1974

Executory Contracts in Bankruptcy: Part II

Vern Countryman

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation

https://scholarship.law.umn.edu/mlr/2460

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
Executory Contracts in Bankruptcy: Part II

Vern Countryman*

Originally, an assignee in bankruptcy taking title to the bankrupt's property could elect to abandon that which was worthless or onerous, including executory contracts. With the amendment of the Bankruptcy Act in the 1930's, Congress codified this option with respect to executory contracts but nowhere undertook to define that elusive term. In Part I of this Article, Professor Countryman defined "executory contract" in the light of the purpose for which the bankruptcy trustee is given the option to assume or reject. Finding the Willistonian meaning of the term too expansive for the purposes of the trustee's option, Countryman concluded that within the meaning of the Bankruptcy Act an executory contract is one under which the obligations 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. With this definition as a touchstone, Professor Countryman began to dredge the morass of judicial analysis of the trustee's option with respect to specific kinds of contracts: (1) land contracts and (2) contracts for the sale of goods. Part II of this Article opens with a continuation of this discussion with respect to (3) employment contracts.

3. Employment Contracts

The bankruptcy trustee's option to assume or reject an executory contract evolved from the judicial doctrine that permitted abandonment of worthless or onerous property the title to which had passed from the bankrupt to the trustee.220 The trustee's exercise of the option to assume or reject an employment contract is thus limited in two respects: (1) the employment contract must be an executory contract; and (2) the title to the contract must pass to the trustee under section 70a of the Bankruptcy Act.221

---

*Professor of Law, Harvard Law School. Part I of this article appeared at 57 Minn. L. Rev. 439 (1973).

220. For a discussion of the origins of the right of the trustee to abandon executory contracts which he finds to be worthless or onerous, see Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 440, 456 (1973) [hereinafter cited as Countryman, Part I].

221. 11 U.S.C. § 1110 (1970). Since U.S.C. section numbers do not correspond to the section numbers of the Act as enacted, cross references to U.S.C. Title 11 will be noted herein. Section 77B of the Act has been superseded by the provisions of Chapter X, and thus no cross references will be provided.
In the absence of a collective bargaining agreement, many employment relationships involve no contract at all. When the employee has been fully compensated for the services he has rendered, there remains at most an outstanding offer by the employer to pay for future services at an established rate. Such an offer can be revoked by the employer at any time before additional services are performed by the employee.

When the employee has not been fully compensated for all the services he has rendered, he retains a claim against the employer for those services. The contract upon which the employee's claim is based is unilateral because only the employer has made a promise, and such a contract is not executory as that term has been defined under the Act because no further performance is owing from the employee. In the event of the employee's bankruptcy, he would have a claim for wages which would pass to his bankruptcy trustee under section 70a unless the claim was exempt. The bankruptcy trustee would not, however, have an executory contract which he could assume or reject. Thus, the employer could gain neither a first priority claim against the employee's estate as a result of the trustee's assumption of the contract nor a provable claim for damages against the estate as a result of the trustee's rejection of the contract. In the event of the employer's bankruptcy, the trustee would not assume the contract so as to elevate the employee's wage claim to a first priority expense of administration, and provability and possible second priority of the em-

222. 1 A. Corbin, Contracts §§ 21, 70, 96 (1963); 1 S. Williston, Contracts § 39 (3d ed. 1957).
223. See Countryman, Part I, at 460.
225. Section 64a(2) provides a second priority for "wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling, or city salesmen...." 11 U.S.C. § 104(a)(2) (1970). In view of the classes of claimants specified, the courts have attempted to limit the priority to those in "menial" or "subordinate" positions and to exclude executives. See, e.g., Frasher v. Robinson, 458 F.2d 492 (9th Cir.), cert. denied, 409 U.S. 1009 (1972); In re Ko-Ed Tavern, 129 F.2d 806 (3d Cir. 1942); Blessing v. Blanchard, 223 F. 35 (9th Cir. 1915). For those entitled to claim the priority, however, the term "wages" has been found sufficiently broad to cover a variety of fringe benefits. The chief difficulty with fringe benefits is the determination whether they were "earned" within three months of bankruptcy. See, e.g., In re Ad Serv. Engraving Co., 338 F.2d 41 (6th Cir. 1964) (vacation pay allocated in part to three month period; severance pay found not to be wages because not "earned"); United States v. Munro-Van Helms Co., 243 F.2d 10 (5th
ployee's claim would not be affected by the trustee's rejection of the contract.

The conclusion that a contract is unilateral and therefore not executory within the meaning of the Act is often obviated in actual decision. Courts frequently avoid the determination that an employment contract is unilateral by finding evidence that the employee and the employer intended to make mutual

Cir. 1957) (vacation pay allocated in part); Division of Labor Law Enforcement v. Sampsell, 172 F.2d 400 (9th Cir. 1949) (same); In re Public Ledger, 161 F.2d 762 (3d Cir. 1947) (vacation and severance pay allocated in part). See also Kavanas v. Mead, 171 F.2d 195 (4th Cir. 1948). NLRB back pay awards are entitled to a second priority to the extent allocable to the three-month period. Nathanson v. NLRB, 344 U.S. 25 (1952). However, the employer contributions to a union welfare fund under a collective bargaining contract which were made to a trustee at a flat rate of $8 per month per employee and in which no employee "had any right whatsoever" have been held to be neither "wages" nor "due to workmen." United States v. Embassy Restaurant, 359 U.S. 29 (1959). See also Joint Indus. Bd. v. United States, 391 U.S. 224 (1928). But Sulmeyer v. Southern Calif. Pipe Trades Trust Fund, 301 F.2d 768 (9th Cir. 1962), gives second priority to an allocable part of employer contributions to trustees under a union vacation fund where the contributions were calculated at a percentage of each employee's gross pay and where the employees had a right to draw against the fund for holidays and annual vacations.

The priorities prescribed by § 64a, including the wage priority, are expressly made inapplicable in Chapter X cases by § 102, 11 U.S.C. § 502 (1970); and § 77b provides that "unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority." 11 U.S.C. § 205 (1970). The latter provision has been held to incorporate the "six-month rule" formerly employed in equity receiverships of railroads and public utilities. Under this rule current debts for wages, supplies, traffic balances and repairs incurred by the debtor within a reasonable period prior to the receivership, usually but not invariably six months, were given priority of payment from operating income. Southern Ry. v. Flournoy, 301 F.2d 847 (4th Cir. 1962); In re Chicago & N.W.R.R., 110 F.2d 425 (7th Cir. 1940). On the theory that the justification for this rule was that the particular claimants favored by it had "relied in extending credit on the availability of current income" for payment, the rule was held inapplicable in the pending reorganization of the New Haven because that road had no net operating income during the six months preceding approval of the petition nor thereafter. In re New York, New Haven & Hartford R.R., 405 F.2d 50 (2d Cir. 1968), cert. denied, 394 U.S. 999 (1969).

Under § 197 a Chapter X judge is authorized to classify claims, and there has been some limited and selective invocation of the six-month rule in Chapter X cases where the debtor is not a public utility. 11 U.S.C. § 597 (1970). See In re Hallmark Medical Servs., Inc., 475 F.2d 601 (5th Cir., cert. denied, Martin v. Mizrahi 94 S. Ct. 359 (1973); In re Yale Express Sys., Inc., 342 F. Supp. 972 (S.D.N.Y. 1972); GA W. COLLOPS, BANKRUPTCY § 5.13 [3] (14th ed. 1972).
promises of service and payment for a fixed or for a reasonable period of time.\textsuperscript{226}

Even where there is an executory employment contract, however, it may not pass to the trustee of the bankrupt employee or employer\textsuperscript{227} so as to allow the trustee to assume or reject the contract. The trustee will be denied this option with respect to a “personal contract,” a label which may be unfortunate and misleading\textsuperscript{228} but one which nonetheless springs from the sound doctrine that the performance called for by the contract may be so “personal” to the bankrupt that it cannot

\begin{itemize}
\item \textbf{226.} 1 A. Corbin, \textit{Contracts} § 70 (1950); 1 S. Williston, \textit{Contracts} § 39 (3d ed. 1957). See, e.g., Whightsel v. Felton, 95 F. 923, 924-25 (S.D. Ohio 1899), where an injured railroad employee had settled his claim against the road in return for $630 and the promise of the road to employ him as a conductor for so long as he was able to serve or until he was given a written statement of cause for dismissal. The court found that the employee “promised to serve the railroad company” so that “there was complete mutuality of obligation” and that the employee had an unsecured claim for damages against the estate when the road went into receivership and the receiver dismissed him without written statement of cause. But the court also held that the employee's damage claim was not of a first priority status because the receiver had not assumed the employment contract merely by employing the conductor for almost a year before discharging him. The money paid to the employee for his services to the receiver was said to be “a part of the operating expenses of the road,” but to elevate his damage claim to that level “would be inconsistent with, and in frustration of, the purposes for which the receiver was appointed.”
\item \textbf{227.} E.g., the employer of a personal secretary.
\item \textbf{228.} Not all employment contracts are “personal contracts” nor are all “personal contracts” employment contracts. For example, it has been assumed that the trustee does not take title to the bankrupt's executory contract to purchase real estate on credit, Texas & N.O.R.R. v. Phillips, 196 F.2d 892 (5th Cir. 1952), and it has been held that the trustee of a bankrupt brewer cannot assume and sell to another the bankrupt's executory contract to supply its beer to a customer, Jetter v. Scollan, 48 Misc. 546, 96 N.Y.S. 274 (Sup. Ct. 1905), aff’d 114 App. Div. 902, 100 N.Y.S. 1112 (1906).
\end{itemize}

For cases where the court was misled by the label “personal contract” into overlooking the fact that the bankrupt had performed all of his nondelegable services before or after bankruptcy, see Countryman, \textit{The Use of State Law in Bankruptcy Cases} (Part I), 47 N.Y.U.L. Rev. 407, 464 (1972). Of course, any money earned by an individual bankrupt for his “personal” efforts after the petition is filed does not pass to his bankruptcy trustee. \textit{Id.} at 449-62. Hence, where a corporation discharges its manager after his bankruptcy and in breach of his employment contract, the damage claim represents a loss of post-bankruptcy earnings and does not pass to his bankruptcy trustee. Villar & Co. v. Conde, 30 F.2d 588, 590 (1st Cir. 1929). Although the court decided that “neither the contract nor the right of action passed to the trustee,” it would doubtless have awarded the trustee non-exempt salary accrued and unpaid at bankruptcy had there been any.
be delegated to his trustee or to one to whom the trustee may sell the contract. The doctrine would doubtless apply so that the trustee could not perform the employment contract of an actress, a musician, a professional football player or even a law professor. Conversely it is unlikely that the doctrine would prevent the trustee's performance of the employment contract of a ditch digger, a street cleaner or a dishwasher. This comes very close to saying that the trustee of the employee only takes title to an executory contract of employment in cases where he would not want to assume it and where the employer would not be damaged by its rejection. It is not surprising, therefore, that most cases dealing with executory employment contracts have arisen in the bankruptcy proceedings of the employer.

Although the trustee would thus not be able to reject the "personal" employment contract of the bankrupt employee, the employer would nonetheless have a provable claim for damages if such an employee ceased performance before or after his bankruptcy. It should be enough for provability under § 63a(4), 11 U.S.C. § 103(a)(4) (1970), that the employment contract was in existence at bankruptcy, even though the breach may have come later. The only problem with such a claim might arise under § 57d, 11 U.S.C. § 93(d) (1970), which requires that the damages be "capable of liquidation or of reasonable estimation" without unduly delaying the administration of the estate. Only if this requirement were not met would the claim be deemed not provable under § 63d, 11 U.S.C. § 103(d) (1970), and hence not dischargeable under § 17a, 11 U.S.C. § 35(a) (1970). See notes 46, 56, and 57, Countryman, Part I. Thus the court in Savoy Record Co. v. Mercury Record Corp., 108 F. Supp. 957, 958-959 (D.N.J. 1952), a modern version of Lumley v. Gye, 2 El. & Bl. 216, 118 Eng. Rep. 749 (1853), arguably reached a correct result despite its incorrect analysis of the discharge issue. In Savoy, a singer under a recording contract with Savoy filed a voluntary petition in bankruptcy listing Savoy as his only creditor. After obtaining a discharge of his "debt" to Savoy, he signed a new contract with Mercury Records. Savoy then sued Mercury to enjoin Mercury's manufacture and sale of the singer's records on the theory that Mercury had induced a breach of his contract with Savoy. Mercury defended on the ground that Savoy's contract with the singer had been discharged in bankruptcy. Because "no monies were due to flow from [the singer] to plaintiff under that executory contract for services," the court concluded that the "petition in bankruptcy was filed for the sole purpose of evading" the singer's contract with Savoy. As the singer was thus not an "honest but unfortunate debtor" for whom the bankruptcy discharge was intended, a preliminary injunction issued pending trial. The Savoy court could have reached the same result by sounder reasoning had it recognized that damages are frequently awarded against parties from whom "no monies were due to flow" under their contracts and that Savoy's contract claim against the singer may well have been discharged. The court could then have held that this discharge did not cover any tort claim Savoy had against Mercury.

The one exception seems to be Villar & Co. v. Conde, 30 F.2d 588 (1st Cir. 1929), discussed supra note 228.
treatment of these cases it will be useful to distinguish between individual employment contracts and collective bargaining contracts.

a. Individual Contracts

In the straight bankruptcy liquidation of an employer, the trustee will not often assume an executory individual employment contract. Such a contract would be assumed only where the trustee continues the business with the intent to sell it as a going concern or where the trustee intends to sell the contract of a particularly valuable employee. If the trustee does assume the contract, any compensation earned but not paid to the employee at the time of bankruptcy is a nonpriority claim unless some part of it qualifies for a second priority under section 64a(2). Any compensation earned by and payable to the employee under the contract after the bankruptcy and prior to sale of the contract is a first priority expense of administration. If the trustee does not assume the contract within the time fixed by section 70b, he will be deemed under that section to have rejected it. Such a rejection is treated by section 63c as a breach of the contract as of the date of the filing of the bankruptcy petition.

