such contracts “executor,” if that is the desired result. See *In re Fryar*, 99 Bankr. 747, 748 (Bankr. W.D. Tex. 1989) (holding that under farm subsidy contracts, debtor’s performance included “preventing erosion”); see also Epling, *Contractual Cure in Bankruptcy*, 61 AM. BANKR. L.J. 71, 73 (1987); Byers & Tuggey, *supra* note 74, at 353 n.73.

This sort of negative Ancillary — not enjoining use of the Burger King name — provides the clearest example of yet another reason that the materiality test is so manipulable. Materiality in the material breach test turns on excusing a party from performance. If other relief is available, short of excusing performance and terminating the contract, it will often be granted. By finding that less drastic relief is available, the court can hold an Ancillary nonmaterial. Where Burger King wrongfully sued to block use of its name, a state court might just dismiss Burger King’s suit and order damages for Rovine, rather than terminating Rovine’s long-term franchise obligations. On that basis, a bankruptcy court could find the obligation nonmaterial, because its breach would not excuse Rovine from further performance.
Even in the absence of state court precedent, a bankruptcy court could intuitively feel that rejection — leaving Burger King with nothing to show for its substantial investment except McEgg on its face — is inequitable, especially if it appeared the debtor company would make a lot of money down the road at Burger King's expense. That judge easily could find the Ancillaries nonmaterial, the contract nonexecutory, and the covenant against competition fully enforceable, all under existing doctrine. The judge might even be right about the equities, but the result is patently wrong. The right way to understand the equities will be addressed shortly, but only after we look at the contract issue using a functional approach.

2. A Functional Analysis

To understand the functional analysis of Rovine, consider a hypothetical Rovine case, one in which the debtor is a natural person. We already have considered a noncompete case involving a natural person, the case of Harry, the free-spending salesman. Now assume that Mr. Rovine, a natural person, was the Burger King franchisee. To start at the very beginning conceptually, also assume that he filed for Chapter 7 liquidation. By so doing, we create two perspectives, that of the trustee and that of Mr. Rovine.

Mr. Rovine's situation is just like Harry's. He will be discharged of the covenant and will emerge from bankruptcy free of it, just as he is free of his debt to VISA and his tort liability to Ms. Jones for an auto accident he caused. Absent a sustainable claim of fraud by Burger King, or some other basis for objecting to discharge, Mr. Rovine will walk away from his obligations in Chapter 7 like any other Chapter 7 debtor. The noncompete covenant is no different from his promise to pay a promissory note five years from now, and to pay interest in the meantime. Both creditors get stiffed and are relegated to their claims against the estate. It is just that simple. If Mr. Rovine wants to open a new burger palace right down the

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295. See infra Section IV. A. 3.
296. This approach would be utterly unnecessary to a court in applying functional analysis, but it will help this discussion to go step by step.
297. See supra notes 211-23 and accompanying text. The analysis here is similar to Harry's case, but because the franchise situation is more complicated than the employment case, the analysis will go a bit further.
298. This conclusion assumes the covenant is a dischargeable claim. See supra notes 214-15.
street, even with assets purchased\textsuperscript{299} from his old store, he is entitled to do that as part of his “fresh start.”

From the perspective of the Rovine trustee in Chapter 7, the estate inherited a group of contractual rights, including the Ancillaries, and a group of contractual obligations, including the royalty payments. The first financial alternative is liquidation of the business and sale of its assets piecemeal. In that case, the remaining franchise contract rights, divorced from a going concern, are worth virtually nothing and the trustee will abandon them. Therefore, it will not even consider assumption of the franchise contract. As to the obligations of the contract, it will breach and pay in Bankruptcy Dollars. One of those obligations is the covenant against competition. Burger King is entitled to include damages for its breach, but because the estate is going out of business, no damage is inflicted by the estate. To this point, the analysis is just like the earlier hypothetical involving the salesman.\textsuperscript{300}

The reader may be impatient at this point, feeling that I am just stating the obvious, but nothing in Rovine speaks to the discharge and its effect, although it was key to the actual case. Furthermore, several other courts have gotten this point wrong.\textsuperscript{301} Yet the fact that the debtor can walk away from the covenant not to compete, despite having very valuable knowledge and training given to him by Burger King under the contract, is directly the result of the bankruptcy discharge and nothing else.

Now let us return to the trustee’s point of view on a different financial assumption, the sale of the business as a going concern. The trustee found a buyer, Ms. Smith. A functionalist trustee will ask Ms. Smith whether she wants to buy the business.

\textsuperscript{299} Purchased with nonestate property, of course — perhaps money just borrowed from his brother-in-law.

\textsuperscript{300} See supra notes 211-15, 219 and accompanying text.

\textsuperscript{301} E.g., In re Noco, Inc., 76 Bankr. 839, 843 (Bankr. N.D. Fla. 1987) (alternative ground) (holding franchisee’s noncompetition covenant not executory when franchisor has no remaining obligations); In re Hawes, 73 Bankr. 584, 586 (Bankr. E.D. Wis. 1987) (lifting stay to allow employer to pursue enforcement of noncompetition covenant as a matter of state law); Immugen, Inc. v. Sapse (In re Sapse), 31 Bankr. 914, 915 (Bankr. S.D. Fla. 1983) (holding non-competition covenant given in exchange for royalties and a stock option fully executed and specifically enforceable). One case did discuss the discharge issue, but held that the covenant was not dischargeable because it was not a “claim.” Carstens Health Indus. v. Cooper (In re Cooper), 47 Bankr. 842, 845 (Bankr. W.D. Mo. 1985). The court apparently believed that if specific performance is a remedy, the obligation can never be a claim, which is simply wrong. See supra notes 214-15.
ness with or without the franchise contract rights and obligations. She might plausibly decide she just wants the business. After all, Rovine did not do so well with the contract and most of the benefits promised by Burger King were already performed. In that case, the trustee will breach and pay the contract obligations and abandon the contract rights, while selling the hamburger shop and ongoing business to Ms. Smith.

If Ms. Smith wants the assets without the contract, can Burger King enforce the noncompete covenant? The answer is that Burger King has no ITI, no “property” interest in those assets. It cannot get specific performance against the estate for the reasons discussed earlier. It cannot get specific performance against Ms. Smith, because she never agreed not to compete. It cannot get specific performance against the assets (whatever that might mean), because it failed to get an interest — for example, a security interest — in those assets.

If Ms. Smith instead wants the franchise rights and obligations as well as the physical business, the trustee will assume the contract and assign it to her. Ms. Smith will get the contract with all of its burdens and benefits, including the noncompete covenant. For a functionalist, that is the end of the matter.

For a court bogged down in executoriness, however, the problem may be tougher. The reason is that the doctrine assumes symmetry, so the same finding is necessary regardless of the economic impact of the bankruptcy remedy rules, even though they are asymmetrical in effect. The court will be safe, as usual, if it finds the contract executory, because the finding leaves the trustee free to do what is best for the estate, performance or breach, depending on the one that will attract Ms. Smith’s best offer. Often, however, faced with cases like

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303. See supra Section II. B.
304. Must the property be destroyed and the shop padlocked? Surely not. Must all of it be given to Burger King? If so, Burger King gets all the assets of the estate, making this unsecured Other Party in effect secured. Bankruptcy policy almost never permits a mere equitable remedy to make an unsecured party secured, so that cannot be the result either. E.g., In re Norquist, 43 Bankr. 224, 225-26 (Bankr. E.D. Wash. 1984).
305. As a condition of assumption and assignment, Ms. Smith will have to provide “adequate assurance of future performance.” 11 U.S.C. § 365(f)(2)(B) (1988). The estate will be relieved of further liability, id. § 365(k), but the operation of that section is outside the scope of the present discussion.
306. See supra note 165 and accompanying text.
the first case — where it is better financially to get rid of the contract — the court finds no executory contract. This seems the easy solution. No harm is done because, as we have seen, to say a contract cannot be rejected makes no difference, as long as confusion can be avoided. The trustee still pays the breach claim and that is that.

Yet the court that solved the first case by finding no executory contract is in trouble when along comes the second case, identical on executoriness analysis, but where the right financial answer is assumption and assignment. Either frantic manipulation of doctrine ensues, or the court denies the trustee the opportunity to maximize the estate.

To this point, the result in this example is perfectly consistent with existing bankruptcy policy. The estate gets the benefit of performance or rejection of the Burger King contract, whichever is best, and Burger King's damage claim will be paid in the same proportions as the other unsecured creditors. Mr. Rovine in Chapter 7 is able to wriggle out of his noncompete promise, but that results, we now see, from the discharge policy. A reader who is troubled by that result may question the "fresh start" policy, but has no reason to challenge the treatment of bankruptcy contracts, as such.

3. The Shift in Equities in Chapter 11

If functional analysis makes sense in the liquidation context, and the results seem fair within the framework of the principles of equality of distribution and discharge, the situation changes when we put Mr. Rovine, the natural person and Burger King franchisee, into a Chapter 11. He now is both debtor and trustee, which is the effect of the Chapter 11 rule making him the DIP, the controller of the business as a fiduciary for the creditors. The DIP concept conflates debtor and trustee and the consequence is a real risk of inequity, the very inequity that many people feel lurking in the Rovine case, but mistakenly attribute to a problem with bankruptcy contract analysis.

Mr. Rovine, as trustee, makes the same economic analysis as the trustee in liquidation, except that the business is to go on rather than being sold to Ms. Smith. Thus the trustee-DIP is in Ms. Smith's economic position and faced with the same ques-

307. See supra notes 247, 262 and accompanying text.
tion about the future value of the Burger King franchise contract. Very plausibly, Mr. Rovine will decide that the business is better off without the franchise contract and will provide for Burger King's breach-damage claim in his plan of reorganization. If the plan is confirmed, then he will be discharged from his debts in Chapter 11, including the covenant not to compete. Here, the risk of inequity in Rovine appears. Mr. Rovine may make a lot of money based on the training and guidance he got from Burger King, while Burger King gets paid some percentage of its damages and is barred by the Chapter 11 discharge from getting the usual injunction against competition in violation of the covenant. That result does not seem fair. And it may not be.

The inequity, however, lies not in the treatment of the contract, but in the step that we have just skipped: confirmation of the plan. The bankruptcy rules we have discussed are based on the general proposition that one forfeits assets in exchange for a discharge or, if one wishes to keep assets, one promises to pay an amount agreeable to a majority of creditors. Bankruptcy does not permit a debtor to keep assets and stiff creditors over the objection of a majority of them. The cramdown rules, under section 1129(b), preserve and protect these central principles; these rules should prevent the apparent or potential inequity in Rovine.

Given the existence of section 502(c), which permits the bankruptcy court to estimate damages without the constraints of strict proof, Burger King may emerge in Mr. Rovine's Chapter 11 as the largest creditor, or at least as one possessing more than one-third of the claims in amount. If so, its negative vote will doom the plan, unless Mr. Rovine can invoke cramdown under section 1129(b). As against unsecured creditors, the absolute priority rule will require that Rovine retain no value, no ownership in the business, as a condition of cramming down the plan against an adverse unsecured class. In effect, the

309. Id. § 1129(a)(8). Chapter 13 substitutes the requirement that the debtor apply all disposable income to claims, id. § 1325(b)(1)(B), with the further protection of the "good faith" test developed in the cases. E.g., In re Greer, 60 Bankr. 547, 549 (Bankr. C.D. Cal. 1986) (discussing factors involved in determining whether or not debtor's proposal is in good faith).