In the event of such a breach the employee has both a nonpriority provable claim for loss of future earnings and a provable claim for compensation earned and unpaid at the time of bankruptcy. Again, some part of this latter claim may qualify for second priority treatment.

But even this much must be deduced from the face of the Act. The only straight bankruptcy case which is relevant to the above analysis of the trustee's option was decided before the Bankruptcy Act made express provision for the treatment of executory contracts. In this case a corporate vice-president attempted to prove a claim for his future salary for the unexpired balance of a five-year contract. Judge Learned Hand

---

231. In the latter case the bankrupt employer's obligations under the individual contract must be delegable to the intended purchaser.


233. Id. § 110(b). See text accompanying note 48, Countryman, Part I.


235. In re Montague & Gillet, Inc., 212 F. 452 (S.D.N.Y. 1914). See also Erie Malleable Co. v. Standard Parts Co., 299 F. 82 (6th Cir. 1924), rejecting the claim of a corporate vice-president with a two-year em-
dismissed the claim as not provable without discussion of the issue of assumption or rejection of the contract. Hand reasoned that if the claim were treated as a claim for future installments of salary at the contractual rate it would be contingent and therefore not provable because dependent on performance of future services. If the claim were treated as one for damages arising from the anticipatory breach of contract caused by the employer's bankruptcy, it would also be contingent and therefore not provable. The employee would have the option either to terminate his employment and sue for damages or to tender his services and sue for payment as his salary came due. Under the latter alternative the employee would subject "himself to the risk of having taken by way of set-off the estimated value of his services, rather than his actual earnings . . . ."

Hand's decision, questionable even in 1914, would likely be different today. Because the trustee took no action within the time prescribed by section 70b, the employment contract would be deemed rejected by the trustee, and the rejection would be treated as a breach as of the time the bankruptcy petition was filed. Section 63a(8) now expressly provides that contingent claims are provable, and section 57d provides that both contingent and unliquidated claims shall be allowed if their amount can be "liquidated or estimated" without undue delay in the administration of the estate. Thus only if the employee's claim could not have been liquidated or estimated without such delay would it have been not provable under sec-

employment contract. The claimant had been allowed by a receiver for his employer to serve out the balance of his term at the salary specified in the contract, but the court refused to conclude that the receiver had thereby renewed his contract for an additional year. A variety of reasons was advanced: (1) the receiver had no authority to renew the contract without court approval; (2) the receiver did not know of the existence of the contract and the vice-president did not advise the receiver of it although he knew it was the receiver's policy to have continuing contracts approved by the court; and (3) the vice-president knew before his contract expired that the receiver planned to recommend to the court that the business be liquidated and that there would thus be no need for the vice-president's services.

236. Hand regarded such a theory as questionable. See text accompanying notes 375–76 infra.
238. Not only is the meaning of Hand's discussion of the employee's alternatives problematical, but his assumption that contingent claims were unprovable is questionable. See note 56, Countryman, Part I.
240. Id. § 103(a) (8).
241. Id. § 93(d).
tion 63d and therefore not dischargeable under section 17a.

Where the issue of the executory individual employment contract arises in chapter cases of the employer, the governing statutory provisions are somewhat different from those in a straight bankruptcy. Inapplicable is the provision of section 70b which fixes a time within which the trustee may assume or reject a contract and which provides that a contract not explicitly assumed within that time shall be deemed rejected. As a result, contracts may be assumed or rejected by the trustee, receiver or debtor in possession prior to the confirmation of a plan if the court approves, or the contract may be assumed or rejected by a confirmed plan. Only if a contract has been explicitly rejected in one of these ways is the other contracting party treated as a creditor with a claim in the proceeding.

In re Greenpoint Metallic Bed Co. is illustrative of the fact that a claimant cannot rely on a statutorily imposed rejection of his contract in a chapter case. In the Chapter XI case of the employer, the debtor in possession had done two things which might have indicated a rejection of the individual employment contract of the employee. It had refused to allow the employee to work while the case was pending and had notified the employee prior to confirmation that the contract was terminated because of an alleged but nonexistent breach by the employee. Moreover, prior to confirmation the employee had asked the referee to determine the status of his contract and the referee had erroneously failed to order the contract rejected. Nonetheless the court refused to recognize the employee as a creditor with a claim in the case because the case had culminated in an unappealed confirmation order. The employee had not obtained a court-approved rejection of his employment contract either prior to confirmation or as a part of the plan of arrangement. Although the employee was therefore not a creditor, "he [was] not helpless, for he [could have

242. Id. § 103(d).
243. Id. § 35(a).
244. Id. § 110(b).
245. See text accompanying note 546 infra.
246. Under most of the chapter proceedings, if a trustee or receiver is not appointed, the debtor may be continued in possession with all of the powers of a trustee. Bankruptcy Act §§ 188, 342, 444, 11 U.S.C. §§ 588, 742, 844 (1970).
247. See text accompanying notes 540-41 infra.
248. 113 F.2d 841 (2d Cir. 1940).
249. The employee's appeal from this treatment by the referee provided the occasion for the Second Circuit ruling.
insisted] that his contract be either rejected or assumed under the plan and [could have applied] to the bankruptcy court to protect his interest at the confirmation hearing or before. 1250

Having so decided, however, the court found a remedy for the employee. The new corporation to which the debtor's assets were transferred pursuant to the plan had made a deposit in excess of the amount required to pay secured and priority creditors 100 percent of their claims and unsecured creditors 20 percent of their claims. Relenting from its own logic, the court allowed the employee to prove damages as if his contract had been rejected and to receive a 20 percent payment thereof from the excess deposit. But for the fortuity of the excess deposit and the indulgence of the court, however, the employee would have been left with no payment under the plan,251 no claim against the new corporation which had not assumed his contract under the plan,252 and a surviving claim against the corporate shell of the debtor.

Another Chapter XI decision, In re Capital Service,253 disposed of the issue of individual employment contracts on grounds more questionable than those in Greenpoint. There the debtor, who had contracts with its employees providing for va-

250. 113 F.2d at 884.

251. Although the plan provided that the new corporation should acquire from the debtor "all its assets," the court concluded that the employee's executory contract was not thereby assumed because (1) the debtor had not filed with the court a list of executory contracts as required by § 324, 11 U.S.C. § 724 (1970); (2) no provision had been made for payment of the employee during the case; and (3) no mention of the employment contract had been contained in the plan. Rather, the Court was prepared to conclude that the plan tacitly rejected the contract, but concluded also that rejection of a contract in a plan must be explicit.

252. Earlier the court had held that a landlord in a § 77B case who failed to object to confirmation of a reorganization plan under which the debtor assigned the lease to a successor corporation was not entitled, after the case was closed, to have it reopened. The plan could not be amended even though the court agreed with the landlord that the assignment to the new corporation without its assumption of the lease "created privity of estate between it and [the landlord] but no privity of contract," so that the new corporation "was bound to pay the stipulated rental so long as it remained in possession, but it could move out at any time, free of liability to the landlord." The court reasoned that the landlord was "entitled to insist that his lease be either rejected or fully assumed under the plan, and he must appear in the reorganization court at the confirmation hearing or before, in order to assure adequate protection for his interests." Mohonk Realty Corp. v. Wise Shoe Stores, 111 F.2d 287, 288, 290 (2d Cir.), cert. denied, 311 U.S. 654 (1940).

cation pay, had been designated debtor in possession and had been authorized to continue the business. The business continued without interruption of employment and with payment of wages at the contract rate until the rehabilitation effort failed and the debtor in possession was adjudicated a bankrupt. The court held that the employees were entitled to a claim for vacation pay accruing during the Chapter XI case as a first priority expense of administration. Normally such first priority status would arise only when the debtor assumed the contracts, but the court avoided this difficulty on alternative grounds. On the one hand, the court held that the contracts were not executory because, under applicable state law on the legal incapacity to contract, they terminated when the debtor was designated debtor in possession—a "new legal entity." Although the debtor in possession therefore could not assume these nonexecutory contracts, it had, by continuing to employ its workers under its authority to continue the business, in effect entered into new contracts of employment which conformed to the terms of the old. On the other hand, even if the original contracts of employment were viewed as executory, the debtor in possession had rejected them as of the date the Chapter XI petition was filed by failing to assume them within the time specified in section 70b. Again, the debtor in possession had entered into new contracts which conformed to the terms of the old.

While the result in Capital Service seems unexceptionable, the first ground for the decision employs a rather rarified conceptionalism, and the second ground applies the section 70b statutorily imposed rejection of a contract which is inapplicable in a Chapter XI case. The contracts were not assumed and were therefore not binding on the estate, and there were no damage claims against the estate. It would still follow, however, that the debtor in possession with authority to continue the business had been authorized by the court to contract to maintain the work force, just as it was authorized to contract

254. Under §§ 64a(1) and 378a(1) & (2), 11 U.S.C. §§ 104(a)(1) and 778(a)(1) & (2) (1970), the administration expenses of the Chapter XI case would be postponed to the administration expenses of the subsequent bankruptcy case, but would come ahead of second priority claims in the bankruptcy case for wages and vacation pay earned in the three months preceding the filing of the Chapter XI petition. See note 225 supra.
256. 136 F. Supp. at 437.
258. See text accompanying note 546, infra.
for supplies, and that the employment during the Chapter XI case could reasonably be said to be under new contracts which conformed to the terms of the old.\footnote{259}

A court may properly treat wages or salaries and fringe benefits which the receiver, trustee or debtor in possession pays to obtain services needed to continue the business as a first priority administration expense. It is improper, however, to so treat such items if they represent compensation for services performed for the debtor prior to the filing of a petition under the Bankruptcy Act by persons not employed by the trustee, receiver or debtor in possession. Yet some courts have elevated to first priority status pension payments to retired officers which could not possibly qualify, even in part, for a second priority.\footnote{260}

This mischief may be inspired by Bowen v. Hockley,\footnote{261} a case in which a federal receiver was continuing the business of a corporation that had been a self insurer under a state workmen's compensation law. The court required the receiver to continue to make periodic payments under the state compensation commission's award to the widow of an employee killed in the service of the corporation before the receiver was appointed. This decision was based in part, and could have been based entirely, on a section of the Federal Judicial Code which provides that a

\begin{center}
trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession according to the requirements of the valid laws of the State
\end{center}

\footnote{259. An additional criticism of the first ground for the decision in Capital Service is that its treatment of the contracts as nonexecutory would deprive the trustee, receiver or debtor in possession of the option to assume or reject them in a successful rehabilitation proceeding. The trustee in In re Maryvale Community Hosp., Inc., 456 F.2d 414 (9th Cir.), cert. denied, 409 U.S. 879 (1972), exercised that option in a Chapter X case by obtaining court approval for rejection of a five-year contract between the debtor hospital and a pathologist. When the doctor then sought to prove damages as a "person injured by such rejection" under § 202, 11 U.S.C. § 602 (1970), he failed because he had assigned his contract to another doctor prior to the rejection. The fact that the assignment was inspired by economic necessity due to the earlier wrongful acts of a receiver, who served until the trustee was appointed, in preventing the doctor from performing his duties was held to give him no claim based on rejection of the contract although it might give him a claim against the receiver for tortious interference with contractual relationships.}

\footnote{260. See note 225 supra.}

\footnote{261. 71 F.2d 781 (4th Cir. 1934).}
in which such property is situated, in the same manner that
the owner or possessor thereof would be bound to do if in pos-
session thereof. \(^2\)\(^6\)\(^2\)

But the court also justified the result by treating the compen-
sation award as an obligation which "in equity and good con-
science . . . should be held a charge on the income of the busi-
ness, just as is the wage of the laborer or the pension of the super-annuated employee." \(^2\)\(^6\)\(^3\) The court reasoned that the compen-
sation award was analogous to a claim preferred under the "six-month rule" \(^2\)\(^6\)\(^4\) and supported this analogy by invoking a number of unreported orders in federal receivership cases re-
quiring operating receivers to continue to pay the pensions of retired employees.

The compensation claim in *Bowen* may well have constitu-
ted a valid claim against the estate in receivership. In the ab-
sence of the federal statute, however, the claim should not have been treated as a first priority expense of administration. The court explained its elevation of the claim only by observing that it had been met by the corporation prior to receivership "as a continuing expense of the business" \(^2\)\(^6\)\(^5\)—a rationale which would probably elevate many prereceivership claims to first priority status.

A similar elevation of priority occurred in the reorganiza-
tion of the New York, New Haven & Hartford Railroad, \(^2\)\(^6\)\(^6\) but there the court relied upon a rationale different from that in *Bowen*. A vice-president of the road had retired before the section 77\(^2\)\(^6\)\(^7\) petition was filed, and the trustee thereafter rejected the contract which provided for his pension rights. \(^2\)\(^6\)\(^8\) The court held that the vice-president and other former officers, whose contracts did not likewise provide pensions but who were re-
ceiving them from the trustees under a plan established by the board of directors, were entitled to receive an amount which "equitably should be considered a fair pension." This result was

\(^{262}\) 28 U.S.C. § 959(b) (1970). At the time of the decision in *Bowen v. Hockley*, this statute by its terms applied only to "a receiver or manager in possession." 36 Stat. 1104 (1911).

\(^{263}\) 71 F.2d at 783.

\(^{264}\) See note 225 supra.

\(^{265}\) 71 F.2d at 784.