311. Id. §§ 1126(c), 1129(a)(10).

312. Id. § 1129(b).

313. Norwest Bank Worthington v. Ahlers, 108 S. Ct. 963, 967-68 (1988). Creditor approval is not required in Chapter 13 and the Chapter 13 discharge is so broad that fewer statutory constraints prevent abuse. Nonetheless, once a
business will become the property of the unsecured creditors, including Burger King. This principle is sometimes difficult to apply, but in theory Rovine cannot keep ownership of the assets and still discharge Burger King without its consent. In principle, the apparent inequity in Rovine should be blocked at the confirmation stage.

If Burger King is owed less than one-third of the unsecured debt of the business and the other creditors believe the plan is in their best interests, Rovine can keep the business and discharge Burger King without its consent. In that case, Burger King is indeed stuck, but only if the great mass of unsecured creditors think they will be better off as a result. The alternative, full performance of the covenant to Burger King and loss of virtually everything by the other unsecured creditors because of the failure of the reorganization, is far more unfair.

The only remaining transformation required to turn our hypothetical case back into the actual Rovine case is to make Mr. Rovine into Rovine Corporation once more. The Chapter 11 analysis is exactly the same, except for two points. One is that the discharge is absolute; even a fraud claim by Burger King will be discharged for a Chapter 11 corporation. Secondly, it is the shareholders who must get the creditors’ agree-

court focuses on discharge and plan approval in potentially abusive bankruptcy contract cases in Chapter 13, it is easy to apply existing concepts to prevent abuse. See infra note 398.

314. 11 U.S.C. §§ 1126(c), 1129(a)(10) (1988). That is unlikely to happen unless the damage to Burger King from Rovine’s competition (expectation damage) is small and Burger King’s expenditures at the start-up stage (reliance damages) also were small.

315. In this Chapter 11 context, the problem may seem different to Burger King because even if it will get paid more by going along with the Plan, it may want to block Rovine lest its other franchisees follow suit. This is the same sort of extraneous consideration that may have been important to the international union in U.S. Truck. In re U.S. Truck, 47 Bankr. 932, 940 (E.D. Mich. 1985), aff’d sub. nom. Teamsters Nat’l Freight Indus. Negotiating Comm. v. U.S. Truck Co., 800 F.2d 581, 587 (6th Cir. 1986) (finding Teamsters’ objection to plan probably based on desire to use its claim for bargaining purposes in later contract negotiations). As the U.S. Truck court held, bankruptcy policy is directed to concrete results as against concrete rights to payment from a particular debtor, and it should not be controlled by these sorts of secondary creditor concerns. Id. at 939. If franchisors are being savaged by bankruptcy, Congress might want to enact a special rule protecting them, but that would be a legislative judgment that franchise protection is more important than bankruptcy policy in that industry. Within the four corners of bankruptcy policy, the effects beyond the particular case cannot override the rights of other unsecured creditors.

ment or forfeit their interests.\textsuperscript{317} Otherwise, the analysis is the same.

The rejection of a contract often comes before the court, as it did in \textit{Rovine}, at a time well in advance of confirmation and the application of the cramdown rules. At that stage in the proceeding, the conflation of trustee and debtor seems to create an unaddressed inequity. A court feeling that concern is tempted to manipulate executoriness to keep the debtor from apparently wriggling out of a valid promise. Yet rejection of the contract and discharge of the covenant not to compete may be crucial to a higher return for unsecured creditors generally. Any other result may be happy for Burger King, but disastrous for all the other, equally innocent unsecured creditors (maybe more innocent, because Burger King may have had more influence over the success or failure of the franchise).

\textit{Rovine}, one of the most debated executory contract cases decided under the Code, illustrates the operation of the equality-of-treatment and discharge principles against Burger King's state law rights, as well as revealing the importance of the Chapter 11 requirements for confirmation in protecting against abuse of these bankruptcy principles.\textsuperscript{318} Properly understood, none of the policy and fairness factors in \textit{Rovine} has anything to do with the remaining performance Burger King might owe under the contract on the date of bankruptcy. Yet the existence of unperformed obligations is central to a finding of executoriness. The threshold requirement of executoriness is irrelevant to the analysis, to policy, and to fairness.

\textbf{B. RICHMOND}

\textit{In re Richmond}\textsuperscript{319} is one of the cases used earlier as an example of the difficulties that the material breach test has encountered in the license cases.\textsuperscript{320} The bankrupt inventor\textsuperscript{321} in

\begin{itemize}
\item \textsuperscript{317} \textit{Id.} § 1129(b)(2)(B)(ii).
\item \textsuperscript{318} Many judges find noncompete covenants nonrejectable because they feel that the debtor is using rejection for its own benefit. \textit{In re Noco, Inc.}, 76 Bankr. 839 (Bankr. N.D. Fla. 1987), for example, held alternatively that the case should be dismissed as an abuse of the bankruptcy process. \textit{Id.} at 845; see infra note 397.
\item \textsuperscript{320} See supra text accompanying note 63.
\end{itemize}
Richmond granted a nonexclusive technology license to Lubrizol, the Other Party, prior to bankruptcy. The license contract was signed about a year before bankruptcy, but Lubrizol promised not to use the technology until May, 1983, just over three months prior to the inventor's bankruptcy.322

Following bankruptcy, the inventor sought to reject the contract and enter into a more profitable arrangement free of Lubrizol's rights. Although the Lubrizol license was nonexclusive, the inventor claimed that the existence of the contract would make it impossible to strike the most profitable deal with another licensee.323 The district court held that Lubrizol could not be deprived of its license, because the contract represented a sale of rights, like a sale of real estate.324 Therefore, the contract was not executory and could not be rejected.

The Fourth Circuit reversed.325 It analogized the contract to a real estate lease and allowed the inventor to reject it. The effect of the Fourth Circuit decision was to cancel the license.326 As too often happens in judicial consideration of bankruptcy contracts, the court sought a "thing," a contract executory for all purposes and for both parties, rather than looking at the relief available to the bankrupt party under state and then bankruptcy law.

As previously noted, the result in Richmond threatens commercial chaos, despite subsequent congressional action.327 In principle, after Richmond any patent or trademark licensor could go into Chapter 11 and invalidate a license perfectly valid under contract law. So serious were the implications for patents and copyrights that Congress amended the Code to deal

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321. The debtor was a company, but I will call it the "inventor" for clarity's sake.
322. Richmond IV, 756 F.2d at 1045.
323. Id. at 1047.
324. Richmond III, 38 Bankr. at 343.
325. Richmond IV, 756 F.2d at 1048.
326. Accord In re Logical Software, Inc., 66 Bankr. 683, 687 (Bankr. D. Mass. 1986) (discussing executorness of software license); see also Fenix Cattle Co. v. Silver (In re Select-A-Seat), 625 F.2d 290, 292-93 (9th Cir. 1980) (holding the exclusivity provision of the software license contract executory and rejectable). But see In re Noco, Inc., 76 Bankr. 839, 843 (Bankr. N.D. Fla. 1987) (prohibiting rejection of the franchise agreement because only debtor had obligations remaining). Other cases have found licenses and similar contracts to be executory, but have refused rejection on the grounds that the debtor was abusing the bankruptcy process for its own benefit. See cases cited infra note 397.
327. See supra notes 63-65 and accompanying text.
with this particular problem. Yet the amendment does not solve the problem even for all intellectual property cases because trademarks are not covered by the new amendment. More generally, the Richmond approach remains available for application in many other types of contract cases. Thus, the recent amendment emphasizes the seriousness of the Richmond problem, while by no means defusing it.

The Richmond analysis is so dangerous because it provides no requirement of insolvency, limitation of time (within one year, for example), or any other limit, except the mirage limit of executoriness. It also leads to the obvious anomaly that the Other Party loses if it has extracted promises of future performance from the debtor, but might win if it has driven a worse bargain, with the debtor promising no future performance. An executoriness analyst stands naked on this bleak, unbounded plain, with all the contract laws struck down, waiting for the Devil to arrive.

1. The Executoriness Analysis

The court found the Richmond contract executory because the debtor-inventor had certain contingent, continuing obligations. The Richmond inventor's obligations were minimal. They included notifying the distributor of other uses of the technology and protecting the distributor against infringement. If the distributor had not bargained for these rights, the court might have held the contract nonexecutory and the distributor would not have lost its license. The distributor's reward for bargaining for these benefits was to see its license taken away. Surely that analysis is off the point — if not backward. No policy, in contract law or bankruptcy, supports that distinction, and one wonders if the results in the courts will really rest upon it in the long run.

Richmond reveals a second, and more profound, anomaly
in the material breach analysis. In that case, it seems highly likely that state law would say that the license contract was final from the perspective of the inventor. In other words, state law would not permit the inventor to terminate the license, even if the inventor paid damages for breaching the contract.  

If the Other Party, the distributor, breached the contract, contract law might leave the inventor a damages remedy, rather than permitting revocation of the license. Far more certainly, contract doctrine would not permit the breacher to benefit from its own breach by revoking the license. Why should the inventor be able to revoke the license in bankruptcy by rejection? No bankruptcy rule or policy requires that reversal of state law.

The executoriness analysis would have led the Richmond court into just as much intellectual disarray if the court had found the contract nonexecutory. The inventor did have some outstanding obligations under the contract. If the contract were nonexecutory and therefore not subject to rejection, would the bankrupt inventor have to perform? It might seem so, as a conceptual matter, because rejection is breach. If the debtor cannot breach, then the only logical alternative is performance. In that case, the licensee would obtain full performance, or payment in U.S. Dollars, while all the other unsecured creditors got some small percentage. The effect would be coerced assumption, which neither the Code nor any bankruptcy policy justifies. On the other hand, if the contract is neither assumed nor rejected, then the outstanding obligations are not accounted for at all; they are neither breached nor performed. Do they just disappear? If these obligations simply are converted into monetary claims, then the effect is exactly the same as rejection: the outstanding contractual obligations become monetary claims based on breach of contract. If so, why do we say nonexecutory contracts are exempt from rejection?

2. A Functional Analysis

The functional analyst would find the problem in Richmond subject to a coherent, ordered, and clear resolution. The

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334. See Fenix Cattle Co. v. Silver (In re Select-A-Seat), 625 F.2d 290 (9th Cir. 1980); see also 4 A. DELLER, DELLER'S WALKER ON PATENTS § 410, at 646 (1965) (stating that "[t]he unilateral action of one party to a license agreement cannot revoke the agreement"); cf. U.C.C. § 2-106(4) (1987).

335. Richmond IV, 756 F.2d at 1045.

336. See supra note 61.
debtor-licensor is in the position of a seller in the functional universe. It transferred a nonexclusive patent license to the Other Party buyer (licensee). It is likely that patent-contract law would not permit the debtor-seller to revoke or rescind the license, even if the Other Party breached, just as Article 2 would not grant return of the onions. Beyond doubt, neither patent-contract law nor Article 2 would permit rescission by the breaching party against a performing Other Party. Absent some special bankruptcy rule granting greater rights to bankruptcy estates, the trustee (or DIP) is equally powerless to revoke the license, especially against a nonbreaching licensee. Under patent-contract law, a breach by the debtor-seller leaves the license in place and the royalties due, with the Other Party Lubrizol entitled to set-off any damages for breach of the ancillary provisions concerning lawsuit defense and the like. In short, nonbankruptcy law would say that Lubrizol had an ITI in the license. For the functionalist, there only remains the calculus of cost and benefit from assuming the contract obligations to defend suits and so on, versus the benefits of avoiding a set-off claim for breach of those obligations.

3. The Pseudo Avoiding Power

The courts often use executory contract analysis as a type of avoiding power because it serves as a surrogate for one of the

337. 6 E. LIPSCOMB, LIPSCOMB'S WALKER ON PATENTS § 20:35 (3d ed. 1987).
340. See 6 E. LIPSCOMB, supra note 337, § 20:55 (stating that licensor's non-performance of independent covenant may result in liability for damages).
341. See supra notes 128-30 and accompanying text. This is a good spot to re-emphasize that the ITI distinction will not usually be difficult to apply. In Lubrizol, for example, we need not be concerned about getting lost in the distinction between a property right and a "mere license." Lubrizol as licensee had the right to enjoy the use of the patent rights, i.e. to produce and sell goods that would violate the patent but for the license. If state law said that the inventor-licensor could revoke the license and get a court order to block further sales by Lubrizol, leaving Lubrizol with only a damage claim, then Lubrizol would have only a general claim and no ITI enforceable in bankruptcy. On the other hand, in the real world state law says that Lubrizol has more than a claim for damages. It has the right to continue sales, defeating any judicial action to block it, and the right to get a court order to prevent any licensor interference with its sales. Therefore, it has an objectively defined state-law right in the patent, an ITI, and that right is enforceable in bankruptcy. There will be marginal cases, as there must always be at the margins of any legal distinction, but the great majority of cases will be easy ones. We need only determine what remedy state law grants for enforcement of a right, damages versus specific rights in specific property.
statutory avoiding powers. A court uses this surrogate when it perceives equities of the sort traditionally associated with the avoiding powers, but cannot see how to use the powers provided by the statute. Richmond is a good example.

In Richmond, a relatively one-sided contract gave the Other Party considerable benefits at the expense of the debtor’s opportunities to relicense its technology, a move which would greatly benefit its other creditors and itself. Revocation of that license would put the debtor’s creditors on a more equal footing and help to rehabilitate the business. These traditional bankruptcy goals are, and should be, very important to a court sitting in bankruptcy. The rhetoric of the Fourth Circuit panel demonstrates that its decision was motivated by these goals. The rhetoric was that associated with the equality of treatment principle and its primary mechanism of enforcement, the avoiding powers. Because the court was unable to identify a method for achieving those goals by using the statutory avoiding powers, it sought the intuitively correct result by using executory contract analysis.

The Richmond court was wrong to enforce the equality of treatment principle through the executory contract device. The avoiding powers, including the preference and fraudulent conveyance provisions, are the method the Code provides for enforcing that principle, not some implied and unbounded contract “power.” If the grant of the license was not avoidable under those provisions, then the equality of treatment principle did not apply. This conclusion is supported by the standard propositions that the particular should control over the general, and the explicit over the implied. If the Code squarely and specifically sets forth a basis for explaining and vindicating a felt equity, then that basis should prevail over a claim of an implied contract “power.”

A contract approach is unbounded, while an avoiding power analysis is subject to all the constraints and exceptions imposed by wise policy and compromise. For example, a contract approach to the delivered onion problem could go back an unlimited time before bankruptcy. To avoid spoilage, we can change from onions to widgets, delivered three years before

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342. Richmond I, 34 Bankr. at 526; Richmond II, 36 Bankr. at 273.
343. Richmond IV, 756 F.2d at 1048 (noting that companies like Lubrizol “share the general hazards created by [§ 365] for all business entities dealing with potential bankrupts”).
345. Id. § 548; see supra note 203 and accompanying text.
bankruptcy, and the Other Party to pay three years after delivery. The debtor has warranty obligations sufficient to make the contract executory. Shall we set it aside and reclaim the widgets in a rising market? Surely not. The damage to commercial expectations (and the effect on the blood pressure of business people and their lawyers) would be too great. Preference law defines 90 days as the relevant time and that makes rough-justice good sense.\textsuperscript{346} When the delivery was within 90 days, the felt-equities arising from a “trivial difference in timing” among creditors is addressed. Further, countervailing equities and commercial policies, like “ordinary course of business,” are considered via the preference exceptions.\textsuperscript{347} The bounded analysis should control over the unbounded one.

We already have seen that bankruptcy contract cases can implicate the avoiding powers, especially the preference power.\textsuperscript{348} The equities that concerned the court in Richmond could have been properly analyzed, and competing policies given the weight accorded by the Code, by viewing the problem as a possible preference or fraudulent conveyance. The preference or fraudulent conveyance issues are not obvious in Richmond, but they are hidden in its facts and in the court’s rhetoric.

a. Preference Analysis

Although the contract in Richmond was signed more than a year before bankruptcy, Lubrizol promised not to use the technology until May 1, 1983, just two weeks more than ninety days before bankruptcy.\textsuperscript{349} Furthermore, the bankruptcy court tells us that Lubrizol had not in fact used the technology — or paid any royalties — by the time the bankruptcy petition was filed.\textsuperscript{350} On that basis, deferring the use of the technology could be construed as delaying the “transfer” to May 1, 1983, the first date on which the contract permitted Lubrizol to use the license. If May 1, 1983 was found to be the date of the

\begin{itemize}
\item \textsuperscript{346} 11 U.S.C. § 547(b)(4)(A) (1988). The period is extended to one year for insiders. \textit{Id.} § 547(b)(4)(B).
\item \textsuperscript{347} \textit{Id.} § 547(c)(2).
\item \textsuperscript{348} See supra Section II. F.
\item \textsuperscript{349} Richmond IV, 756 F.2d at 1045. The facts are scattered through all four Richmond opinions and show some inconsistencies. For example, the district court opinion suggests that Lubrizol was barred from using the license until July, 1983, which would have been within 90 days of the August 16, 1983, bankruptcy. See Richmond III, 38 Bankr. at 342.
\item \textsuperscript{350} Richmond I, 34 Bankr. at 526.
\end{itemize}
transferred under section 547, and if the debtor Richmond had filed bankruptcy within 90 days of that date, then the transfer could have been voidable for the benefit of the other creditors if the other section 547 elements were present.\footnote{11 U.S.C. § 547(b).} including insolvency on May 1.\footnote{Id. § 547(b)(3).} The antecedent debt element\footnote{Id. § 547(b)(2).} would have been easy, because the Richmond license was granted largely, if not entirely, in satisfaction of antecedent debt owed to Lubrizol by the debtor at the time the original contract was signed.\footnote{Richmond III, 38 Bankr. at 342 n.1. This fact is an unusual circumstance. In a more common transaction, a two-level analysis might be necessary. See supra note 200. We discussed this very example earlier, in the section examining the impact of the avoiding powers on bankruptcy contract analysis. See supra text accompanying note 199.}

On the actual facts in \textit{Richmond}, assuming a May 1 transfer of the license, the debtor filed two weeks too late to avoid the license as a preference. If the court found that fact painful, a proper analysis would force the court to realize that sometimes trivial differences in timing do matter. The preference provisions push back the bright line 90 days before the bankruptcy, but we have to stop somewhere. Under the old Bankruptcy Act, the license transfer would have been within the four month period then provided for preferences and would have perhaps been avoidable.\footnote{Bankruptcy Act, § 60(b), 30 Stat. 544 (1898), repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401(a), 92 Stat. 2549, 2682 (codified as amended as The Bankruptcy Code, 11 U.S.C. §§ 1-15132 (1988).} Congress, however, reduced the preference period in conjunction with a host of policy changes amid political compromises among various elements in the commercial community.\footnote{Countryman, The Concept of a Voidable Preference in Bankruptcy, 38 Vand. L. Rev. 713, 726 (1985).} The result is that large and important pre-bankruptcy transfers cannot be avoided, but those are the lines that Congress drew.

\textbf{b. The No-Transfer, Undelivered-Seller Analysis}

A second analysis was available to the \textit{Richmond} court to avoid the transfer of the license, depending on the facts in the record. The court could have found the transfer of the license to have taken place even later than May 1, 1983, because it is possible the contract could have been construed to say that the transfer was not effective until Lubrizol actually began to use...
the license. It appears from the opinions that Lubrizol may not have been liable for royalties until it began to use the process. A royalty-deferral clause, under all the facts and circumstances, might suggest that the parties intended no actual transfer of the license until Lubrizol started to use the technology. Given these facts, the court might hold that the license was not transferred prior to bankruptcy. In that case, bankruptcy contract law permits the debtor-seller to breach-and-pay, keeping the license, because it is in the position of an undelivered seller, as discussed earlier.358

I am not suggesting that the Richmond court should have manipulated doctrine to find for the debtor come hell or high water. Perhaps on a proper record no one could plausibly claim that the transfer took place any time except when the contract was first signed, in which case the transfer was long prior to bankruptcy and was not a preference and therefore the license transfer should stand.359

c. Fraudulent Conveyance Analysis

The rights of the Other Party in Richmond also might have been vulnerable to a fraudulent conveyance attack. Lubrizol did not use the technology and might not ever use it, thus producing no revenue for the debtor-seller. The commitment of Lubrizol under the contract may have been so tenuous that its promises could properly be characterized as “less than reasonably equivalent value” for even a nonexclusive license. If so, and if the debtor was insolvent at the time of the transfer of the license, then the transfer could be avoided as a fraudulent conveyance.362

357. Richmond IV, 756 F.2d at 1045. The bankruptcy court found no evidence that any royalty had been paid or would be paid in the future. Richmond I, 34 Bankr. at 526. Again in the context of royalties, the court also implied that Lubrizol might not be able to prove damages because it had not exercised its rights under the contract. Richmond II, 36 Bankr. at 272. The district court implied, ambiguously, that Lubrizol was not liable for any royalties until it chose to use the license. Richmond III, 38 Bankr. at 342.

358. This conclusion assumes that the contract did not create an ITI under nonbankruptcy law that might face avoiding power attack, so the court would not have to go through that analysis as well. See supra Section II. E.

359. This conclusion is subject to the fraudulent conveyance analysis that follows.

360. Richmond IV, 756 F.2d at 1045.

361. The bankruptcy court noted that “Lubrizol did not demonstrate that any royalty payments had been made or would be forthcoming in the future.” Richmond I, 34 Bankr. at 521.