\(^{266}\) Tate v. New York, New Haven & Hartford R.R., 332 F.2d 449 (2d Cir. 1964) [hereinafter referred to as *Tate*].


\(^{268}\) Under the analysis proposed above, the contract does not ap-
pear to be executory since the vice-president apparently owed no fur-
ther performance. In any event, the trustees' attempted rejection of it added nothing to their discontinuance of pension payments.
justified because the priority treatment of the vice-president's claim was related to the trustees' need to maintain a working force. The court expressed this rationale by saying that "the purpose of continuing pension payments to employees retired prior to reorganization—maintaining the loyalty and incentive of present employees and facilitating the recruitment of new employees—might well be undercut by discontinuance of the retired vice-president's pension. But this explanation will hardly suffice as a reason for first priority treatment of pension payments to any employees who retired before the petition was filed. The avowed purpose of the priority treatment could be served as well merely by treating the pension rights of those still working for the trustees as administration expenses and by providing in the plan or reorganization that the reorganized debtor (if any) should assume the pension obligations of those employees.

In a later decision in the same reorganization proceeding, the court denied first priority status to the claim of the New Haven's chief executive officer. His five-year employment contract with the road had expired one month before the section 77 petition was filed and had provided 12 annual payments of $25,000 by way of severance pay and as deferred compensation. Distinguishing its earlier decision in Tate, the court held that the payments provided by this contract did not constitute a pension, but merely a claim for deferred compensation—an ordinary contract claim entitled to no priority. The claim bore no relation to the pension payments made under the established pension plan because it was subject to no conditions respecting age or length of service and because it called for payments far in excess of those payable under the pension plan. Moreover, the court reasoned, the denial of priority to this claim would not impair the loyalty and incentive of present employees nor hinder the recruitment of new employees. The decision is completely correct, and the circumvention of the Tate rationale is laudable, if not completely successful.

In the current section 77 proceeding of the Penn Central,

269. 332 F.2d at 452.
271. The court also declined to extend the six-month rule (see note 225 supra) to the contract payments, the first of which became due almost a year after the § 77 petition was filed.
the court has ordered continuation of pension payments. To the extent that the order relates to pensions funded in a manner not challenged by the trustees so that the court could conclude the funds were not the property of the debtor, there can be no quarrel with it. But the order extends also to unfunded pensions to retired officers. On the authority of Bowen and Tate, such unfunded pensions are to be paid "as cash permits" while the reorganization case is pending. Treated as "normal operating expenses," these payments are made so that "employee morale [is] maintained at a high level" and "capable employees [are] encouraged to continue in the employ of the railroad." One must wonder just how it will boost the morale of those trying to salvage the road to know that those who presided over its financial collapse will continue to siphon off large parts of their whopping pensions.

b. Collective Bargaining Contracts

In the straight bankruptcy proceeding of an employer there is only one situation in which the trustee would apparently want to assume an executory collective bargaining contract. That is where the search for a buyer of the business as a going concern extends beyond the time specified in section 70b so that the trustee must assume the contract to avoid that section's statutorily imposed rejection. Not surprisingly then, the reports reveal only one straight bankruptcy case involving assumption or rejection of a collective bargaining agreement. All of the other cases involving such contracts have arisen from the employer's chapter case where the trustee, receiver or debtor in possession normally continues operations until a plan is consummated or the proceeding aborts.

In the treatment of the collective bargaining contract in a chapter case (and in a straight bankruptcy case where the
business is continued), federal labor legislation applicable to the employer applies also to the trustee, receiver or debtor in possession.\textsuperscript{277} Hence, even if the collective bargaining agreement is not assumed, the trustee, receiver or debtor in possession is under an obligation to bargain with the union representatives of the employees and to refrain from forbidden unfair labor practices.\textsuperscript{278}

Since its enactment in 1935 the National Labor Relations Act has been applicable not only to private employers but also to their "legal representatives, trustees, trustees in bankruptcy or receivers."\textsuperscript{279} As a result, the NLRA has been held applicable to a state court receiver\textsuperscript{280} and to a straight bankruptcy trustee continuing the business.\textsuperscript{281} The jurisdiction of the National Labor Relations Board\textsuperscript{282} has been delineated in several cases involving bankruptcy proceedings. After a section 77b case is closed and the debtor reorganized, the Board has jurisdiction to entertain a complaint alleging the commission of unfair labor practices by the debtor in possession during the section 77b proceedings.\textsuperscript{283} If the Board has initiated a representati-
tion proceeding after the filing of a Chapter X petition, the Chapter X court has no jurisdiction to enjoin the proceeding.\textsuperscript{284} However, nothing in the NLRA or the jurisdiction of the Board prevents a straight bankruptcy trustee from rejecting an executory collective bargaining contract. But if the straight bankruptcy trustee who is continuing the business decides to reject such a contract, he must continue to comply with the NLRA after the rejection.\textsuperscript{285}

In the various chapter proceedings,\textsuperscript{286} unlike the trustee in a straight bankruptcy, the trustee, receiver or debtor in possession often has the need to maintain a working labor force. Again, the trustee, receiver or debtor in possession has the option to assume or reject an executory collective bargaining contract. But the contract will not support a first priority claim for administration expense unless assumed and will not give a claim against the estate for damages unless rejected. There have been many chapter cases,\textsuperscript{287} however, in which the option has not been exercised. The cases show that the trustee, receiver or debtor in possession may be faced with a first priority employees' claim without having assumed the collective bargaining contract. In a section 77B proceeding the trustee, receiver or debtor in possession had authority to enter a supplemental contract with the union for vacation pay so as to give all employees a first priority claim for pay earned after the in-

\begin{footnotes}
\item [285] Durand v. NLRB, 296 F. Supp. 1049 (W.D. Ark. 1969); Carpenters Local Union v. Turney Wood Prods., Inc., 289 F. Supp. 143 (W.D. Ark. 1968). See Comment, Collective Bargaining and Bankruptcy, 42 S. Cal. L. Rev. 477 (1969). Where the court suspects that the bankruptcy proceedings are a subterfuge, however, the contract cannot be rejected. In the § 77B proceeding in In re Mamie Conii Gowns, Inc., 12 F. Supp. 478 (S.D.N.Y. 1935), the court disallowed the rejection by the debtor in possession. There the employer had filed a § 77B petition alleging assets of $63,000 and liabilities of only $31,000. Thereafter the employer, as debtor in possession, sought to reject a closed shop collective bargaining contract.
\item [286] A Chapter XI court, mistakenly assuming that a Chapter X provision was applicable in the case before it, has found no obstacle to the rejection of an executory collective bargaining contract by the debtor in possession. In re Klaber Bros., Inc., 173 F. Supp. 83 (S.D.N.Y. 1959). The Chapter X provision in issue was § 272, 11 U.S.C. § 672 (1970), which preserves the right of employees to join the union of their choice. Section 15 of the NLRA provides that the NLRA shall prevail in the event of conflict with § 272, 49 Stat. 457 (1935), as amended 61 Stat. 151 (1947), 29 U.S.C. § 165 (1970).
\item [287] These cases have not treated the contracts as nonexecutory as was done in Capital Services. See text accompanying notes 254-59 supra.
\end{footnotes}
ception of the contract and before a bankruptcy adjudication.\textsuperscript{288} In a Chapter X proceeding the trustee, receiver or debtor in possession may enter into a separate contract conforming to the existing collective contract providing for vacation and severance pay so as to give a first priority claim for all such pay earned before adjudication.\textsuperscript{289} The Chapter X trustee, receiver or debtor in possession may conform to wage rates specified in the existing contract and thereby adopt pensions for employees who had retired before the trustee was appointed. Such pensions as became payable while the trustee was operating the business are entitled to first priority payment.\textsuperscript{290} Where the Chapter X reorganization plan provides that the reorganized debtor assume all executory contracts, the debtor is liable to pay all pensions that become payable under an existing collective bargaining contract before and after the case is closed.\textsuperscript{291}

\begin{itemize}
\item \textsuperscript{288} In re Wil-Low Cafeterias, Inc., 111 F.2d 429 (2d Cir. 1940).
\item \textsuperscript{289} In re Public Ledger, Inc., 161 F.2d 762 (3d Cir. 1947); In re Capital Foundry Corp., 61 F. Supp. 332 (E.D.N.Y. 1945). The court in Public Ledger said that “it makes little difference . . . whether the trustees expressly assumed the contract or merely knowingly conformed to its terms” (161 F.2d at 767) and thus ignored the possible requirement in chapter cases of court approval for assumption of a contract (see text accompanying notes 548-51 infra). The court found that:
\begin{quote}
There is nothing in the evidence to indicate that the trustees sought to extend the contract beyond their own period of service, but the evidence is conclusive that they sought and obtained the services . . . with full knowledge that the services were being given under the terms of the [existing] contract.
\end{quote}
\item \textsuperscript{290} In re Schenectady Ry., 93 F. Supp. 67, 70 (N.D.N.Y. 1950). The court’s conclusion that the collective bargaining contract made the monthly payments to retired employees “a part of the consideration for the services presently performed” by other employees may be supported by the language of the contract, but would be more compelling with respect to employees who qualified for retirement during the period of operation by the trustees.

The court in Schenectady also indicated that employees not covered by the collective bargaining contract who had been receiving pensions but who had no contractual commitment therefor were not to be paid by the trustee. The same is true of pensions which had been paid by the employer to employees covered by the collective contract if that contract does not obligate the employer to pay them. In re Compania De Los Ferrocarriles De Puerto Rico, 76 F. Supp. 521 (D.P.R. 1948).
\item \textsuperscript{291} In re American R.R. of Porto Rico, 110 F. Supp. 45 (D.P.R. 1952), aff’d, 202 F.2d 149 (1st Cir. 1953). See also Vallejo v. American R.R. of Porto Rico, 168 F.2d 513 (1st Cir. 1951). Cf. L.O. Koven & Brother, Inc. v. Local Union No. 5767, 381 F.2d 196 (3d Cir. 1967). There the court did not mention anything about assumption or rejection of a collective bargaining contract either by a Chapter XI receiver or in the confirmed plan. The court found that prepetition claims for vacation pay were excepted from the discharge of the order of confirmation under § 371, 11 U.S.C. § 771 (1970), because they were wage claims earned
In the reorganization of a railroad, the Railway Labor Act applies to "any receiver, trustee, or other individual or body, judicial or otherwise, when in the possession of the business of" a railroad. Section 77n of the Bankruptcy Act, moreover, forbids any change in "the wages or working conditions of railroad employees except in the manner prescribed in the Railway Labor Act." Thus in a railroad reorganization the RLA requires advance notice of proposed changes, negotiation and mediation. If no settlement is reached and the parties do not submit to arbitration, there must follow a 30-day "status quo" period. Thereafter an emergency board reports to the President, and that report is followed by another 30-day "status quo" period.

In the pending reorganization of the Penn Central this statutory procedure consumed a period of 18 months, yet elicited no settlement of a dispute between the trustees and the unions over the size of train crews. In the court in July then ordered the trustees to reduce the crews unilaterally but to continue ne-

---

295. Cf. Birmingham Trust & Savings Co. v. Atlanta, B. & A. Ry., 271 F. 731 (N.D. Ga. 1921), where, before the enactment of the RLA, the receiver of a railroad within three days of his appointment had obtained an order reducing all wages of employees below those provided by union contracts. But the order was held invalid as to certain employees covered by the old Newlands Act, which required that any order reducing wages be made only after hearing on 20 days' notice.
gations to resolve the issue.\textsuperscript{298} The trustees then set and postponed dates for reducing crews, and the unions set and postponed dates for calling strikes. Finally the trustees ordered the crew reduction and the unions called a strike on February 8, 1973. On the following day Congress passed and the President signed a bill extending the last "status quo" period of the RLA to May 9, 1973.\textsuperscript{297} As no settlement of the issue was reached by that date, the trustees initially set June 9, 1973, as the date for crew reduction but, before that date arrived, cancelled all plans for crew reduction to avoid a strike.\textsuperscript{298} Meanwhile, the court had advanced from April 1 to July 2, 1973, the date by which the trustees were to file either a feasible plan of reorganization or a proposal for the liquidation or other disposition of the road. The court also warned that
to the extent that . . . statutes and regulations, whether in the area of abandonment, tariffs, or resolution of labor disputes, preclude the exercise of self-help in achieving profitability, the legislative and executive branches of government must be looked to for solutions, if solutions are to be forthcoming.\textsuperscript{299}

The trustees on June 29, 1973, filed a plan of liquidation which may be designed more to inspire governmental financial aid than to gain court confirmation.\textsuperscript{300}

The pertinent provisions of the RLA apply also to air carriers,\textsuperscript{301} and one court entertaining the Chapter XI case of such a carrier reversed a referee's order permitting the rejection of collective bargaining contracts with pilots and stewardesses both because the debtor in possession had not complied with the RLA and because the court did not believe that a case for rejection had been made on the merits.\textsuperscript{302}

\textsuperscript{297} 87 Stat. 5 (1973).
\textsuperscript{300} Wall Street Journal, July 2, 1973, at 9, col. 1.

[T]he Bankruptcy Court, when it has the power to reject a collective bargaining agreement, should do so only after thorough scrutiny, and a careful balancing of the equities on both sides, for, in relieving a debtor from its obligation under a collective bargaining agreement, it may be depriving the employees affected of their seniority, welfare and pension rights, as well as other valuable benefits which are incapable [sic] of forming the basis of a provable claim for money damages. That would leave the employees without compensation for their losses, at the same time enabling the debtor, at the expense of
It is doubtful that the Penn Central reorganization will continue long enough to enable its trustees to resolve the train crew dispute with the unions. It is even more doubtful that a Chapter X or XI proceeding for an airline can remain viable for the period required to exhaust the procedures of the RLA. Hence, the operation of that Act seems effectively to preclude the resolution of most labor relations disputes in a bankruptcy rehabilitation proceeding for a railroad or an airline. Moreover, the RLA seems also to preclude any interim relief from the onerous collective bargaining contract of a railroad or an airline in bankruptcy proceedings. Where the trustee, receiver or debtor in possession does not exercise the option to assume or reject such a contract, the Act forestalls the negotiation of a new and less onerous contract to apply while the proceedings are pending.