If the Richmond court was concerned with equities such as the need to apply the equality principle, then it should have looked for an avoidable preference or fraudulent conveyance. If not, it should have let the transaction stand, while leaving the DIP free to assume or reject the remaining bundle of Ancillaries.

The preference and fraudulent conveyance analysis explains the results in cases like Richmond that seem to grant the bankruptcy estate greater contract rights than exist under state law. Because the results in those cases cannot be explained by the bankruptcy rules that I have identified as central to the “magic” of bankruptcy contract results, these decisions must be understood in terms of other principles or some special contract “power.” I believe that they can be understood by the specific, bounded provisions of the avoiding powers, and therefore it is unnecessary, and harmful, to conjure up some special contract power not given the trustee or DIP by the Code.

The fact that avoiding power problems are often hidden in a bankruptcy contract case does much to explain why rejection of executory contracts appears to the courts much like an independent avoiding power. In some bankruptcy casebooks the executory contract section is within a section devoted to avoid-

value” as applied to antecedent debt is exquisitely complicated and far beyond the present discussion.

363. See Epling, supra note 96, at 195. The impact of the avoiding powers re-enforces the proposition that the ITI (property-contract) distinction is essential in understanding the enforceability of the Other Party's rights under a bankruptcy contract. Only that distinction provides symmetry with the avoiding powers, because only the debtor's grant of an interest in a specific asset is subject to avoidance. For example, in Lubrizol the license was granted in satisfaction of antecedent debt. Richard III, 38 Bankr. 342 n.1. If it had been granted within 90 days of bankruptcy, the transfer would have been avoidable as a preference, if the grant created an ITI, because creation of an ITI is a transfer of property. If the license was not a transfer of an ITI in property, it could not be subject to preference avoidance. This example demonstrates that the distinction between a transfer of a property interest and creation of a general claim is the crucial one for bankruptcy contracts, because it is central to all of bankruptcy law. If the license in Lubrizol was not the creation of a property interest but would nonetheless be enforceable in bankruptcy, then it would represent the ideal vehicle for a nonavoidable preference. If so, then a grant of a security interest in the debtor's equipment within 90 days before bankruptcy would be avoidable, but the creation of the rights represented by the license would be immune from avoidance. That result makes no sense. The whole system is coherent only if there is continuity between those rights that are enforceable in bankruptcy and those that are avoidable. The only distinction that provides that symmetry is the distinction between rights in specific assets versus general claims.

364. See supra text accompanying notes 119-32.
ing powers. That is true of the casebook I co-authored, notwithstanding that the logic of functional analysis would place the section 365 discussion in the estate administration section, just as the section itself is placed in the administration chapter of the Code. Other casebooks put the executory contract materials between administration and avoidance, reflecting its ambiguous position. Thus, it is not surprising that the courts often assume that there is a special bankruptcy contract "power."

C. OTHER IMPORTANT RECENT CASES

Functional analysis of bankruptcy contracts is at bottom a simple concept: The estate has the same rights and obligations as other contract parties under nonbankruptcy law, subject to the special bankruptcy limitations on remedies and the avoiding powers. Nonetheless, this discussion demonstrates that it is not always simple to apply. It sometimes requires hard work on difficult state law contract questions, and occasionally raises hard bankruptcy remedy and avoiding power questions as well. Its advantages, the payoff for the analytical work involved, are: a) it makes the easy cases, the great majority, really easy; b) properly applied, it is highly likely to yield the right answer; and c) it is much harder to apply improperly, in contrast to the constant temptations to err presented by the "executoriness" requirement.

As we saw, the executoriness approach often is manipulated as an easy way out of a hard bankruptcy contract problem. We also noted that today's easy way out becomes tomorrow's nightmare, when a precedent seems to require a re-

366. E.g., D. BAIRD & T. JACKSON, supra note 210, at 451-520; D. EPSTEIN, J. LANDERS, & S. NICKLES, DEBTORS AND CREDITORS: CASES AND MATERIALS 879-98 (3d ed. 1987); S. RIESENFELD, CASES AND MATERIALS ON CREDITORS' REMEDIES AND DEBTORS' PROTECTION 629-41 (4th ed. 1987); J. WHITE, BANKRUPTCY AND CREDITORS RIGHTS: CASES AND MATERIALS 164-220 (1985). From a pedagogical point of view, the functionalist should put the executory contract materials after the preference and fraudulent conveyance materials because, as the preceding discussion demonstrated, it is not possible to understand fully the treatment of bankruptcy contracts until the students understand these avoiding powers. It is, of course, crucial in every field to keep in mind the students' need to learn "A" before tackling "B" in ordering teaching materials, although some casebook authors seem to prefer instead an organization that fits the theoretical framework most satisfactory to someone already expert in the field.

367. See supra Section III.
sult that feels intuitively wrong in the next case that comes along. In the long run, the effort required by the functional approach is less painful than the frustration that produced the cry of anguish from the Sixth Circuit panel in Jolly.

Nonetheless, the challenge of working through the problems presented by each category of contemporary case is sufficiently great that I wonder whether stopping at this point will leave the reader unsatisfied, because this or that category of troublesome case is left unanalyzed.

The answer must be that this article is too long already, a point that the patient reader may justly regard as understatement. Therefore, I will touch just briefly on some other bankruptcy contract problems as further examples of the way a functional analysis opens up the issues in bankruptcy contract cases.

1. Land-Sale Option Contracts

One type of troublesome problem that yields simply and quickly to a functional approach is the real estate option case. Typically, the debtor-buyer prior to bankruptcy held a naked option to buy, with no obligation to purchase that constitutes material performance due from the debtor. The cases have split as to whether the contract is executory and hence assumable. One recent case was notably sensible and analytical in permitting assumption. The debtor in that case purchased an option to buy land and then sold that option to a third party for a potential two million dollar profit. The court explicitly noted that Ancillaries would permit finding an executory contract, (although it did not so label them), but the court preferred to rest its decision on the straightforward fact that the estate would benefit from assumption. The analysis was purely

368. Id.
372. Id. at 466. Another real estate problem generating recent litigation is the oil and gas lease. See Byers & Tuggey, supra note 74, at 337. The courts have divided as to its status as an executory contract or unexpired lease under § 365, but have generally gotten the right result: a debtor-lessee should never be able to reject effectively, while a debtor lessor would virtually never want to reject. Id. at 337-54. A recent article suggests the right results, but is forced to review all the metaphysical wrenchings re-
The contract right (the option to buy) was valuable and could be realized without paying any price for assumption because the price had already been paid. To hold the contract nonexecutory and deny the estate the benefit of the option because of the lack of a debtor obligation would be a dysfunctional and aberrant result.  

A functionalist sees only a contract right for the estate and no contract obligation to the Other Party seller. The estate obviously should realize on the right by assuming and performing, or assuming and assigning.

2. Land-Sale Contracts as Mortgages

Functional analysis would benefit another, more complex category of recent cases involving treatment of certain pre-petition transactions as either contracts to sell or as secured transactions. In the classic instance, a real estate contract or a sale of goods with the Debtor as Buyer could reasonably be viewed as either an executory contract of sale or as a security device dressed up in contract clothes. The most typical case involves the sale of land. The court frames the issue in terms of

quired by the "executoriness" requirement and the occasional case that equates rejection with rescission. Id. at 346-52. For the functionalist, the key point for a debtor lessor is that state law would never permit rescision or its equivalent by virtue of the lessor's breach. The problem with lessees has been primarily the "deemed rejection" rule under § 365(d). Because a debtor lessee would never want to reject, any deemed rejection by a lessee must be inadvertent. The deemed rejection rule permits the Other Party to use the executory contract rule against the estate and the other creditors which does not make much sense. A functionalist would suggest that § 365(d) be modified to prevent such results, perhaps blocking deemed rejection where a) it could not possibly be in the estate's interest to reject; and b) the Other Party has failed to seek an assumption-rejection decision by notice to the trustee in bankruptcy. There are some interesting problems at the margins of oil and gas leases — for example, with covenants to develop and farm-out agreements — but most of these cases are easy ones from a functional standpoint.

373. Another simple category of recent cases involves retrospective insurance premiums. The courts nearly always get these cases right, finding the contracts nonexecutory and leaving the insurer with its monetary claim for premiums. E.g., In re Wisconsin Barge Line, 76 Bankr. 695, 698 (Bankr. E.D. Mo. 1987); In re Placid Oil Co., 72 Bankr. 135, 138 (Bankr. N.D. Tex. 1987). Functionally, there is no benefit to assumption, the coverage period having passed, and the premiums are pre-petition unsecured debts without any need to speak of rejection. The only advantage of a functional approach here is that it is simpler and clearer.

374. Executory: Speck v. First Nat'l Bank (In re Speck), 798 F.2d 279, 280 (8th Cir. 1986) (per curiam) (holding contract for deed between seller and debtor-buyer to be executory; debtors obligated to buy); In re Waldron, 65 Bankr. 169, 174 (Bankr. N.D. Tex. 1986) (finding land sale contract between
whether the transaction is a contract to sell, in which case the trustee-DIP must assume the contract or forfeit the land, or is really the functional equivalent of a form of mortgage or deed of trust. The latter characterization means that the estate can keep the land while paying the Other Party seller only the value of the land, which is assumed to be something less than the amount still due on the purchase price.\textsuperscript{375} These cases often are addressed as problems of executoriness.\textsuperscript{376}

In fact, these cases are merely another example of the need to properly characterize the transaction under state law in order to know the remedy state law gives the Other Party seller.\textsuperscript{377} Then the relevant bankruptcy rules can be applied. The lure of executoriness diverts too many courts from the obviously helpful line of cases distinguishing leases from secured

\begin{itemize}
\item seller and debtor-buyer executory under state law; \textit{In re} McCallen, 49 Bankr. 948, 952 (Bankr. D. Or. 1985) (finding land sale contract between seller and debtor-buyer was executory); Shaw v. Dawson (\textit{In re} Shaw), 48 Bankr. 857, 861-62 (D.N.M. 1985) (holding real estate contract in which debtors were buyers executory under state law); \textit{see also} Hall v. Perry (\textit{In re} Cochise College Park, Inc.), 703 F.2d 1339, 1348 (9th Cir. 1983) (holding it question of fact whether land sale contracts between bankrupt land development corporation and purchasers were executory contracts); Benevides v. Alexander (\textit{In re} Alexander), 670 F.2d 885, 887 (9th Cir. 1982) (holding deposit sales agreement on debtor-seller's home to be executory); McCannon v. Marston, 679 F.2d 13, 18 (3d Cir. 1982) (holding agreement for purchase and sale of apartment to be executory where buyer had not paid purchase price and debtor-seller had not transferred title); \textit{In re} W&L Assocs., 71 Bankr. 962, 966 (Bankr. E.D. Pa. 1987) (finding contract for sale of realty to be executory despite debtor-seller's pre-petition breach); \textit{In re} Aslan, 65 Bankr. 826, 828 (Bankr. C.D. Cal. 1986) (contract for sale of debtor-seller's real property was executory).