4. Publishing Contracts

The contract between an author or composer and a publishing house commonly provides that the publisher will edit (if a literary work is involved), publish and market the author's or composer's work and will pay the author or composer a specified royalty. The copyright may be retained by the author or composer or it may be assigned to the publisher.

If either party to such a contract goes into bankruptcy before the author or composer has substantially completed his work, the contract would be executory under the test here proposed because neither party would have substantially performed. Moreover, in the bankruptcy of the author or composer, his rights under the contract would doubtless be held "personal" and would not pass to the trustee because performance of such artistic obligations would be nondelegable. The few bankruptcy cases dealing with such contracts suggest that the same result would follow in the bankruptcy of the publisher.

These cases, however, did not involve executory contracts and therefore did not involve the trustee's option of assumption or rejection. In each case the author or composer had fully performed and the publisher had become a bankrupt without completing performance. Nonetheless, the judicial
appraisal of the delegability of the performance of the publisher's obligation would doubtless have been the same even if the contracts had been executory. In the early case of In re D. H. McBride & Co., the court held that the trustee of a bankrupt corporate publisher could take no rights under a publishing contract with an author because the publisher's obligation, involving "personal trust and confidence," was nondelegable. Therefore, the trustee was compelled to reassign the copyright to the author. The court recognized that the publisher was a corporation but reasoned that its "management...may be such as to command especial confidence." Although the court emphasized that the contract was expressly made nonassignable without the consent of the author, such a provision alone could not have prevented the contract from passing to the publisher's trustee nor could it have prevented the trustee from transferring it to another.

In a case more recent than McBride, the Oxford University Press had entered a contract with an American publisher who was to revise, publish and sell one of Oxford's encyclopedias in this country. Oxford retained the copyright, and the contract expressly forbade any assignment without the consent of Oxford. The publisher's bankruptcy trustee, appointed following adjudication in an abortive Chapter XI proceeding, was held to have no salable rights in the contract. Again, the publisher's obligation was considered nondelegable.

In a case where the producer initiated a Chapter XI proceeding after having completed the pictures. The only question involved was whether the contract gave the distributor the right to contract for the television broadcasting of pictures which were originally produced for theater exhibition. It was assumed by all concerned that the debtor in possession took whatever rights it formerly had under the contract without any assumption of the contract. The court further assumed (incorrectly because the producer had fully performed) that the contract would be executory if its provisions as to television broadcasts were separable from its provisions as to theater exhibition, but concluded (correctly; see Countryman, Part I, at 470) that they were not severable.

305. 132 F.2d 5 (S.D.N.Y. 1904).
306. Under § 70a(2), 11 U.S.C. § 110(a)(2) (1970), the bankruptcy trustee takes the title of the bankrupt to all "interests in patents, patent rights, copyrights, and trademarks."
307. 132 F. at 288. The exclusive market for the author's books consisted of Catholic schools and convents, and the management of the publisher was Catholic.
308. Countryman, Part I, at 445, and text accompanying notes 385-400 infra.
309. In re Little & Ives Co., 262 F. Supp. 719 (S.D.N.Y. 1966). Alternatively, Oxford was held entitled to exercise an option expressly given it by the contract to terminate the contract if the publisher ini-
Although these decisions relied on the "personal contract" doctrine to find the obligations under a publishing contract non-delegable to a bankruptcy trustee, one court has reached a different conclusion. The Court of Appeals for the Second Circuit reversed a decision directing the bankruptcy trustee of a music publisher to reassign copyrights to composers. It held that the trustee should instead be authorized to sell the copyrights subject to the royalty obligations imposed by the composers' contracts with the publisher. The court was influenced in part by the fact that the form contracts purported to run to the publisher, "its successors and assigns" and in part by the consideration that the decision below "appears to give no weight to the labor, skill, and capital which a publisher expends in putting a song on the market." It was doubtless influenced also by the fact that the composers had asked that the trustee be required, alternatively, to reassign the copyrights to them or to sell the copyrights subject to the contract royalty obligations.

To the extent that bankrupt publishers are involved, these decisions seem to apply the "personal contract" doctrine too mechanically. In this context the purpose of the doctrine is to prevent an author or composer from being required to accept the inadequate performance substituted by a bankruptcy trustee. However, if the trustee can locate a prospective purchaser quickly enough to avoid a breach of the contract, he should be given an opportunity to show that the prospective purchaser is as well qualified to publish and market the work as was the bankrupt publisher. If the court then approves the sale of the contract to the prospective purchaser, the creditors of the bankrupt publisher will get the value of the sale price of the contract. But the effort to preserve that value should not, without the consent of the author or composer, carry so far as to require him to continue the contract with any publisher without regard to that publisher's qualifications.

This pragmatic approach to the proposed sale of the publi-
lishing contract should be adopted in both a straight bankruptcy and in a chapter case, and the same approach should be taken in a chapter case where the rehabilitated debtor is to continue performance rather than sell the contract. If this approach were taken in cases where the author or composer has substantially performed, the “personal contract” doctrine would not dictate termination of the contract whenever the publisher entered a proceeding under the Bankruptcy Act. By the same token, where the author or composer has not substantially performed so that the contract remains executory, the pragmatic approach would in some cases allow either the assumption and sale of the contract by the trustee of the publisher, or the assumption and performance of the contract by a rehabilitated publisher.

In every case the inquiry should be whether the proposed treatment of the contract would leave the author or composer with a publisher inferior to the one with which he originally contracted. And perhaps the inquiry into possible prejudice to the author or composer should not stop with an examination of the management of the purchaser or the rehabilitated debtor. At least where literary works are involved, the most important matter for many authors is probably the quality of the editor to whom their work is to be assigned.312 If the author could retain the same editor, or one equally acceptable, after the contract was sold by the trustee or assumed by the rehabilitated debtor, the relationship of “trust and confidence” on which the author had relied would in most cases be preserved. True, the author would also have an interest in the financial responsibility of the new or reorganized publisher, but that interest is shared by the nonbankrupt party to a contract not classified as a “personal contract.” In the latter case, the concerns of the nonbankrupt party are not allowed to interfere with the sale of the contract or its assumption by a rehabilitated debtor.

5. Patent Licenses

The usual patent license, by which the patentee-licensor authorizes the licensee to exercise some part of the patentee's exclusive right to make, use and vend the patented item in return for payment of royalties, ordinarily takes the form of an executory contract. A license simply to use patented equip-

ment is typically a part of an agreement by which the equipment is leased to the licensee in return for royalty payments. Such an agreement is clearly within the Bankruptcy Act's concept of an executory contract. A license merely to use a consumable patented product necessarily provides for the supplying of the product to the licensee. If the patentee-licensor is in any way responsible for supplying the product, the contract is executory. The same is true of a license to sell patented products manufactured by the patentee-licensor.

Where there is no express undertaking by the licensor, the agreement with the licensee may not be executory because the licensor may have fully performed merely by executing the license agreement. Thus a close question may be presented by a license to make and sell a patented product where another licensee undertakes to apply the product. Even in these close cases, however, there may be an implied undertaking by the licensor which brings all patent licenses within the ambit of an executory contract. It has been held in a patentee-licensor's infringement action against a third party that a final judgment adjudicating the patent invalid constitutes a “complete failure of consideration” amounting to an “eviction” which releases the licensee from any further obligation to pay royalties.\(^{318}\) Moreover, since the death of the doctrine of “licensee estoppel,” the licensee can set up the invalidity of the patent as a defense when sued by the licensor for royalties due under the license.\(^{314}\) Hence, all patentee-licensors are now substantially in the position of having warranted to their licensees the validity of their patents. Although the sanction for the breach of such a warranty is only forfeiture of royalties rather than liability for damages, this continuing undertaking by the licensor is enough to justify the treatment of all unexpired patent licenses as executory contracts.\(^{315}\)

While this analysis would provide the bankruptcy trustee of the licensor the option to assume or reject the license, another doctrine developed in nonbankruptcy cases could be ap-


\(^{315}\) See Countryman, Part I, at 453.
plied to deprive the bankruptcy trustee of the licensee of a similar option. In *Oliver v. Rumford Chemical Works*\(^{316}\) a flour manufacturer obtained a license to use and sell a patented acid supplied by the patentee-licensor, but the license obtained no words indicating that it was assignable. Because the license was “personal” to the licensee, the Supreme Court held that on the death of the manufacturer-licensee it would not pass to his personal representative. The Court thought it “apparent that licenses of this character must have been granted to such individuals as the grantor chose to select because of their personal ability or qualifications to make or furnish a market for the self-raising flour, and thus for the acid . . . .”\(^{317}\) Subsequent Supreme Court cases have accepted the rule that licensees’ rights are not assignable unless expressly made so in the license and have applied it without further explanation.\(^{318}\) There is dictum in one of these cases, however, that a license may pass from a licensee partnership to a corporation “formed . . . to carry on the same business and in the same interests . . . .”\(^{319}\) This dictum has been interpreted by some lower federal courts to mean that a patent license may pass to a “successor” of the licensee not only where a licensee partnership is incorporated\(^{320}\) but also where it is not so clear that the new business is conducted “in the same interests.”\(^{321}\)

Although none of these cases arose in a bankruptcy context,\(^{322}\) the notion that a patent license is not assignable unless

---

316. 109 U.S. 75 (1883).
317. Id. at 83.
322. In Schmidt v. Central Foundry Co., 218 F. 466, 470 (D.N.J. 1914), aff’d on other grounds, 229 F. 157 (3d Cir. 1916), the court held
expressly made so may carry over to bankruptcy proceedings involving patent licenses. The uncertain "successors" exception to the nonassignability rule may be applicable in some chapter proceedings, but it will hardly be available in straight bankruptcy liquidation. Moreover here, as with publishing contracts, the application of the notion that all patent licenses are "personal" and nonassignable because of the licensor's reliance on peculiar qualifications of the licensee seems too mechanical. Here again, it is conceivable that the licensee's bankruptcy trustee could locate a sufficiently qualified prospective purchaser of the license, or that the license could be assumed by a sufficiently rehabilitated debtor, so that no prejudice to the licensor would result. As long as the court is convinced that the licensor's interests are adequately protected, neither the "nonassignability" rule nor the "personal contract" doctrine should automatically prevent the trustee's assumption of a patent license. Section 70a(2) should be read to mean what it says: The trustee of a licensee-debtor has title to all "interests in patents."

All of the bankruptcy cases dealing with patent licenses have arisen in the bankruptcy proceedings of a patent licensee. Only one of these cases has expressly treated the patent license as an executory contract, but such a characterization would apparently not have changed the result in any other case. Thus, where the bankrupt had a license to sell at a

that where the licensee goes into bankruptcy and a receiver is appointed to continue the business the license will protect the receiver against liability for infringement since he did not take title to the licensee's assets, including the license. The receiver's "acts in making use of the device covered by the patent were the acts of" the bankrupt licensee. Cf. Waterman v. Shipman, 55 F. 982, 986 (2d Cir. 1893). In Waterman the court held that a patent licensee could maintain an action for violation of the license by the patentee-licensor even though a state court had appointed a receiver for the licensee in supplemental proceedings initiated by the patentee-licensor. The court's rationale was that the license was "purely a personal license" and "the receiver could not acquire it."

323. See text accompanying notes 311-12 supra.
325. See text accompanying note 329 infra.
326. This is most obviously true of In re Wisconsin Engine Co., 234 F. 281 (7th Cir. 1916). There the licensee in consideration for the grant of the license had given the licensor notes against which royalty payments might be credited but which were to be payable whether or not royalties were earned. The court held that such notes gave the licensor a provable unsecured claim when the licensee went into bankruptcy before any royalties were earned. See also In re Diana Shoe Corp., 80 F.2d 827 (2d Cir. 1936).
fixed retail price the patented fountain pens supplied by the licensor, the licensor was not entitled to reclaim any pens the "title" to which had passed to the licensee before its bankruptcy. The licensee's bankruptcy trustee, however, was entitled to sell the pens only at the price specified in the license, and any such sale was subject to the licensor's royalty rights under the license. In a different case with a similar license the licensee's bankruptcy trustee sold a great volume of electric shavers and parts in bulk. The trustee's activity was held to have conferred on the licensor a first priority claim for damages for infringement. The result in both of these cases would have been the same had the licenses been viewed as executory contracts so as to give the trustee the option of assumption or rejection. If the trustee had rejected the license, he would have had no right to sell the patented articles; if the trustee had assumed the license, he would have had only such right to sell as the license conferred.

In the one case in which the license was held to be an executory contract, the licensor's "pre-existing right to terminate the agreement" was held to survive a belated attempt by the debtor in possession to assume the contract. The license provided that the licensor could terminate the license 60 days after notice of default was given to the licensee, and the licensor had given the licensee such notice three weeks prior to the licensee's Chapter XI filing. As the default remained uncured for the requisite 60-day period, the debtor in possession was not allowed to assume the executory contract. To the extent that they give effect to provisions in licenses for automatic termination of the license on the bankruptcy of the licensee, this and other cases


The court in In re Tidy House Prod. Co., 79 F. Supp. 674 (S.D. Iowa 1948), where the bankrupt had bought a business, including trademarks, under a contract requiring the payment of royalties on all trademarked goods sold, held that the contract was executory and that the trustee could not assume the contract and sell the trademarked goods and the trademark free of the obligation to pay royalties.

328. In re Progress Lektro Shave Corp., 35 F. Supp. 915 (D. Conn. 1940).

329. In re Schokbeton Indus., Inc., 466 F.2d 171, 175 (5th Cir. 1972).


In re Diana Shoe Corp., 80 F.2d 827 (2d Cir. 1936), involved a license to use equipment leased from the licensor. In this case the license provided for termination "in case the licensee becomes bankrupt or has a receiving order made against him," and the appointment of a trustee
seem erroneous. But even if the courts had perceived the licenses as executory contracts, these cases would have reached the same erroneous result.

III. THE EFFECT OF MATERIAL BREACH

Most cases do not deal with all aspects of the effect of a material breach on the bankruptcy trustee's option to assume or reject an executory contract. Moreover, those cases which do deal with some aspects of the effect of such breach are almost completely devoid of analysis. It seems desirable, therefore, to set out the assumptions on which my analysis of the effect of such breach is based.

A. PREBANKRUPTCY BREACH

A material breach by a party to an executory contract before the bankruptcy of either party gives the other party a unilateral option either to treat his own obligations under the contract as discharged and claim damages for the breach or to waive the breach and treat the contract as still in effect. Under § 77B was treated as a "receiving order." Cf. Simmons v. National Tool Co., 110 F.2d 850 (6th Cir. 1940), holding that reorganization under § 77B did not involve "bankruptcy, insolvency or dissolution" within the meaning of a termination provision in a patent license.

331. See text accompanying notes 384-400 infra.

332. A breach of an executory contract not sufficiently material to excuse performance by the other party should not affect the trustee's option to assume or reject the contract. Such a breach by the nonbankrupt party before or after bankruptcy merely creates a cause of action for damages which the trustee can enforce if the contract passes to the bankruptcy trustee under § 70a, 11 U.S.C. § 110(a) (1970). Such a breach by the bankrupt party before or after bankruptcy, but before the trustee assumes or rejects the contract, merely gives the nonbankrupt party a provable claim. See Countryman, Part I, notes 46, 56 and 57, on the provability of claims under contracts existing at the time of the bankruptcy petition where the breach occurs thereafter. Such a breach after the trustee has assumed the contract and before he has disposed of it creates a first priority claim against the estate. The estate is expressly exonerated by the last sentence of § 70b, 11 U.S.C. § 110(b) (1970), from liability for breaches occurring after the trustee has disposed of the contract with the approval of the court.

333. 5A A. CORBIN, CONTRACTS § 1244 (1964). The presumption seems to be that the nondefaulting party's waiver of the discharge of his own obligation constitutes a waiver of any claim for damages. This presumption may be a justifiable interpretation of most waivers that induce the defaulting party to resume performance.

While the nondefaulting party's other alternative is sometimes described as a remedy of rescission, it is to be distinguished from a rescission by mutual agreement of both parties. Id. §§ 1131, 1236. Whether a rescission by agreement discharges any existing right to damages be-
This option of the nondefaulting party is qualified only to the extent that some provision of the contract or some provision of the applicable nonbankruptcy law gives to the defaulting party a right to cure the default.334

If the bankrupt party is the party in default, his trustee takes any right of the bankrupt to cure the default. This right to cure the default passes to the trustee either under section 70a(5)335 as property which could have been transferred by the bankrupt or under section 70a(3)336 as a power which the bankrupt might have exercised for his own benefit. Hence, if the trustee wishes to assume an executory contract, he should be able to cure a default in the contract unless the bankrupt's time for curing the default has expired. And a rather inscrutable provision in section 11e might be interpreted to mean that, if the time for cure has not expired at the filing of the bankruptcy petition, the trustee may in some cases have at least 60 days thereafter to cure the default.337 Although the Act338 authorizes plans under

cause of a breach is a matter of interpretation of the rescission agreement. Id. § 1244. See Kenyon v. Mulert, 184 F. 825 (3d Cir. 1911), discussed in Countryman, Part I, at 646 n.96. Under the Uniform Commercial Code the unilateral option to treat a contract for the sale of goods as at an end is described as an option to "cancel." At least for the buyer, however, cancellation does not preclude resort to other remedies. U.C.C. §§ 2-703(f), 2-711(1); R. Nordstrom, Sales §§ 146, 165 (1970); Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 YALE L.J. 199, 216-23 (1963).

334. See U.C.C. § 2-508, which gives the seller of goods a right to cure a defective tender or delivery. See R. Nordstrom, supra note 333, § 105; Peters, supra note 333, at 209-16; cf. In re Burke, 76 F. Supp. 5 (S.D. Calif. 1948). In Burke a lessor had terminated a lease for the lessee's default and failure to cure before the lessee filed a Chapter XI petition. The lessee as debtor in possession, however, was allowed to reinstate the lease because a state statute provided relief from forfeiture.


336. Id. § 110(a) (5) Section 70a(3) has not been confined to technical powers at common law, but has been extended to reach, e.g., the bankrupt's statutory right to redeem property from a foreclosure sale, Garber v. Bankers Mortgage Co., 27 F.2d 609 (D.C. Kan. 1928), and his contractual right to change beneficiaries under a life insurance contract, Cohen v. Samuels, 245 U.S. 50 (1917).


Where, by any agreement, a period of limitation is fixed for instituting a suit or proceeding upon any claim, or for presenting or filing any claim, proof of claim, proof of loss, demand, notice, or the like, or where in any proceeding, judicial or otherwise, a period of limitation is fixed, either in such proceeding or by applicable Federal or State law, for taking any action, filing any claim or pleading, or doing any act, and where in any such case such period had not expired at the date of the filing
section 77 and Chapters X and XII to provide "for the curing or waiver of defaults," it has not yet been established that these provisions confer upon the trustee a separate right of cure without limit as to time. If the trustee of the defaulting party does not wish to cure the default, he holds the contract subject to the option of the non-bankrupt party to waive or assert the consequences of the prebankruptcy breach and can assume the contract only if the nonbankrupt party so waives.

If the bankrupt party is not the party in default, his trustee takes the contract subject to any right of the nonbankrupt party to cure the default. If the nonbankrupt party does not cure the default, the trustee has the option either to assert the consequences of breach (which would rid the estate of the contract without subjecting it to a damage claim for rejection) or to waive the breach (which would enable him to assume the contract).

Although not explicitly employed by the courts, these assumptions fairly well explain the cases dealing with executory contracts with respect to which there has been a material breach before bankruptcy. Not surprisingly, in all but two of these cases it was the defaulting party who later went into bankruptcy. In re Shokbetan Industries, Inc. involved an exclusive patent license to manufacture and sell which provided that if a default in royalty payments continued for 60 days after

of the petition in bankruptcy, the receiver or trustee of the bankrupt may, for the benefit of the estate, take any such action or do any such act, required of or permitted to the bankrupt, within a period of sixty days subsequent to the date of adjudication or within such further period as may be permitted by the agreement, or in the proceeding or by applicable Federal or State law, as the case may be. (emphasis added)

The suggestion that this provision might apply involves reading "doing any act" to include the curing of a default. Even if so read, however, the provision would cover only the time fixed for curing defaults "in any proceeding" or by other applicable law, and not the time fixed by agreement. When both this provision and § 70b, 11 U.S.C. § 110(b) (1970), were enacted in 1938, the 60-day time periods within which the trustee could act under § 11e or could assume an executory contract under § 70b both ran from the date of adjudication. Since the 1962 amendment to § 70b that is no longer true. See Countryman, Part I, at 448.

340. See notes 356-59 infra and accompanying text.
341. 466 F.2d 171 (5th Cir. 1972), discussed in text accompanying note 329 supra.
the licensee's receipt of notice thereof the licensor would have the right to terminate the license. Three weeks after the licensor gave such notice the licensee filed a Chapter XI petition. As debtor in possession, the licensee allowed the 60-day period to run without curing the default and thereby entitled the licensor to terminate the license. The court reasoned that the filing of the petition did not extend the time fixed by the contract to cure defaults both because section 11e extends only the time fixed by agreement within which a debtor must prosecute a claim and because the bankruptcy court had no power to extend that time. While the debtor in possession could have assumed the contract, it must take it cum onere, subject to the licensor's right to terminate the license as soon as the 60-day period expired. Hence, the court below had properly refused to enjoin the licensor from terminating the license and had properly confirmed the plan of arrangement "in all respects except as it provided for a perpetuation of the exclusive licensing agreement."

Several other decisions recognize that where the trustee fails to cure a prebankruptcy default of the bankrupt, waiver of the breach by the nonbankrupt party will preserve the bankruptcy trustee's option to assume or reject the contract. In one such case the vendor under a one-payment land contract had

---

344. In re Shokbetan Indus. Inc, 466 F.2d 171, 178 (5th Cir. 1972). This decision apparently did not foreclose the success of the confirmed plan because the licensor was willing to allow another corporation which was acquiring all of the debtor's stock to continue with a nonexclusive license and without use of the licensor's trade name. Apparently, also, no attempt was made to provide for the belated curing of defaults in the Chapter XI plan—something not expressly authorized by §§ 356 and 357, 11 U.S.C. §§ 756, 757 (1970). Cf. text accompanying note 338 supra.

Lindeke v. Associates Realty Co., 146 F. 630 (8th Cir. 1906), reaches a similar conclusion with respect to a lease under which the landlord had given prebankruptcy notice of default and the trustee of the lessee allowed the time specified in the lease for curing defaults to expire without curing them. Because the landlord was not entitled to terminate the lease until the time for curing defaults had expired, his acceptance of rent from the trustee during that time did not constitute a waiver of the default. Cf. Texas & N.O.R.R. v. Phillips, 196 F.2d 692 (5th Cir. 1952). There the bankruptcy trustee was held entitled to assume a lease despite a prebankruptcy default by the debtor. Although the lease required that the lessee receive a notice of default and that the lessee thereafter be given 60 days within which to cure the default, the lessor failed to serve such notice.
reacted to the buyer’s prebankruptcy failure to make payment on the contract date by putting an executed deed in escrow with instructions that it be delivered on payment of the purchase price. The court held that the vendor’s action constituted a waiver of the breach so as to entitle the buyer’s trustee to assume the contract on payment of the purchase price and interest from the date of breach.\textsuperscript{345} In a similar case the bankrupt was in default on its contract with the government to manufacture and deliver goods at the time it filed a Chapter XI petition. The government was found to have waived the breach during the pendency of the case so that, when the case was closed without any assumption or rejection of the contract, the debtor remained liable for damages when the contract was finally terminated by the government because of the default.\textsuperscript{346}

\textit{Burns Mortgage Co. v. Bond Realty Corp.}\textsuperscript{347} presents the case of defaults by both parties to an executory contract and at least suggests the possibility of waivers by each. The buyer in possession under a land sale contract had defaulted on three of four annual installment payments prior to her bankruptcy. Although the contract permitted the vendor to accelerate maturity in event of such a default, the vendor had not done so, perhaps because it had mortgaged the property and thus was not prepared to convey the good title required by the contract. Instead of accelerating the maturity date, the vendor sold both the land, subject to the mortgage, and buyer’s installment notes to a third party. After a post-bankruptcy default on the fourth installment, the third party obtained a release of the mortgage,

\footnotesize{\textsuperscript{345} Mound Mines Co. v. Hawthorne, 173 F. 882 (8th Cir. 1909), discussed in Countryman, Part I, at 464. The court was undoubtedly influenced by the fact that the buyer before its bankruptcy had taken possession of the property and erected a $15,000 building on it. The total purchase price for the land was $500. The bankrupt’s possession was held to give the court summary jurisdiction to order a third party with knowledge of the bankruptcy, to whom the vendor had purported to sell the property for $500, to convey the property to the trustee on payment of $500 with interest. See also Weaver v. Hutson, 459 F.2d 741 (4th Cir.), cert. denied, 409 U.S. 957 (1972), finding that a lessor under a real estate lease had waived the prebankruptcy default of the tenant by accepting postdefault rental payments even though the lessor had an eviction action pending when the Chapter X petition was filed.

\textsuperscript{346} United States Metal Prods. Co. v. United States, 302 F. Supp. 1263 (E.D.N.Y. 1969). This consequence of the failure either to assume or to reject a contract in a chapter case is discussed more fully in the text accompanying notes \textsuperscript{575–86 infra.}

\textsuperscript{347} 47 F.2d 985 (5th Cir. 1931), discussed in Countryman, Part I, at 463.
tendered a deed to the original buyer's bankruptcy trustee, and sought to prove a claim on the notes in the bankruptcy case. Finding that neither the vendor nor its transferee was in a position to transfer good title on the date of bankruptcy, the court concluded that the transferee had no provable claim for the purchase price because the buyer was entitled to treat her performance as excused by the vendor's default. The buyer, however, had contracted to sell part of the land to others and the trustee had apparently occupied it for several years so that the vendor of its transferee had administrative claims for use and occupancy. The court suggested, therefore, that it might be desirable for the trustee to "waive the vendor's default and accept for the estate the performance now offered, with compensation for the [vendor's] failure, if any, to make . . . promised improvements."