- Not Executory: Eugene Squire Motel v. Thurmond (\textit{In re} Thurmond), 46 Bankr. 723, 724 (D. Or. 1985) (holding land sales contract between seller and debtor-buyer was a lien rather than an executory contract); All-American Life & Casualty Co. v. Adolphsen (\textit{In re} Adolphsen), 38 Bankr. 780, 781 (D. Minn. 1983) (holding contract for deed between seller and debtor-buyer was a financing agreement for sale which had already occurred and not an executory contract); \textit{In re} Flores, 32 Bankr. 455, 460 (Bankr. S.D. Tex. 1983) (construing contract for deed where debtor is buyer as a lien and not an executory contract); \textit{In re} Booth, 19 Bankr. 53, 58 (Bankr. D. Utah 1982) (classifying contract for deed between seller and debtor-buyer as a lien rather than an executory contract).

375. \textit{E.g.,} Mitchell v. Streets (\textit{In re} Streets & Beard Farm Partnership), 882 F.2d 233, 235 (7th Cir. 1989); \textit{In re} Kratz, 96 Bankr. 127, 129 (Bankr. S.D. Ohio 1988). Two recent opinions permitted rejection of contracts where the debtor was seller and the contract price was lower than the value of the property. \textit{W&L Assocs.}, 71 Bankr. at 968; \textit{Aslan}, 65 Bankr. at 831.

376. \textit{E.g.,} Streets, 882 F.2d at 234; Kratz, 96 Bankr. at 129-30; \textit{W&L Assocs.}, 71 Bankr. at 966; \textit{Aslan}, 65 Bankr. at 828.

377. \textit{See, e.g.,} Streets, 882 F.2d at 235; Kratz, 96 Bankr. at 129; \textit{W&L Assocs.}, 71 Bankr. at 964-66; \textit{Aslan}, 65 Bankr. at 831.
transactions. These cases involve the same problem and the courts, in their “substance over form” analysis, essentially have been proceeding in a functional way by searching for the economic function of the agreement.\textsuperscript{378} The inquiry is, of course, under state law.\textsuperscript{379}

We can begin with a secured sale-of-goods case, dredging up the onion contract once more. We are back to Article 2 treatment of the delivered and undelivered seller, although this time the delivered seller has a purchase money security interest in the onions. The undelivered seller is still superior in position under state law, because it has the right to the onions themselves.\textsuperscript{380} The secured delivered seller has only the Article 9 right of a secured party to realize the value of the onions by sale, up to the amount of the purchase price plus damages.\textsuperscript{381} The difference under state law between a right to the thing itself and the right to the value of the security interest can be important. It will matter, for example, in the rare case when the resale of the onions brings more than the purchase price, because the secured delivered seller will have to give the surplus back to the debtor.\textsuperscript{382}

That state law difference also matters in bankruptcy where the bankruptcy-ascribed value of collateral can be different than the amount still owed to the seller. To elaborate requires several excursions\textsuperscript{383} that would violate my promise to the tiresome reader. For now, I simply assert, with the support of many cases, that in bankruptcy the price still owed for the goods can be different than their bankruptcy-ascribed value.\textsuperscript{384}

As a result of this potential difference in value, a delivered secured seller may be forced to accept less than the amount

\textsuperscript{378} See, e.g., Liona Corp. v. PCH Assocs. (In re PCH Assocs.), 804 F.2d 193, 201 (2d Cir. 1986) (holding transaction structured as a sale-leaseback not a lease within the meaning of § 365); Blue Barn Assocs. v. Picnic ‘N Chicken (In re Picnic ‘N Chicken), 58 Bankr. 523, 527 (Bankr. S.D. Cal. 1986) (holding “lease” to be disguised financing arrangement, and therefore not a lease within § 365).

\textsuperscript{379} In re Speck, 798 F.2d 279, 280 (8th Cir. 1986) (per curiam).

\textsuperscript{380} U.C.C. §§ 2-703(a), (d), (f), 2-706 (1987).

\textsuperscript{381} Id. § 9-504.

\textsuperscript{382} Id. § 9-504(2).

\textsuperscript{383} We would have to consider bad bargains (purchase price greater than value) not bad enough to be avoidable as fraudulent conveyances, as well as cases where the market had plunged after the contract was made. We also have to explore going-concern value as contrasted with liquidation value, and possibly the difference between going-concern value and firm-specific value.

\textsuperscript{384} E.g., In re Arnold, 806 F.2d 937, 940 (9th Cir. 1986).
owed in exchange for the estate’s keeping the collateral, because state law and bankruptcy law give the delivered seller the right to recover only the value of the collateral, not the collateral itself. Because the undelivered seller has a right to the collateral itself, it keeps the collateral unless the estate assumes and pays in full. Thus, where the collateral is valued at $100 in bankruptcy and the remaining purchase price is $150, the debtor who got delivery before bankruptcy has to pay only $100, plus interest, to the Other Party secured seller in order to keep the collateral in a Chapter 11 proceeding. Against an undelivered seller, the debtor has to pay $150 to get the goods because it has to assume the contract.

The same analysis applies in real estate cases, although with different terminology. Thus, the court should determine whether state law treats the seller as the equivalent of a delivered or undelivered seller. In a land case, we ask whether state law entitles the seller in case of default to the land itself, or only its value as realized at a foreclosure. In the latter case, the seller is a delivered secured seller and the estate may keep the land by paying its value, rather than assuming the contract and paying in full. The details of this analysis would take considerably more space, but this discussion covers the key points.

The most well-known case in this genre is In re Booth. Booth goes beyond an executoriness analysis and asserts that the bankruptcy court can treat a sales contract as either an executory contract or as a secured transaction, whichever is better for the debtor. Although the court gives a nod to protection of the Other Party, the overall thrust is improvement of the debtor’s chances for rehabilitation.

Judge Mabey’s sensitive opinion in Booth reveals two telling points. The first is that judges are led to the Booth approach, at least in part, because the executoriness analysis suggests a separate bankruptcy-contract policy that permits or even requires the bankruptcy courts to reshape contract law.

389. Id.
390. Id. at 55-57.
Because this policy does not exist, the reshaping must go on without statutory support and without bounds or limits.\footnote{391} If instead the courts focus on the general bankruptcy policies that affect treatment of Other Parties to bankruptcy contracts, then the impositions on those parties will be bounded and relatively predictable.\footnote{392}

The second point is that the real policy question has nothing to do with executoriness.\footnote{393} Perhaps there should be a special bankruptcy policy about land-sale contracts, especially in rehabilitation proceedings. If so, perhaps Congress should adopt it and in the process give it bounds and limits. In the land-sale cases, state law generally offers buyers and sellers a "two-deal option." They can choose to structure a land sale as a contract or as a security device, although the states vary widely in drawing the line between the two.\footnote{394} Generally, state law gives the buyer in a contract situation fewer rights than a buyer who "owns" the property subject to a lien, the same overall result as in bankruptcy.

Congress might decide that bankruptcy should convert contract deals into security deals to enhance rehabilitation or to prevent over-reaching. But if it does so, then sophisticated sellers may not make sales on a contract basis, because of the bankruptcy risk. If over-reaching was the principal concern, Congress might decide to decree the conversion for consumer buyers, but not for commercial buyers. It might go further in drawing distinctions, and permit conversion only when the buyer is a consumer and the seller is not a consumer. Congress also might decide it is better to do nothing, "letting fifty flowers bloom" in the several states, depending on local credit availability and regional traditions. In an ideal world, Congress might even spend a little money to hire experts — practitioners or academics — to find out what is really going on in this market around the country, before changing the law based on anecdote or lobbying power. Given the many factors to consider in this area, caselaw development, with no statutory guidance, may not be the best approach. In any case, courts should un-

\footnote{391. Cf. United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (\textit{In re Timbers of Inwood Forest Assocs.}), 793 F.2d 1380, 1402-05 (5th Cir. 1986) (stating that courts allowing interest payments to undersecured creditors confront many issues for which no statutory guidance exists), \textit{aff'd}, 484 U.S. 365 (1988).}
\footnote{392. \textit{See} Booth, 19 Bankr. at 59-61.}
\footnote{393. \textit{See id. at} 56.}
understand that no special bankruptcy-contract “power” exists and that executoriness has nothing to do with the case.

3. “Qui bono?” Cases

A great many of the difficult bankruptcy contract cases of recent years implicate, and even turn upon, the question “qui bono?” The licensee in Richmond and the franchisee in Rovine seemed to use bankruptcy more for the benefit of themselves than their creditors, although the courts did not address those questions. Of course, the bankruptcy laws are very much designed to benefit debtors, as well as creditors, so benefit to a debtor hardly makes a bankruptcy filing illegitimate. The question, as always, is the balance that the system maintains between debtors and creditors. More profoundly, benefits to assist debtors in trouble are very different from benefits that enable debtors to ignore their promises with no justification.

The issues raised by this concern are far too large for this paper, but in a whole category of bankruptcy contract cases the courts perceived just these sorts of problems and confronted them explicitly. These cases might be called the “qui bono” cases, because the courts plainly were concerned that debtors might be using the system to benefit themselves by escaping state law obligations illegitimately. I do not want to analyze these cases here, so suffice it to say that they can normally be


396. See Warren, supra note 101, at 777 n.3.

397. E.g., Chinichian v. Campolongo (In re Chinichian), 784 F.2d 1440, 1444-46 (9th Cir. 1986); Shell Oil Co. v. Waldron (In re Waldron), 785 F.2d 936, 941 (11th Cir.), cert. dismissed sub nom. Waldron v. Shell Oil Co. 478 U.S. 1038 (1986); In re Noco, Inc., 76 Bankr. 839, 844-45 (Bankr. N.D. Fla. 1987); In re Southern Cal. Sound Sys., 69 Bankr. 893, 900 (Bankr. S.D. Cal. 1987); In re Carrere, 64 Bankr. 156, 160 (Bankr. C.D. Cal. 1986). As one court put it, “Here, the debtor is attempting to use its rejection power to create a business rather than preserve one.” Southern Cal. Sound, 69 Bankr. at 898. But see In re Alexander, 670 F.2d 885, 889 (9th Cir. 1982) (permitting debtor-seller who filed under Chapter 13 on trial date of buyer-creditor’s action for specific performance to reject executory contract because Chapter 13 rejection may benefit debtor as well as creditors); In re W&L Assocs., 71 Bankr. 962, 967-68 (Bankr. E.D. Pa. 1987) (filing under Chapter 11 to avoid an executory contract is not an abuse of the bankruptcy process); see also In re Taylor, 103 Bankr. 511, 517 & n.5 (D.N.J. 1989) (permitting singer to reject personal services contract because necessary for fresh start).
resolved by applying the usual rehabilitation checks and balances, as in the analysis of Rovine.\textsuperscript{398} If we find the results inadequate to prevent abuse, then corrective steps should focus upon those provisions, rather than section 365 and the treatment of bankruptcy contracts.

\section*{V. THE EXCLUSIONARY APPROACH}

The reader who has studied Michael Andrew's recent article\textsuperscript{399} will see that he and I agree on many issues concerning the nature of the present bankruptcy contract dilemma. We also agree about several of the key distinctions in fashioning a better analysis. Yet we disagree in some important respects, conceptually and practically.