Absent any waiver of the bankrupt's prebankruptcy breach, the nondefaulting party can successfully assert the consequences of the breach. Sometimes this has been done before bankruptcy, as where the government officially terminated the contract because of the breach, or where the vendor under a land contract initiated a repossession action in a state court before bankruptcy and thereafter took a judgment under which the statutory redemption period had expired before a trustee was elected. As often, however, the nonbankrupt party as-

---

348. Id. at 988.
349. An exception arises, of course, where the nondefaulting party has contracted away its normal remedy. See text accompanying note 354 infra.
350. Crittenden v. Lines, 327 F.2d 537 (9th Cir. 1964). The Crittenden court held that termination of the contract after the debtor filed a Chapter XI petition and before he was adjudicated a bankrupt rendered the contract nonexecutory. As the contract was nonexecutory, the bankruptcy trustee did not reject it by failing to assume it within the time allowed by § 70b, 11 U.S.C. § 110(b) (1970), and was entitled to claim any payments due to the bankrupt from the government. See also United States v. Chichester, 312 F.2d 275 (9th Cir. 1963) (government has a provable claim for damages for a prebankruptcy breach). Cf. Robertson v. Langdon, 72 F.2d 148 (7th Cir. 1934) (bankruptcy trustee could not assume a lease where the landlord had, prior to bankruptcy, terminated it by peaceable reentry because of default in an annual rental payment).
351. In re Winter, 17 F.2d 153 (E.D. Mich. 1927), discussed in Countryman, Part I, at 463 n.94, held that the trustee could not recover the land from the vendor. The further holding that the filing of the bankruptcy petition did not oust the state court of jurisdiction in the pending repossession action is supported by the later decision in Straton v. New, 293 U.S. 318 (1931). Straton held that a bankruptcy court cannot stay a pending action to foreclose an indefeasible judgment lien on the bank-
serts his rights in the bankruptcy court to establish a provable claim for damages without completing his performance. And

rupt's real estate. On the other hand, Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734 (1931), held that a mortgage foreclosure action could not be initiated in another court after bankruptcy of the mortgagor without consent of the bankruptcy court. Isaacs apparently applies to any postbankruptcy judicial action for the recovery of property because of the bankrupt's defaults.

The Isaacs postbankruptcy initiation rule has been applied by a receivership court to a landlord seeking to recover the premises because of bankruptcy default by the tenant. Odell v. H. Batterman Co., 223 F. 292 (2d Cir. 1915). In lease cases, moreover, the Isaacs rule has been extended to give the bankruptcy court some say in a landlord's repossession action initiated prior to bankruptcy. For example, a pending repossession action has been stayed to give the bankruptcy receiver time to decide whether to intervene in and defend against it. In re Lombardy Inn Co., 266 F. 394 (D. Mass. 1919). Even where the landlord had obtained a final order for repossession and an eviction warrant had issued before a Chapter XI petition was filed by the tenant, the execution of the warrant was stayed in order to give the debtor in possession an opportunity to renegotiate the lease or to locate new premises without interrupting the operation of the business. In re Lane Foods, Inc., 213 F. Supp. 133 (S.D.N.Y. 1963). Lane Foods drew support from the treatment of pledgees in Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & Pac. Ry., 294 U.S. 648 (1935), discussed in Countryman, Part I, at 485.

Similar treatment has been given a landlord seeking the consent of the bankruptcy court to initiate a repossession action because of prebankruptcy default by the tenant. See In re Crawford Plummer Co., 253 F. 76 (D. Mass. 1918), aff'd sub nom. Gardner v. Glessen, 259 F. 755 (1st Cir. 1919); In re Schwartzman, 167 F. 399 (D.S.C. 1909); In re Kleinhaus, 113 F. 107 (W.D.N.Y. 1902); In re Chambers, Caldo & Co., 98 F. 865 (D.R.I. 1900). Cf. Vincent v. Nat'l Drug Stores, Inc., 3 F.2d 504 (E.D. Pa. 1925). The Case of Central Manhattan Properties, Inc. v. D.A. Schulte, Inc., 91 F.2d 728 (2d Cir.), cert. denied, 302 U.S. 243 (1937), suggests, moreover, that a debtor in possession in a § 77B case may still have a reasonable time to decide whether to exercise the option to assume or reject a lease despite a prepetition breach entitling the lessee to terminate the lease. See also American Brake Shoe & Foundry Co. v. New York Ry., 282 F. 523 (2d Cir. 1922), where a receiver was appointed for a lessee railroad after the lessee had defaulted in rental payments. Although the receiver took no action within the 90-day period after which the lease gave the lessor the power to terminate, the court refused to allow the lessor to repossess for six months while the receiver decided whether to assume or reject the lease. The decision on appeal did not rule on the propriety of the imposed delay, and it appears that earlier the lessor itself had been unable to operate the leased properties.

352. In re Marshall's Garage, 63 F.2d 759 (2d Cir. 1933), discussed in Countryman, Part I, at 464. In Marshall's Garage the bankrupt vendee under a land contract had defaulted on the first four annual installments prior to bankruptcy. The court held that the vendor had a provable claim for the discounted value of the difference between the total purchase price and the value of the land which the vendor retained. See also In re Ross Dev. Co., 98 F. Supp. 872 (E.D.N.Y. 1951), discussed
in one case, where the nonbankrupt party after bankruptcy terminated the contract for the bankrupt's prebankruptcy default, the trustee negotiated a new contract with the nonbankrupt party and thus could perform free of a security interest which a bank held in the proceeds of the old contract.\textsuperscript{353}

The nondefaulting party may, however, contract away any right to assert the consequences of the bankrupt's prebankruptcy breach. In Application of Baby World Co.,\textsuperscript{354} the nonbankrupt party held one-half of the outstanding stock of the issuing corporation. He had agreed to sell the stock back to the corporation at a purchase price of $250,000, of which $100,000 was paid at the time of the contract and the balance was to be paid in monthly installments. The stock was placed in escrow, and the contract provided that if the corporation defaulted in a monthly payment the seller would have an option which he could exercise within 100 days after such default, to return one half of the payments received and take back all the stock or to keep all the payments received and surrender all the stock and any right to the unpaid balance of the purchase price. The corporation defaulted on a monthly payment and less than a month later filed a Chapter XI petition. The seller failed to exercise his option to retake the stock and return one-half of the payments received within the time prescribed, and the court held that he was bound by the contractual provision that relieved the corporation from liability for the unpaid balance of the purchase price. Because the corporation was insolvent and the default was not deliberate, the court saw no unfairness in holding the seller to a contract under which he would

very quickly get $100,000 and as much more as the Debtor could pay up to $250,000, and, in the event of a default, have the power then to make an informed judgment whether to keep what he had received and cry quits, or to get back into the business and effect a rescue, keeping half of what he had received as his "liquidated damages" and putting the rest back into the business as—obviously—much needed working capital.

\textsuperscript{353} In Countryman, Part I, at 467 n.109; In re Elk Bank Coal Co., 261 F. 445 (M.D. Pa. 1919). Except for the fact that his damage claim is reduced by the saving resulting from the excuse of his performance, the nonbankrupt party is in the same position as a nonbankrupt who has fully performed before the bankrupt's prebankruptcy breach. See In re Beverlyridge Co., 35 F.2d 818 (9th Cir. 1929), discussed in Countryman, Part I, at 463 n.94.

\textsuperscript{354} In re Luscombe Engineering Co., 268 F.2d 683 (3d Cir. 1959).

\textsuperscript{355} 236 F. Supp. 283 (E.D.N.Y.), aff'd sub nom. Baby World Co. v. Daniels, 330 F.2d 588 (2d Cir. 1964).
The latter alternative may be thought a species of rescission plus damages for breach.\textsuperscript{355}

The two cases involving prebankruptcy breach by the nonbankruptcy party are consistent with, but add little to, the assumptions set forth above. In \textit{Tobin v. Plein}\textsuperscript{356} a corporation and its two stockholders had entered into an agreement for the liquidation of the corporation. After the corporation's bankruptcy, its trustee charged one stockholder with a pre-bankruptcy breach of the agreement and sought to invoke an arbitration clause in the agreement. The defaulting stockholder contended that the trustee had rejected the contract by failing to assume it within the time specified in section 70b.\textsuperscript{357} The court denied this contention and permitted the arbitration on two grounds: (1) Even if the trustee had rejected the contract and his rejection constituted a breach, he would not lose any claim he might have for prebankruptcy breaches by the stockholder. (2) If the prebankruptcy breaches by the stockholder were material, the corporation would be relieved of any further obligation to perform and the contract would therefore no longer be an executory contract.\textsuperscript{358}

\textit{Archer-Daniels-Midland Co. v. Paull}\textsuperscript{359} involved a bankrupt who had failed to schedule a claim for the prebankruptcy breach of a contract with a third party to finance a business in which he and another were engaged as joint venturers. Harkening back to ancient learning,\textsuperscript{360} the court held that the bankruptcy trustee had not abandoned the cause of action for the third party's breach. Although the joint venturer could similarly maintain an action for damages for the breach, he would have to account for the bankrupt's share of the recovery either to the bankruptcy trustee if the bankruptcy case was reopened or to the bankrupt as trustee for his creditors if it was not.

\textbf{B. Postbankruptcy Breach}

An analysis of the effect of a material postbankruptcy breach on the bankruptcy trustee's option to assume or reject an executory contract must proceed with little aid from the

\textsuperscript{355} Id. at 287.
\textsuperscript{356} 301 F.2d 378 (2d Cir. 1962).
\textsuperscript{357} 11 U.S.C. § 110 (b) (1970).
\textsuperscript{358} Id.
\textsuperscript{359} 188 F. Supp. 277 (W.D. Ark. 1960), rev'd on other grounds, 293 F.2d 389 (8th Cir. 1961).
\textsuperscript{360} See text accompanying note 14, Countryman, Part I, at 442.
cases. In re Dermer, was decided before the Bankruptcy Act provided expressly for the treatment of executory contracts. There the vendee was not in default under his land purchase contract at the time of his bankruptcy, but thereafter a default in the annual installment payment occurred despite the vendors’ notice to the bankruptcy trustee of the due date. When the vendors asserted their rights under a contractual option to terminate for such default, the referee ordered the trustee to abandon the property, and the trustee sought no review of that order. When the referee later ordered the trustee to pay to the vendors any rents collected from the vendee’s tenants after the default, however, the trustee appealed that order and lost. Inasmuch as the trustee’s right to possession of the property was no better than that of the vendee after the default, the trustee’s possession after that time was wrongful and required surrendering the rents which he had collected while “holding tortious possession in defiance of” the vendors’ rights.

In the absence of any pertinent provision in the Bankruptcy Act and of any assertion by the trustee of a right to cure the default, the decision in In re Dermer and its assumption about the vendors’ power to terminate the contract would be sound today. The trustee of the vendee took only the vendee’s interest in the contract, and such interest was taken subject to any contractual burdens. While the trustee could have assumed or rejected the contract before the postbankruptcy default occurred, he had not done so. Even in the absence of an express power in the vendors to terminate for default, a default in an annual installment payment was doubtless sufficiently material to entitle the vendors to treat their own further performance as discharged. By electing to treat it so, the vendors could prevent the trustee from assuming the contract, had he wished to do so. Had they elected instead to waive the breach, the vendors would then have had to await the trustee’s decision whether to assume or reject the contract.

The analysis of the respective rights of vendor and trustee in Dermer, however, follows only in the absence of some contrary provision in the Bankruptcy Act. Since 1938, section 70b has given the trustee a fixed period, subject to reduction or extension by the court, in which he must decide whether to

---

361. 56 F.2d 223 (S.D. Cal. 1931), discussed in Countryman, Part I, at 464.
362. 56 F.2d at 224.
In the factual context of Dermer the question then arises how this provision is to be applied where a material postbankruptcy breach in the bankrupt's obligation occurs before that time has expired and before the trustee has either rejected or assumed the contract. When the question does arise, the nonbankrupt party will doubtless argue both that the right to terminate the contract is unaffected by section 70b and that the contract is no longer executory if it has been so terminated. If that argument prevails, future bankruptcy trustees can preserve their option to assume or reject an executory contract only by making the expenditures necessary to avoid a material postbankruptcy breach.

The acceptance of this argument raises another question. If the trustee uses funds of the estate to avoid a postbankruptcy breach and ultimately elects to reject the contract, are the expenditures so made to be treated as a first priority expense of administration? After all, the nonbankrupt party's claim for damages based on the rejection of the contract (which claim will be reduced by the prior payments from estate funds) is not entitled to such priority. If the expenditures are treated as a first priority expense, the nonbankrupt party benefits from the fortuity that some part of the bankrupt's performance came due during the section 70b period within which the trustee must exercise his option to assume or reject. This conundrum may persuade the courts that the effect of the section is to deprive the nonbankrupt party of the usual right under state contract law to treat a material breach which occurs during the period prescribed by the section as an excuse of his performance under the contract. Such a conclusion may perhaps compel the concomitant conclusion that where the trustee elects to assume rather than to reject the contract he has not only the right but also the obligation to cure the earlier default at the expense of the estate.

The conundrum is even more pronounced where the postpetition breach of the debtor's obligation occurs after the initiation

---

364. See Countryman, Part I, at 448.
366. The question would not arise in those cases where the trustee elects ultimately to assume the contract. The assumption is effective as of the date of the petition. Palmer v. Palmer, 104 F.2d 161 (2d Cir.), cert. denied, 308 U.S. 590 (1939). Moreover, all postpetition expenses involved in performing the bankrupt's assumed obligations, until the trustee disposes of the contract, are first priority administrative claims.
of a chapter proceeding rather than a straight bankruptcy liquidation. The Act provides quite clearly that the chapter proceeding trustee, with court approval, may assume or reject an executory contract at any time before confirmation of a plan and that, if he does not reject, the contract may be assumed or rejected by the terms of a confirmed plan. The time during which a material postbankruptcy breach may occur, that is between the filing of the petition and the exercise of the option to assume or reject, thus may be more prolonged in a chapter proceeding than in a straight bankruptcy case. The Act sheds no additional light on the effect of this option upon the right of the nonbankrupt party to treat a postpetition material breach as an excuse of his performance except by the unconstrued provisions in section 77 and Chapters X and XII that a plan may provide for the curing of defaults. Although the only clear statutory guidance is that rehabilitation plans are expressly authorized to alter contractual rights, the courts have been willing to impose restrictions on the contractual rights of individual creditors where the exercise of those rights would jeopardize a rehabilitation. The cases involving preplan restraint of the nonbankrupt's exercise of contractual rights have dealt with secured creditors whose contracts were not executory within the meaning of the Act, but the rights of unsecured creditors can hardly rise higher than those of the secured. For example, in the section 77 reorganization of the Rock Island road the Supreme Court held that pledgees in possession of their collateral could be restrained from foreclosing despite the debtor's postpetition default if such foreclosure would jeopardize the reorganization. The Court also suggested that the same result might not follow in a straight bankruptcy liquidation case.

In re American National Trust sheds little light on the problem of the nonbankrupt's right to terminate a contract for a material breach which occurs after the filing of a Chapter X petition. There the court held that a Chapter X court could authorize the trustee to reject an executory contract to purchase land despite the fact that the sellers had already terminated it for postpetition breach under a provision in the contract which

---

367. See text accompanying notes 597-600 infra.
368. See text accompanying note 338 supra.
372. 426 F.2d 1059 (7th Cir. 1970).
allowed the seller in event of termination to retain as liquidated damages a money deposit and a deed to other land. The decision of the court below had also ordered the seller to return this security to the debtor, but the reversal of this order as not within the summary jurisdiction of the court left unresolved what had been accomplished by the trustee’s rejection of the contract.

There are fewer problems where the trustee commits a material postbankruptcy breach after he has assumed an executory contract and before he has disposed of it. If such a breach is not cured, there is no apparent reason why the nonbankrupt party should not have the usual option to assert the consequences of the breach or to waive them. If the nonbankrupt party elects the first alternative, any claim for damages would be entitled to first priority as an administrative expense because the trustee has assumed the executory contract. If the postbankruptcy breach occurs after the trustee has both assumed and disposed of the contract, with court approval, however, the last sentence of section 70b provides that the trust is not liable for such breaches and the nonbankrupt party must pursue his options against the trustee’s assignee.

The effect of a material postbankruptcy breach by the nonbankrupt party is similar to that of a prebankruptcy breach. If the default occurs before the trustee has assumed or rejected the contract and is not cured, the trustee either can assert the consequences of the breach and thereby rid himself of the con-

373. In re Forgee Metal Prods., 229 F.2d 799 (3d Cir. 1956), discussed in Countryman, Part I, at 489, did not speak of cure but perhaps should have. Erroneously treating a conditional sale contract as an executory contract, Forgee held that where the Chapter X proceeding aborts and the vendee is adjudicated a bankrupt the bankruptcy trustee can assume the contract within the time allowed by § 70b despite a default in payment after the vendee had originally filed the Chapter X petition. Finding that the trustee had assumed the contract, the court confined the vendor to a claim for the balance of the price and denied his petition to reclaim machinery concededly worth more than that balance. Forgee may be explained by the fact that the contract was subject to § 19 of the old Uniform Conditional Sales Act which allowed the vendee 10 days to redeem the machinery after the vendor repossessed it. Absent such redemption, moreover, the vendee was entitled to insist that the vendor sell the machinery at public auction and account to him for any surplus because the vendee had paid more than 50% of the purchase price.

374. 11 U.S.C. § 110(b) (1970). If the assignee had not assumed the obligations of the contract, the option to assert the consequences of the breach would not provide a damage claim against the assignee. 4 A. CORBIN, CONTRACTS § 906 (1951).
tract without a rejection and a resulting claim for damages or can waive the breach and assume the contract. If the default occurs after the trustee has assumed the contract, he can either assert the breach and pursue any damage claim or waive it.

C. Bankruptcy as Breach

There remains the possibility that in the absence of an actual default by the bankrupt party to an executory contract the mere fact of his bankruptcy may be treated as a breach of the contract. The treatment of bankruptcy as a breach may spring from the common law doctrine of anticipatory breach, some other provision of nonbankruptcy law or an express provision in the contract.

1. Anticipatory Breach

In the early case of Central Trust Co. v. Chicago Auditorium Association\(^{375}\) the Supreme Court held that, at least where the bankrupt's performance would require some capital, the mere fact of the bankruptcy constituted an anticipatory breach which gave the nonbankrupt party a provable claim for damages. Presumably the bankruptcy would also entitle the nonbankrupt party to treat the breach as an excuse for nonperformance and thus to prevent the trustee from assuming the contract, but in most of the cases which might have turned on this particular issue the courts have been ingenious in avoiding it.\(^{376}\)

---

375. 240 U.S. 581 (1916). Although the decision on this point was unnecessary because the trustee had rejected the contract, other courts have followed the Supreme Court's example by unnecessarily invoking the doctrine of anticipatory breach in cases where there had been an actual prebankruptcy default. In re Marshall's Garage, 63 F.2d 759 (2d Cir. 1933), discussed in note 352 supra; In re Beverlyridge Co., 35 F.2d 818 (9th Cir. 1929), discussed in Countryman, Part I, at 463 n.94.

As argued at more length elsewhere, this court-created doctrine of bankruptcy-as-anticipatory-breach (based, apparently, on state common law contract doctrine) was at its creation inconsistent with the earlier court-created doctrine giving the bankruptcy trustee the option to assume or reject executory contracts.\(^{377}\) And in 1938 Congress expressly incorporated the trustee’s option to assume or reject an executory contract and ignored the doctrine of bankruptcy-as-anticipatory-breach. This congressionally authorized trustee’s option should override any inconsistent option that state common law might give to the nonbankrupt party solely because of the fact of bankruptcy.

2. Other Nonbankruptcy Law

The only other generally recognized provisions of nonbankruptcy law which might conceivably apply in the bankruptcy of one party to an executory contract are certain provisions of the Uniform Commercial Code\(^{378}\) applicable to contracts for the sale of goods. Section 2-609 provides that either party to such a contract may, when “reasonable grounds for insecurity arise” with respect to the performance of the other party, make written demand for “adequate assurance of due performance.” Failure of the other party to provide such assurance within a reasonable time not exceeding 30 days is treated as a repudiation of the contract. And under section 2-610 a repudiation of performance the loss of which will substantially impair the value of the contract to the other party may be treated as a breach of the contract and an excuse for nonperformance.

Clearly, as a matter of fact, the bankruptcy of either the buyer or the seller of goods under an executory contract might provide the “reasonable grounds for insecurity” which would entitle the nonbankrupt party under the provisions of the UCC to demand “adequate assurance of due performance.” If the UCC applies, after such a demand the bankruptcy would have only 30 days to provide such assurance—less time than the Bankruptcy Act gives him to decide whether to assume or reject an executory contract in a straight bankruptcy case and much less time than the Act gives him to decide in a chapter proceeding. This conflict between the UCC and the Act poses the question whether the UCC can compel the bankruptcy

\(^{377}\) Countryman, supra note 376, at 418-20.

\(^{378}\) The Uniform Commercial Code is hereinafter referred to in text as the UCC.
trustee to incur the cost of posting adequate assurance\textsuperscript{379} as a condition to taking the full time for decision allowed by the Act. If the trustee posts such assurance but ultimately decides to reject the contract, the bankruptcy court must again face the question posed when the trustee uses funds of the estate to avoid other postbankruptcy defaults, that is, whether the costs incurred by the trustee are to be treated as first priority expenses of administration.\textsuperscript{380}

If the trustee avoids this dilemma by accelerating his decision and assuming the contract, a whole series of questions arises. Is the nonbankrupt party entitled to demand a greater assurance of performance than the trustee's assumption of the contract?\textsuperscript{381} Is the nonbankrupt party entitled to question the adequacy of the estate to meet his and other first priority claims against it? Is the nonbankrupt party entitled further to speculate that the trustee may, with court approval, assign the assumed contract to a financially irresponsible assignee or to an assignee who does not assume its obligations?\textsuperscript{382}

Although interesting, these questions are obviated by a recognition of the primacy of the Bankruptcy Act. The provisions of the UCC, like the common law doctrine of anticipatory breach, should not be available to fetter the option, and the time for exercising that option, that the Act gives to the trustee.\textsuperscript{383}

3. Express Provisions of Contract

Before the Bankruptcy Act expressly dealt with executory contracts, including leases, the draftsmen for real estate lessors had met with some success in the use of clauses providing that the bankruptcy of the tenant would ipso facto terminate the lease or would give the lessor an option to terminate it.\textsuperscript{384}

\textsuperscript{379} Comment 4 to § 2-609 specifies, as examples of "adequate assurance," the posting of a guaranty, replacement or repair of goods, and a money allowance.

\textsuperscript{380} See text accompanying notes 365-66 supra.

\textsuperscript{381} See Weaver v. Hutson, 459 F.2d 741, 743 (4th Cir.), cert. denied, 409 U.S. 957 (1972), discussed in note 345 supra. Weaver held that a lessor under a real estate lease had waived prebankruptcy defaults in rent payments by accepting such payments after default and that he had been relieved of any injury from the tenant's prebankruptcy default under a trust deed to which the lessor's reversion was subordinated "through the [Chapter X] trustee's assurance."

\textsuperscript{382} See note 374 supra.

\textsuperscript{383} Countryman, supra note 376, at 420-23.

\textsuperscript{384} See Countryman, Part I, at 445-46.
As enacted in 1938, section 70b provides in part:

A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election and subsequently assigning the same; but an express covenant that an assignment by operation of law or bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable.\textsuperscript{385}

The draftsmen of this language explained that it was "perhaps only declaratory of the existing law, and is here included for the sake of comprehensiveness and clarity."\textsuperscript{386} Certainly the first clause seems to codify the Supreme Court decision in Gazlay v. Williams,\textsuperscript{387} holding ineffective against a bankruptcy trustee of the lessee a provision in a real estate lease forfeiting the leasehold if the lessee "shall assign [his] lease . . . or if said lessee's interest therein shall be sold under execution or other legal process. . . .\textsuperscript{388} The second clause, insofar as it gives effect to an ipso facto provision automatically terminating a lease on the bankruptcy of the lessee, codifies the decision in Irving Trust Co. v. A. W. Perry Co.\textsuperscript{389} And that part of the second clause which authorizes an option to terminate upon the bankruptcy of the lessee codifies the decisions of lower federal courts involving real estate leases prior to the enactment of section 70b.\textsuperscript{390}

In any event, the forfeiture provisions of section 70b are by their terms confined to leases, and the "existing law" declared by the section was confined to real estate leases\textsuperscript{391} wherein

\begin{footnotes}
\item 388. 210 U.S. at 41.
\item 389. 293 U.S. 307 (1934), discussed in Countryman, Part I, at 445-46 but misited in note 30. Cf. Jandrew v. Bouche, 29 F.2d 346 (5th Cir. 1928), treating as an ipso facto clause a recital in a lease that it was "personal to the lessees and shall not inure to the benefit of any receiver or trustee in bankruptcy as an asset of the said lessees."
\item 390. In re Lindy-Friedman Clothing Co., 285 F. 22 (5th Cir. 1922); Empress Theatre Co. v. Horton, 266 F. 657 (8th Cir. 1920). See also In re Walker, 93 F.2d 281 (2d Cir. 1937), holding that a provision giving the lessor the option to terminate in the event of insolvency of the lessee or the appointment of a receiver entitled the lessor to terminate, both because of the filing of a petition under § 77B alleging inability to meet debts as they matured and because the order continuing the debtor in possession was tantamount to the appointment of a receiver. Cf. In re Burke, 76 F. Supp. 5 (S.D. Cal. 1948); In re Larkey, 214 F. 867 (D.N.J. 1914).
\item 391. Since the language of § 70b, 11 U.S.C. § 110(b) (1970), is con-
\end{footnotes}
CONTRACTS IN BANKRUPTCY

draftsmen attempted to grapple with the unique judicial conceptions with respect to such leases.\textsuperscript{392} These forfeiture provisions should be confined to real estate leases,\textsuperscript{393} and a fair negative implication of the provisions is that neither ipso facto clauses nor options to terminate for bankruptcy should be effective against the bankruptcy trustee when they appear in executory contracts other than leases.\textsuperscript{394} Except where expressly permitted by the Bankruptcy Act, the parties should not be able by contractual provision to deprive the bankruptcy trustee of the option to assume or reject expressly provided by the Act.

In the event the Act's forfeiture provisions are not confined to real estate leases so that ipso facto clauses and options to terminate on bankruptcy are enforced in executory contracts generally,\textsuperscript{395} the treatment of such clauses in real estate leases

---

392. See Countryman, Part I, at 439, 446.
393. See Countryman, supra note 376, at 423-28. In re Little & Ives Co., 262 F. Supp. 719, 723 (S.D.N.Y. 1966), discussed in text accompanying note 309 supra, does treat the forfeiture provisions of § 70b, 11 U.S.C. § 110(b) (1970), as validating an option to terminate a publishing contract on the bankruptcy of the publisher. The principal basis for this decision, however, is that the relationship between the parties "was based on trust and confidence" so that the contract was one that did not pass to the trustee under § 70a, 11 U.S.C. § 110(a) (1970). Lichman v. Moore, 131 F. Supp. 434 (D.N.H. 1955), discussed in note 330 supra, concludes without reference to § 70b that a provision for forfeiture of a patent license on the bankruptcy of the licensee is enforceable against the bankruptcy trustee. It is also argued in 4A W. Collier, BANKRUPTCY § 70.43[9] (14th ed. 1971), that the forfeiture provisions of § 70b should apply to all executory contracts since they represent "merely an adoption of prior case law," but the prior case law cited is confined to real estate leases. Id. § 70.44[3].
394. A party with sufficient bargaining power or one willing to offer sufficient inducement to obtain a power to terminate at will need not worry about the problem. In Thompson v. Texas Mexican Ry., 328 U.S. 134, 141 (1946), a trackage agreement between the Brownsville and Tex-Mex railroads which gave the Brownsville the right to operate over the track of the Tex-Mex also gave either party the power to terminate on 12 months' notice. The Brownsville went into § 77 proceedings, 11 U.S.C. § 205 (1970), in 1933, and the court held the Tex-Mex entitled
illustrates problems that may arise with such clauses in other executory contracts.