The central conceptual disagreement is that Andrew would treat rejected contracts as never becoming property of the estate,\textsuperscript{400} and would create special rules to account for the effects of nonassumption by granting the Other Party a claim against

\textsuperscript{398} See supra Section IV. A. 3. For example, Carrere concerned a Chapter 13 proceeding where a soap opera actress was trying to escape her current television network contract in order to accept a better one. Carrere, 64 Bankr. at 157. The analysis in this case should start with the potential benefit to her other creditors. If her disposable income, 11 U.S.C. § 1325(b)(2) (1988), under the current contract would not permit 100\% payment to her other creditors and the new contract would pay them much more, rejection is for the other creditors' benefit. If the creditors would be paid 100\% by applying all her disposable income under the current contract, the rule barring specific performance against the estate should not apply because specific performance would give the network the same full performance obtained by all the other creditors. Therefore, if the actress rejects the network contract, a negative injunction of the usual sort should be available.

The better analysis may be that the bankruptcy court should estimate the damages to the network, using its uniquely broad powers to do so, 11 U.S.C. § 502(c) (1988), and require 100\% payment of that amount to the network in case of rejection. One measure of damages would be her increase in salary under the new contract. Such a rule would surely deter, if not eliminate, uses of bankruptcy to reject contracts in illegitimate ways.

\textsuperscript{399} Andrew, supra note 15, \textit{passim}.

\textsuperscript{400} In a thoughtful and helpful letter commenting on a draft of this Article, Andrew indicates that the concept of exclusion of the contract from the estate until assumption merely reflects the historical development of the doctrine rather than being important to his theoretical understanding. Letter from Andrew to Westbrook (June 6, 1989) (copy on file with the author). With deference, I am unable to understand important parts of his analysis without the exclusionary idea. For example, the "ride-through" doctrine, see \textit{infra} note 426, seems to be important to his analysis, but he feels it is a "spurious historical artifact." Letter from Andrew, supra, at n.3. I can only conclude that we are somehow talking past each other. For now, I am stuck with my understanding of his article, as explained in the text.
the estate "as if" the debtor breached the contract. 401 This "exclusionary" approach substitutes a new metaphysics of bankruptcy contracts for the old one.

At the core of my suggested analysis is a much simpler idea: the estate inherits the debtor's pre-bankruptcy contracts and is in exactly the same position as any other contract party under nonbankruptcy law, with just two exceptions: a) after rejection (breach), the remedies of the Other Party are limited by the general bankruptcy rules constraining the remedies of unsecured creditors; and b) ITIs of the Other Party may be subject to avoidance under the bankruptcy avoiding powers. Unlike an exclusionary rule, which requires a new set of special rules and concepts to understand the proper treatment of an obligation that hovers somehow outside of bankruptcy, the functional approach permits a simple, two-step analysis. What are the rights and obligations of the estate under nonbankruptcy law in case of breach? How are the Other Party's remedies under nonbankruptcy law limited by bankruptcy remedies rules and by the avoiding powers? Unless there are compelling reasons to develop special rules for nonassumed contracts, Ockham's rule prefers the simpler analysis within the existing framework of concept and doctrine. 402

The exclusionary analysis requires us to ignore the language and the structure of the Code. Andrew devotes considerable attention to the idea that rejection of a contract is not breach, 403 but the Code says "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach." 404 If, as I argue, treatment of rejection as breach leads straightforward and intuitively correct results, why read this language out of the Code? To adopt the exclusionary concept forces us to read section 365(a) as saying "the trustee may . . . assume or not assume" executory contracts. 405 All this twisting and bending

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401. Andrew, supra note 15, at 877-78. In his letter, Andrew emphasizes that my view that the estate's breach gives rise to the claim of the Other Party is central to our disagreement. Letter from Andrew, supra note 400, at 2. His view rests on the historical development of the doctrine, as well as his understanding of the intention of the drafters of the Code. I certainly agree that the measure of damages for breach (rejection) often refers to the effect of the debtor's discharge of the obligation giving rise to the claim, see supra note 219, but only when coupled with nonassumption by the estate.

402. W. OCKHAM, QUODLIBETA SEPTEM (1320).

403. Andrew, supra note 15, at 877-78.


405. See Andrew, supra note 15, at 848-49. Section 502 would be tacitly
of the language of the Code should be avoided unless some overriding problem of concept and policy compels it.

Even more fundamental are the problems the exclusionary analysis creates under section 541 (Property of the Estate). The estate includes "all legal or equitable interests of the debtor in property." Contract rights undoubtedly are property, as illustrated by the fact that billions of dollars in financing are secured by such rights (for example, accounts receivable). Indeed, expectancies much less concrete and certain are routinely included in the "property of the estate." Yet the exclusionary analysis requires us to exclude "unassumed" contracts in section 541. It also requires discovery of a provision in section 541 that admits a bundle of contract rights to the estate after assumption. Section 541(a) is carefully drafted to include in the estate interests in property acquired after bankruptcy by use of the avoiding powers. It even provides for post-petition acquisition of proceeds and profits and bequests. It has no provision for adding to the property of the estate those contracts that the exclusionary approach permits in the door only after assumption. The exclusionary concept has no foundation in the Code. Worse still, it forces us to evade and distort the whole structure of section 541, creating manifold possibilities for confusion and error.

The difference between the exclusionary and the functional approach is not merely conceptual. Conceptual differences nearly always have concrete and practical consequences, whether or not we think of them when we first form the concepts. Some of the operational differences between an exclusionary and a functional treatment of bankruptcy concepts are evident from the Andrew article.

Andrew is particularly concerned with the locus of an excluded contract, which he says remains in the original debtor. He says, correctly, that if the original debtor

amended to read: "A claim arising from the nonassumption . . . of an executory contract."

407. E.g., In re Dennison, 84 Bankr. 846, 846 (Bankr. S.D. Fla. 1988) (including NFL disability insurance coverage in estate); Professional Sales Corp. v. United States (In re Professional Sales Corp.), 48 Bankr. 651, 660 (Bankr. N.D. Ill.) (including pollution permit in estate), vacated on other grounds, 56 Bankr. 753 (N.D. Ill. 1985).
409. Id. § 541(a)(6).
410. Id. § 541(a)(5)(A).
411. See Andrew, supra note 15, at 879. Because of the confusion engen-
breaches or fails to perform the contract, the discharge relieves
that debtor of the resulting liability. The exclusionary ap-
proach, however, leaves open the opportunity for the original
debtor to attempt to proceed with the contract after the bank-
rupcy petition is filed. That consequence of excluding unas-
sumed contracts would create many problems.

The most important difficulty in permitting an original
debtor to claim the right to enforce a pre-bankruptcy contract
post-petition is that it is unfair to the Other Party, as well as a
trap for the unwary. In effect, it creates an assumption-rejec-
tion right in the original debtor, requiring the Other Party to
continue with a contract after the debtor has been stripped of
all of its assets. It establishes a new twilight world of perform-
ance and breach with no statutory time limits on assumption or
rejection and no court control. None of the protection the Code
provides to the Other Party as against the estate protects the
Other Party in this darkling outer world, with the ironic result
that the Other Party is protected in its dealing with the entity
with all the assets, the estate, but not with the destitute origi-
nal debtor. After a period of time under this legal regime,
well counseled Other Parties would re-insert bankruptcy or
ipso facto clauses in their contracts, and these clauses presum-
ably would be good against the original debtor. From that time,
the rule would be merely a trap for the unwary and under-
lawyered Other Party.

The whole notion that rejection merely creates a claim "as
if" the debtor had breached, an idea central to the exclusionary
analysis, apparently rests on the premise that bankruptcy
might not accelerate contract claims. Although that subject
is too large for extensive treatment here, the better part of the
little authority we have suggests that bankruptcy does acceler-
te all claims, at least in the sense that every pre-petition obli-
gation of the original debtor must be accounted for in the
bankruptcy case. The extraordinarily broad definition of

| 412. Andrew, supra note 15, at 877-78. |
| 414. Would performance by the original debtor (or its offer to perform) bar the "as if" breach claim contemplated by the exclusionary rule? |
| 415. See Andrew, supra note 15, at 878. |
| 416. See Andrew, supra note 15, at 882. |
| 417. See, e.g., General Motors Acceptance Corp. v. Bell (In re Bell), 700 |
claim in section 101,\textsuperscript{418} and the policies served by that sweeping definition, compel this result.\textsuperscript{419} That conclusion is re-enforced by the power given to the debtor in rehabilitation cases to maintain pre-bankruptcy contracts and financing agreements, a power unnecessary if they continue unaffected by bankruptcy in the absence of contractual default.\textsuperscript{420} Once again, the functional approach fits neatly within the existing structure and the detailed provisions of the Code, while the exclusionary concept requires us to invent whole new provisions and procedures. For example, Andrew feels compelled to develop a new definition of executory contract that threatens, in my view, to undo much of the good done by his analysis.\textsuperscript{421}

One of the points on which the exclusionary notion princi-

\textsuperscript{418} Claim means —

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

\textsuperscript{419} See supra note 215.


\textsuperscript{421} See Andrew, supra note 15, at 893 & n.174. For example, when the debtor holds a valuable land option on Bankruptcy Day, but owes no further performance, the Andrew definition would make the contract nonexecutory and therefore, presumably, nonassumable, for no good reason that I can see and to the prejudice of the estate and the unsecured creditors. See supra note 373 and accompanying text.
pally rests is the set of “ride-through” cases, in which contracts “ride-through” bankruptcy if they are neither assumed nor rejected, rather like a stowaway sneaking around the immigration shed and jumping back into the boat. The only “ride-through” provision in the Code preserves the rights of lienholders under certain circumstances of inaction. No equivalent provision exists for unsecured Other Parties. Yet it is said that they may sleep on their rights, pray for a mistake by the trustee, and grab hold of their part of the estate assets as the assets emerge from bankruptcy. It would be painful indeed if the Code required such a result, but happily it does not.

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Cases decided under the Bankruptcy Code: see, e.g., International Union, UAW v. Miles Mach. Co., 34 Bankr. 683, 686-87 (E.D. Mich. 1982); Central Control Alarm Corp. v. Black (In re Central Watch), 22 Bankr. 561, 565 (Bankr. E.D. Wis. 1982); see also NLRB v. Bildisco & Bildisco, 465 U.S. 513, 546 n.12 (1984) (Brennan, J., concurring and dissenting) (stating that “in the unlikely event that the contract is neither accepted nor rejected, it will ‘ride through’ the bankruptcy proceeding and be binding on the debtor even after a discharge is granted. . . . The nondebtor party’s claim will therefore survive the bankruptcy proceeding”); See also Andrew, supra note 15, at 879 & 880 n.142. Analogous to the claim that the rights of Other Parties may ride-through bankruptcy, is the assertion that an undersecured creditor can claim post-petition interest, even though both rights are given only to fully secured creditors under §§ 506(b), 506(d). The Supreme Court rejected the latter position as obviously inconsistent with the statute. United Sav. Ass'n v. Timbers of Inwood Forest Assoc's, 484 U.S. 36 (1988).

424. Andrew, supra note 15, at 879 & n.142. Analogous to the claim that the rights of Other Parties may ride-through bankruptcy, is the assertion that an undersecured creditor can claim post-petition interest, even though both rights are given only to fully secured creditors under §§ 506(b), 506(d). The Supreme Court rejected the latter position as obviously inconsistent with the statute. United Sav. Ass'n v. Timbers of Inwood Forest Assoc's, 484 U.S. 36 (1988).

425. Most of the cases Andrew cites as “ride-through” cases were decided under the old Bankruptcy Act. Generally they rest on the fact that a contract claim was not “provable” without rejection, so its holder did not get a bankruptcy distribution but did avoid discharge of its claim. Eg, Federal's, 555 F.2d at 581 (holding that default on unexpired lease of real property did not give rise to a provable claim and contract remained executory); Mohonk, 111 F.2d at 290 (holding that landlord does not become creditor with provable claim until tenant rejects lease). Andrew suggests that the changes wrought by the Code do not affect these cases. See Andrew, supra note 15, at 880 n.142. In fact, the abolishment of the requirement of “provability” and the dramatic ex-
The effect of a "ride-through" as described by Andrew is exactly the same as if the contract had been assumed by the estate. The estate must perform the contract or pay 100% U.S. dollars for breach. The same result is achieved by a doctrine of implied assumption. If that result is ever desirable and fair, implied assumption is the preferable analysis, because assumption is closely regulated by the Code and its effects are defined.

Other cases that Andrew cites really are "bar" cases, where the Other Party tries to get its claim recognized after plan confirmation. Some succeeded, at least to some extent, and some did not. Compare Mohonk, 111 F.2d at 290 (barring claim) with Alfaro Dairy, 458 F.2d at 1260 (allowing school board's milk contract claim as setoff against post-petition milk deliveries). See also Greenpoint, 113 F.2d at 884 (finding "ride-through" permitted payment of a rejection claim at 20%). None of these cases clearly stands for the ride-through proposition, despite Collier's adoption of their dicta. 8 COLLIER 14th, supra note 135, ¶ 3.15[10] & n.37 (citing Greenpoint); 2 COLLIER 15th, supra note 17, ¶ 365.03[2]; 5 id. ¶ 1123.02[1b]. Of the Code cases Andrew cites, one adopts the old Act cases with no analysis under the Code whatsoever. International Union, UAW, 34 Bankr. at 687. The other case, Central Watch, 22 Bankr. at 565, relies completely on In re Shoppers Paradise, Inc., 8 Bankr. 271 (Bankr. S.D.N.Y. 1980), discussed infra note 427.

426. See Andrew, supra note 15, at 879.

427. See Shoppers Paradise, 8 Bankr. at 278-79. Judge Schwartzberg's opinion clearly suggests that the contract was assumed by implication from the parties' conduct. Id. at 279. The opinion quotes the cases cited by Andrew for the "ride-through" principle, but it obviously is based on an idea of implied assumption. The case focuses on the status of a bankruptcy contract prior to assumption or rejection, a difficult and important point not addressed here. See, e.g., Skeen v. Denver Coca-Cola Bottling Co. (In re Feyline Presents, Inc.), 81 Bankr. 623, 626 (Bankr. D. Colo. 1988) (stating that "an executory contract under Chapter 11 is . . . enforceable against the nondebtor party prior to the debtor's assumption or rejection of the contract"). The equities protected in most such cases could be satisfied under the Code by a "use and benefit" analysis, rather than the straight-jacket of implied assumption. See, e.g., Broadcast Corp. v. Broadfoot, 54 Bankr. 606, 610-11 (N.D. Ga.) (use versus benefit in compensation for television transmission facility pending assumption or rejection; discusses principal "use and benefit" authorities), later proceeding sub nom. Broadcast Corp. v. Subscription Television, 177 Ga. App. 199, 338 S.E.2d 775 (1985), aff'd sub nom. In re Subscription Television, 789 F.2d 1530 (11th Cir. 1986). In both Shoppers Paradise and Central Watch, the nonbankrupt party tried to use executoriness to wriggle out of its obligations, and that "reverse twist" procedural posture may help explain the results. See Westbrook, supra note 61, at 620 n.100 (discussing Tobin v. Plein, 301 F.2d 378 (2d Cir. 1962) (addressing nonbankrupt party's argument that court should use trustee's "avoiding" powers against the trustee)).
in the Code and the caselaw, while "ride-through" takes us to
an extra-Code no-man's-land.

Assumption is supposed to be approved by the court. In
a Chapter 11 case, it is often part of the plan approved by the
creditors. Implied assumption, or any result with the same
effect, like "ride-through," violates these statutory commands
and offends the policies that these commands enforce. It
defeats court control over preferential treatment of a pre-pet-
tion claim, creates a special, hidden class of preferred creditors,
and may materially mislead creditors voting on a plan. It ought
not to be permitted except on a clear showing that the equities
are substantially in favor of assumption, considering not merely
the debtor's conduct and interest, but the other creditors as
well. If a contract is to "ride-through" bankruptcy, it should
be on the basis of that sort of strict scrutiny and not by an ex-
tra-statutory conceptual twist.

The principal reason that the exclusionary analysis is so in-
consistent with the statutory scheme is that modern bank-
ruptcy law rests upon the fundamental policy of "once and for
all," resolving all of the debtor's pre-petition affairs in one pro-
ceeding. Under the Act, concepts like "provability" caused
many types of claims to be denied distribution, on the one
hand, and to survive to taint the fresh start, on the other. The
Code, in its broad definition of claim and otherwise, was
designed to make bankruptcy a true financial watershed, for
natural persons and for reorganizing corporations. The enor-
mous social and financial problems in cases like Kane v. Johns-
Manville Corp. and Grady v. A.H. Robbins Co. never could
have been resolved, and no plan acceptable to financiers and
markets could have been confirmed, without this all-embracing,
now-and-forever approach. The exclusionary concept runs
against this tide of modern bankruptcy law and thus is thor-
oughly inconsistent with concepts and rules throughout the

429. See Epling, supra note 96, at 192-93.
430. See Andrew, supra note 15, at 880 n.143 (discussing difficulties
presented by ride-through rule).
431. See HOUSE REPORT, supra note 50, at 180, 309, 1978 U.S. CODE CONG. &
ADMIN. NEWS at 6140-41, 6266.
432. 843 F.2d 636, 639 (2d Cir. 1988) (dealing with claims against major
manufacturer of asbestos products).
433. 839 F.2d 198, 199 (4th Cir.) (addressing claims against manufacturer of
201 (1988).
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Code.434

One key reason that Andrew and I are so far apart in concept, despite agreement on a number of the crucial issues in the treatment of bankruptcy contracts, is that we have different

434. The new intellectual property amendment is consistent with the analysis presented here and therefore inconsistent with the Andrew approach. See 11 U.S.C.A. § 365(n) (West Supp. 1989). The amendment is modeled on § 365(h)(1), which protects the Other Party as lessee or vendee of real property if the estate rejects. See S. Rep. No. 505, 100th Cong., 1st Sess. 4, reprinted in 1988 U.S. CODE CONG. & ADMIN. NEWS 3200, 3202-03 [hereinafter SENATE AMENDMENT REPORT]. Like those provisions, the new § 365(n) gives the Other Party an option to accept rejection and proceed on the basis of breach under nonbankruptcy law, or to retain its pre-bankruptcy interest in the property.

Section 365(n) differs from the earlier provisions with regard to damages for rejection. Although all three require the Other Party to continue contractual payments, it appears that § 365(n) provides the Other Party with a different form of relief for damages caused by the rejection. Sections 365(h)(2) and 365(i)(2)(A) permit the Other Party to set off its damages from rejection against the payments due, balancing this offset right by imposing a forfeiture of the Other Party's right to assert a damage claim beyond the offset. See 2 COLLIER 15th, supra note 17, ¶ 365.09 to -10. Section 365(n) gives the Other Party relief that is the reverse of that given by §§ 365(h) and (i). Under § 365(n), the Other Party may make a claim for rejection damages under § 502(g), but may not offset that claim against the estate's entitlement to royalties. See SENATE REPORT, supra note 50, at 10, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5796; 2 COLLIER 15th, supra note 19, ¶ 65.13.

The results commanded by all three provisions are close to what would emerge from functional analysis in their absence, assuming that nonbankruptcy law gave the Other Party an ITI. On that assumption, the principal difference is that a functional analysis is better for the Other Party because it permits both setoff and a rejection-damage claim. With this exception, the new amendment is symmetrical with functional analysis, assuming an unavoidable nonbankruptcy ITI, because the new provision is not intended to make any change in the estate's avoiding powers. See SENATE REPORT, supra note 50, at 11, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5797. Therefore, under a functional regime the new amendment, along with the other two provisions, are unnecessary to the extent they track the proper result under nonbankruptcy law.

On the other hand, these three sections may give the Other Party greater rights than it has under nonbankruptcy law in cases where nonbankruptcy law does not give the Other Party an ITI. To the extent that they do give greater rights to an Other Party, these sections represent congressional mistakes, unless Congress intended to make special policy judgments that such interests should receive greater protection in bankruptcy than under nonbankruptcy law. Because the legislative history contains no hint of such policy conclusions, see HOUSE REPORT, supra note 50, at 349-50, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6305-06; SENATE REPORT, supra note 50, at 60, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5846; SENATE AMENDMENT REPORT, supra, passim, these sorts of provisions create the risk that Congress is changing state law entitlements in bankruptcy without recognizing that it is doing so and without a good reason.
views of the statutes' development and of the role of Professor Countryman's analysis in that development. Although Andrew's discussion of the history of bankruptcy contracts is interesting and illuminating, I disagree that the nineteenth century "title" view of bankruptcy contracts is close to the correct approach, and that the material breach test is a wrong turning. I have stated my contrary view that the caselaw before Countryman was a conceptual morass and that the statutory moves in the correct direction were a triumph of practical intuition over conceptual confusion. Professor Countryman's material breach test was a vital step forward in the proper understanding of bankruptcy contracts. That is why so many experienced judges adopted it. By standing on his shoulders, we can see past the conceptual problems that bedeviled those nineteenth century courts to a solution that reunites the treatment of contracts in bankruptcy with the treatment of all other kinds of property and claims.

VI. PRECEDENT

Even the reader who feels attracted by a functional analysis of bankruptcy contracts may feel that this whole, long, forest-destroying discussion is rather pointy headed, given the firm establishment of executoriness in the precedents and in the Code itself. The judicial reader who likes this analysis may be especially frustrated, seeing no point in learning to solve these problems in a way forbidden by the law. There are at least two approaches to an answer.

One is that the judge could become a "closet functionalist." Locking the door to chambers, the judge could functionally analyze bankruptcy contracts and then emerge to announce a result in terms of executoriness, leaving precedent safely undisturbed. Because executoriness is almost infinitely manipulable, this approach would almost always work. If the judge is concerned about the need for intellectual assistance from the lawyers in a system that presupposes an adversarial framing of the issues and development of a record, the judge could invite the lawyers into chambers for functional analysis among consenting adults. Or a cryptography could be developed, with the

435. See Andrew, supra note 15, at 850.
436. See generally id. at 874 & n.122, 875 & n.129.
437. See supra notes 29-35 and accompanying text.
438. See Fogel, Executory Contracts and Unexpired Leases in the Bankruptcy Code, 64 Minn. L. Rev. 341, 344 & n.12 (1980).
lawyers presenting the functional analysis of a case hidden in the statement of facts (the facts being the key to functionalism), while translating the desired result into executoriness terms in the memorandum of points and authorities.

All this would be quite practical. A number of cases already come close to doing just that. Cases, like Richmond, that suggest an executory contract "power," can be solved without questioning the executoriness approach by showing that they are really avoidance power cases, and by finding that certain aspects of performance are final under state law. The court could hold that the trustee cannot use rejection to rescind and "get the onions back," even if the contract is executory. Nearly all the remaining contract cases can be solved, as we saw, by finding the contract executory, so that the trustee can assume or reject, whichever maximizes the estate. The existence of Ancillaries, especially passive, negative ones, like not enjoining the Other Party from doing something, makes it easy to find a contract executory, and therefore to permit the trustee to do the best thing. Thus, a hidden substratum of functionalism might work well in practice, although at the cost of that candor so dear to Professor Llewellyn and those of us who admire him.

The alternative is to abolish the requirement of executorness as a threshold requirement for performance or breach. This direct approach might seem to fly in the face of the Code, which authorizes the assumption or rejection of executory contracts, especially since the legislative history refers to the material breach test. Yet the legislative history does not adopt the material breach test, but only says that the test is a good example of the general understanding of the phrase executory contract. A number of opinions suggest that Congress delib-

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439. E.g., In re Norquist, 43 Bankr. 224, 225-26 (Bankr. E.D. Wash. 1984) (discussing functional nature of an executory contract in bankruptcy); In re Adolphsen, 38 Bankr. 780, 781 (D. Minn. 1983) (stating that it is "inappropriate to apply a generalized rule such as in Countryman to all situations").


441. See supra notes 274 and accompanying text.

442. See Wiseman, The Limits of Vision: Karl Llewellyn and the Merchant Rules, 100 HARV. L. REV. 465, 470 (1987) (discussing Llewellyn's realist theory and his "belief that legal rules must relate to the facts and must fit the realities of the transactions they govern").

443. See supra note 50 and accompanying text.

444. Id.
erately left the definition open, and that the courts are free to continue caselaw development. 445

Given that position, the courts might decide to look at contract rights and obligations one by one, as functionalism suggests, bundling together those rights that arise from a "single contract" under nonbankruptcy law to the extent that nonbankruptcy law makes realizing some of the rights depend on performance of some of the obligations. Courts could then interpret the congressional references to the material breach standard as exemplary. They could find a congressional intent to permit the courts to continue common law development of a fuller understanding of executoriness. In that case, the term "executory" could be used in its ordinary sense: A contract is executory when there is any right or obligation unperformed or unsatisfied on the date of bankruptcy. A functional analysis could proceed from there.

In fact, judicial criticism of the material breach test is increasing, 446 although much of that criticism is unfair. The problem is the threshold requirement of executoriness that the material breach test first brought under rational control. Yet those courts uneasy with the material breach test certainly might be inclined to look for ways to avoid the problem by eliminating the unnecessary and confusing requirement of executoriness.

Given the confusion in the courts, it is difficult to claim that commercial expectations would be seriously threatened by this redefinition of executory contracts, or by the proposed new analysis. Instead, the commercial world would be relieved from


446. For example, one opinion suggests that the material breach test is helpful, but should not be exclusive:

Countryman's definition is somewhat simpler and more easily applied [than Jolly's] in that the relevant facts may simply be plugged into the formula and a clear answer produced. Yet, Countryman himself probably did not intend such a result, for he recognized the principle recited in Jolly. . . . Thus, it would appear that Professor Countryman recognized that no all-purpose definition of an 'executory contract' in bankruptcy was possible, but that the courts could establish certain threshold elements of inquiry which could be useful.

guarding against unbounded threats to expectations presented by cases like *Richmond*, as well as the dilution of predictability resulting from the present eccentric results throughout the field of bankruptcy contracts.

Finally, courts sympathetic to the functional approach could do a bit of both, analyzing functionally but adapting to existing doctrine, until the executoriness doctrine quietly ceases to matter, like the veriform appendix.

However the courts proceed, a proper analysis of bankruptcy contracts would enable us to avoid congressional reactions like the recent intellectual property amendment. It is sometimes necessary for Congress to create exceptions to bankruptcy rules, because some nonbankruptcy policy may be overriding. It is clearly not a good idea, however, to solve our conceptual confusion about bankruptcy contracts by burdening the Code with endless exceptions arising from our confusion rather than from the policies underlying bankruptcy law. Such an approach invites unfair special treatment based on political advantage. It invariably creates a different set of rules for certain kinds of contracts in bankruptcy, without any congressional determination that different bankruptcy treatment is appropriate as a matter of federal commercial policy.

**CONCLUSION**

After such an arduous journey, a closing summary is the least I can do. The four basic propositions of this article are:

1. There should be no threshold requirement that a contract be “executory” as a prerequisite to assumption or rejection (performance or breach) by the trustee. The trustee may, indeed must, assume or reject every pre-bankruptcy contract of the debtor that is not completely performed or satisfied on Bankruptcy Day.

2. The trustee’s contract rights are the same as those of the pre-bankruptcy debtor, except that under the equality of distribution principle, the trustee may pay for breach in tiny Bankruptcy Dollars, which makes breach profitable for the trustee much more often than for a nonbankruptcy party, and the Other Party cannot get specific performance of a

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448. *See supra* notes 106-14 and accompanying text; Section III. A.
449. *Id.*
450. *See supra* text accompanying note 120.
451. *See supra* notes 121-32 and accompanying text.
purely contractual covenant. The trustee's financial decision to perform or breach is made in light of the estate's right to pay in tiny Bankruptcy Dollars and its immunity from specific performance.

3. The major exception to the equality principle is that bankruptcy courts enforce a state-law interest in a specific asset of the debtor, an ITI. When a contractual covenant is not purely contractual (a general claim against the debtor and its assets), but instead creates an ITI, then the Other Party can obtain enforcement — specific performance — of its ITI.

4. The avoiding powers limit the enforcement of state-law ITIs created by contract. If an ITI is avoidable, it is not enforceable against the trustee and the analysis proceeds as if no state-law ITI exists.

In a court that adopts a functional approach to bankruptcy contracts, the trustee's analysis proceeds almost backwards through the foregoing propositions in analyzing each pre-bankruptcy contract that is not fully performed or satisfied before Bankruptcy Day:

1. Does this contract create a state-law ITI?
2. If the contract gives rise to a state-law ITI, is the ITI avoidable?
3. A) If there is no ITI, or only an avoidable one, will the estate profit more from performance of this contract, or from breach and payment in Bankruptcy Dollars?
   B) If the ITI is unavoidable and therefore enforceable, will the estate profit more from performance or breach, given that any breaches of the other covenants in the contract will be payable only in Bankruptcy Dollars?

Following the trustee's analysis, the court must evaluate the additional question of the equities of the case where the benefits of the bankruptcy remedy rules appear to flow to a DIP or debtor. The court should evaluate alleged abuses on the basis of the policies underlying discharge (including the possibility of denial of discharge) and, in Chapter 11 cases, upon

452. See supra notes 133-37 and accompanying text.
453. See supra notes 138-50 and accompanying text.
454. See supra notes 151-56 and accompanying text.
455. See supra notes 190-205 and accompanying text.
456. Id.
457. See supra note 308 and accompanying text; Section IV. C. 3.
458. See supra Section II. F; supra note 308 and accompanying text.
the policies related to cramdown.\textsuperscript{459}

The study of contracts in bankruptcy illustrates that the joys and the frustrations of bankruptcy law are intimately intertwined. Its youth and complexity make it a fascinating object of study. Yet the difficulty of some of its problems, and the lack of a complete theoretical understanding of its functioning, too often leads its students, especially overburdened judges, to throw up their hands and “do equity.” That recourse is usually a serious error. To some extent, the doctrines of Dean Jackson and some other scholars, who seek to rein bankruptcy within a very narrow intellectual and policy compass,\textsuperscript{460} may represent an overreaction to the chaos threatened by “doing equity.” This reaction may be strengthened by a deep suspicion of bankruptcy judges,\textsuperscript{461} the judges of the fourth clause.\textsuperscript{462}

Those of us who believe that American bankruptcy laws, especially the “chapter” proceedings,\textsuperscript{463} are richly complex and do not lend themselves to simple theoretical explanations,\textsuperscript{464} must do considerable work to unravel their complexities. In treating bankruptcy contracts, as elsewhere, the bankruptcy bench has done a remarkable job, but it is the task of the academic community to offer theoretical help. Decisions like Richmond\textsuperscript{465} and Booth\textsuperscript{466} leave bankruptcy law too unbounded and too greatly unsettle the commercial world that bankruptcy serves. Yet the narrow premises of scholars like Dean Jackson are unpersuasive to many who believe bankruptcy law is more than the Creditors’ Dilemma.\textsuperscript{467} The middle ground is the pa-

\textsuperscript{459} 11 U.S.C. § 1129(b) (1988); id. §§ 1322, 1325; see supra notes 309-18 and accompanying text.
\textsuperscript{460} See Jackson, supra note 74, at 10-13.
\textsuperscript{461} See Baird & Jackson, supra note 104, at 126-28.
\textsuperscript{462} U.S. CONST. art. I, § 8, cl. 4. The reference is by analogy to the phrase coined for federal judges by my late, distinguished colleague, Bernie Ward: “the judges of the Third Article.” Wright, The Wit and Wisdom of Bernie Ward, 61 Tex. L. Rev. 13, 19 (1982). It is interesting that leading practitioners, as well as academics like me, who have had substantial experience in bankruptcy practice, have a very different view of bankruptcy judges.
\textsuperscript{463} The “chapter” proceedings are Chapters 11 and 13, the “payout” chapters. 11 U.S.C. §§ 1101-74, 1301-30 (1988).
\textsuperscript{464} See Nimmer, supra note 104, at 1011; Warren, supra note 101, at 811-14.
\textsuperscript{465} Lubrizol Enters. v. Richmond Metal Finishers, Inc. (\textit{In re Richmond Metal Finishers, Inc.}), 756 F.2d 1043 (4th Cir. 1985), cert. denied sub nom. Lubrizol Enters. v. Canfield, 475 U.S. 1057 (1986), discussed supra Section IV. B.
\textsuperscript{466} \textit{In re Booth}, 19 Bankr. 53, 58 (Bankr. D. Utah 1982).
\textsuperscript{467} See Jackson, supra note 74, at 10 & n.9 (describing creditors’ choices as
tient work of scholarship. I will be gratified if this Article contributes to that work.

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a type of prisoner's dilemma when the debtor's estate is insufficient to satisfy all claims).