In *Finn v. Meighan*396 the Supreme Court found that the forfeiture provisions of section 70b were not inconsistent with the provisions of Chapter X397 and were therefore applicable in a Chapter X case, even though in some such cases a forfeiture of a lease would frustrate reorganization. The lease in question had been drafted 12 years before Chapter X was enacted and contained an ipso facto clause which was to apply “if the tenant shall be adjudged bankrupt or insolvent by any Court, or if a trustee in bankruptcy of the tenant shall be appointed. . . .”398 The debtor in Chapter X had not been “adjudged” a bankrupt, however, and the Court ignored the fact that a trustee had been appointed who under sections 186 and 187 had the title, rights, duties and powers of a trustee in straight bankruptcy.399 After announcing that the “bankruptcy court does not look with favor upon forfeiture clauses in leases” and that such clauses “are liberally construed in favor of the bankrupt lessee,” the Court concluded that the Chapter X case constituted an adjudication of insolvency which would trigger the ipso facto clause. The Chapter X petition alleged that the debtor was unable to pay its debts as they matured,400 and prior to the enactment of Chapter X corporations had been reorganized in federal courts by equity receiverships initiated on general creditors’ bills alleging

---

396. 325 U.S. 300 (1945) (lease of one of a chain of restaurants).
398. 325 U.S. at 301.
insolvency in the equity sense. The Court reasoned that the ipso facto clause by its reference to an adjudication of insolvency was aimed at that earlier practice and should therefore be construed to reach its statutory equivalent.\textsuperscript{401}

Thereafter in the Hoboken Railroad case,\textsuperscript{402} the Court held that the forfeiture provisions of section 70b were not on their face inconsistent with section 77\textsuperscript{403} and that an option to terminate a railroad lease (drafted in 1906) was enforceable against the section 77 trustee in the event of any transfer of the lease "whether made by the Lessee or in any proceeding . . . whereby any of the rights, duties and obligations of the Lessee shall . . . be transferred . . . without the consent of the Lessor."\textsuperscript{404} The lessor had petitioned the court below to be allowed to terminate the lease, but the court ordered the trustee to adopt the lease before it ruled on the lessor's petition. The Supreme Court concluded that "[w]hen the trustee adopted the lease, the lessee's interest was transferred to him . . . in a 'proceeding . . .' " within the meaning of the lease's option to terminate.

Although other courts have been similarly generous to the lessor in construing lease forfeiture provisions not precisely applicable to the various proceedings under the Bankruptcy Act,\textsuperscript{405} such provisions have caused enough litigation to inspire more precision in their drafting.

The termination of leases in section 77 cases involves other problems, however, and the Supreme Court's resolution of those problems later produced new uncertainties about the application of the forfeiture provisions in other rehabilitation cases. Section 77d\textsuperscript{406} provides both that no reorganization plan for a railroad can be confirmed until it has first been approved by the Interstate Commerce Commission and that the Commission may approve plans different from those proposed by the parties as long as the plans are fair and equitable and compatible with the

\textsuperscript{401} Despite the termination of its lease after this decision the debtor was held entitled to remain in possession for a limited period of time under a state emergency rent control law. Finn v. 415 Fifth Ave. Co., 153 F.2d 501 (2d Cir.), cert. denied, 328 U.S. 838 (1946). Cf. In re Burke, 76 F. Supp. 5 (S.D. Cal. 1948), discussed in note 334 supra.


\textsuperscript{404} 328 U.S. at 126.


public interest. Section 770407 also requires ICC approval pursuant to section 1(18) of the Interstate Commerce Act408 before any lines can be abandoned in a section 77 case.409 Consequently, the Supreme Court held in the Hoboken Railroad case410 that, while a lessor's option to terminate a lease was enforceable against the section 77 trustee of the lessee, the reorganization court could not declare the lease forfeited until the ICC had performed its functions under sections 77d and o. With respect to the Commission's authority over the reorganization plan under section 77d, the Court noted that forfeiture of the lease would deprive the debtor of all of its railroad properties and might frustrate its reorganization. The Court further indicated that the Commission might conclude either that forfeiture of the lease as provided by section 70b would be compatible with the public interest or that the public interest required that the lease be adopted by the terms of the reorganization plan. If the public interest required the adoption of the lease, any application of the forfeiture provisions of section 70b would not be "consistent with the provisions of" section 77 within the meaning of section 77(1), and the plan which adopted the lease could also provide for the curing of defaults as authorized by section 77b(5).411

407. Id. § 205(o).
409. Section 77c(6), 11 U.S.C. § 205(c)(6) (1970), provides that if a lease is rejected and the lessee elects no longer to operate the leased line the lessor shall do so. If the judge finds that it would be impracticable and contrary to the public interest for the lessor to do so, however, the lessee shall continue operation for the account of the lessor until the Commission authorizes abandonment. See Palmer v. Webster & Atlas Nat'l Bank, 312 U.S. 156 (1941); Warren v. Palmer, 310 U.S. 132 (1940).

Chapter X excludes from those executory contracts which may be rejected by the trustee or by the terms of the plan "contracts in the public authority." §§ 116(1), 216(4), 11 U.S.C. §§ 516(1), 616(4) (1970). This language has not been officially construed, but it seems to have been inspired by the ultimately unavailing effort of Mayor LaGuardia to preserve the five cent subway fare provided by contracts between the City of New York and public utility corporations operating the subways. See 6 W. Collier, Bankruptcy §§ 3.23(7) & n. 83 (14th ed. 1971). It has been suggested that the language is not applicable where the trustee of a public utility in reorganization seeks to reject a lease with another public utility. In re Chicago Rapid Transit Co., 129 F.2d 1, 8 (7th Cir.), cert. denied, 317 U.S. 683 (1942).
411. 11 U.S.C. § 205(b)(5) (1970). See also Thompson v. Texas Mexican Ry., 328 U.S. 134, 143 (1946), discussed in note 395 supra, dealing with the same problem where the bankrupt party sought to termi-
In reliance on Hoboken Railroad, two federal courts of appeal have concluded that it would be inconsistent with Chapter X to allow a section 70b forfeiture of the leases of publicly held corporations where that forfeiture would deprive them of the properties upon which they operated motels and thus frustrate their prospects for reorganization under Chapter X.\(^{412}\) When the Supreme Court denied certiorari in the more recent of these cases, only Justice White dissented on the ground that Finn v. Meighan\(^{413}\) had rejected the argument that application of the forfeiture provisions of section 70b might frustrate some Chapter X reorganizations.\(^{414}\) The frustration of reorganization, however, was not shown to be a likely result of the forfeiture in Finn v. Meighan. Perhaps all that can be said of the test of inconsistency of the forfeiture provisions of section 70b with the provisions of section 77 and the chapters is that it will be made on a case-by-case basis.

The doctrine of waiver has also been invoked to prevent a lessor from employing ipso facto clauses and options to terminate which would otherwise be enforceable under section 70b. Although waiver has not resulted merely from the fact that that the lessor delayed in exercising his option to terminate,\(^{415}\)
waiver has been found where the lessor accepted rental payments from the trustee for more than a year after the lessee's bankruptcy\(^{416}\) and where the lessor waited three months to exercise her option while assuring both the referee and the trustee that she would cooperate in the assignment of the lease.\(^{417}\) And both waiver and estoppel have been found where the lessors, acting through a trustee who was also an indenture trustee for creditors and who had filed the Chapter X petition, had for two months assured the trustee that they would not exercise their option to terminate.\(^{418}\)

Several cases have involved a lessor who received payments, not as rent under the lease but rather for use and occupancy of the premises, from the debtor in possession under section 77B or Chapter XI. The receipt of such payments has been held not to constitute a waiver of the lessor's option to terminate because the lessor would have a valid claim for such payments even if the lease were terminated.\(^{419}\) The receipt of rental payments, however, has often been found to constitute such a waiver. Thus a lessor had waived his option to terminate by consenting to the trustee's assignment of the lease and by accepting rental payments accruing after the petition was filed from the prospective assignee.\(^{420}\) Similarly a lessor has waived an ipso facto clause and an option to terminate merely by accepting payments of postpetition rents from the debtor in possession or the trustee with knowledge of the pendency of the proceeding under the Bankruptcy Act.\(^{421}\) A provision in the

\(^{416}\) Ten-Six Olive, Inc. v. Curby, 208 F.2d 117 (8th Cir. 1953).
\(^{418}\) Davidson v. Shivitz, 354 F.2d 946 (2d Cir. 1966).
\(^{419}\) B.J.M. Realty Corp. v. Ruggieri, 326 F.2d 281 (2d Cir. 1963); In re Wil-Low Cafeterias, 95 F.2d 306 (2d Cir.), cert. denied, 304 U.S. 667 (1938); In re Walker, 93 F.2d 281 (2d Cir. 1937). See also Model Dairy Co. v. Foltis-Fischer, 67 F.2d 704 (2d Cir. 1933), applying the same rule in an equity receivership. Inasmuch as the use and occupancy payments made to the lessor by the debtor in possession in the B.J.M. Realty and Walker cases were in the precise amount of the monthly rental payments specified in the lease, the courts' conclusions that they were not paid as rent but rather for use and occupancy were rather heroic ones. And, as the trial court had not yet fixed the reasonable value to the estate of the use and occupancy, the payments so characterized would be subject to later adjustment. See also Sproul v. Help Yourself Store Co., 16 F.2d 554 (3rd Cir. 1926).
\(^{420}\) Entin v. Stevens, 323 F.2d 894 (8th Cir. 1963).
\(^{421}\) In re Sound, Inc., 171 F.2d 253 (7th Cir. 1948), cert. denied,
lease that receipt of rent with knowledge of any breach shall not be deemed to constitute a waiver, however, has been effective to forestall the waiver consequences of the lessor's acceptance of postpetition rent. But such a provision has not been effective where the lease also required the lessor to exercise his option within a reasonable time, and when he made a written offer to accept rental payments from the Chapter XI receiver and did in fact accept partial payments from the receiver before attempting to exercise his option seven months after the petition was filed.

Double-barreled options to terminate have also been effective to forestall the waiver consequences of the lessor's acceptance of postpetition rent. One lessor, for example, waived his option to terminate on the appointment of a receiver by thereafter accepting rent payments from the Chapter XI receiver, but retained an option to terminate for bankruptcy adjudication where the Chapter XI case aborted and an adjudication followed. Another lessor had the option to terminate either if bankruptcy proceedings were initiated or if the lease was transferred by operation of law. The lessor waived the first option by accepting rent from the bankruptcy receiver but did not waive the second because title would not pass to the bankruptcy trustee until he assumed the lease—an event which the lessor was allowed to preclude by exercising his option.

336 U.S. 962 (1949) (ipso facto clause); B.J.M. Realty Corp. v. Ruggieri, 338 F.2d 653 (2d Cir. 1964). At an earlier stage of the B.J.M. Realty case, the court found no waiver in the lessor's mere acceptance of postpetition rental payments and required a showing that the lessor knew of the pending Chapter XI proceeding—a showing that the court was unwilling to find from the fact that the checks which the lessor accepted were stamped "debtor in possession." B.J.M. Realty Co. v. Ruggieri, 326 F.2d 281 (2d Cir. 1963). No waiver results from the lessor's postpetition acceptance of payment of prepetition rent. In re Wise Shoe Co., 26 F. Supp. 762 (S.D.N.Y. 1938). Cf. Ten-Six Olive, Inc. v. Curby, 208 F.2d 117 (8th Cir. 1953). In Curby the lessor did not exercise his option to terminate during the pendency of an abortive Chapter X case, but accepted rental payments from the Chapter X trustee and then accepted possession of the premises from the bankruptcy trustee shortly after the debtor was adjudicated. The court held that there had been a surrender and acceptance of the lease which terminated all liability for further rent.

424. Robinson v. Hadley, 351 F.2d 385 (9th Cir. 1965).
425. In re Frazin, 183 F. 28 (2d Cir. 1910).
IV. MANNER AND CONSEQUENCE OF ASSUMPTION OR REJECTION

The questions remain as to how the trustee assumes or rejects an executory contract and the consequences of his action. In the chapter cases there is the additional question of the consequences when the trustee neither assumes nor rejects. This discussion will therefore deal separately with the problems in straight bankruptcy liquidation and in rehabilitation cases.

A. STRAIGHT BANKRUPTCY

For the first 40 years of the administration of straight bankruptcy cases under the Act of 1898, the courts merely applied doctrines which were created earlier and developed contemporaneously in equity receivership cases. Having created the option to assume or reject executory contracts in receivership cases and having carried the option over to the bankruptcy cases, the courts also created for themselves the obligation to prescribe how the equity receiver, or the bankruptcy receiver or trustee, must exercise his option and defined the consequences of his action.

In the earliest of its decisions involving the options of a receiver, the Supreme Court dealt with a lease of rolling stock to a railroad which was to be converted into a purchase and which also gave the lessor the right to ship goods over the road at specified rates. Two weeks after his appointment, the receiver had failed to purchase on the date specified in the lease and successfully resisted the lessor's attempt to compel specific performance. In what is apparently dictum, the Court said that the receiver of the road "was entitled to a reasonable time to elect whether he would adopt" the lease or would "return the property . . . paying, of course, the stipulated rental for it so long as he used it" and that the receiver had the right to set off freight charges owed by the lessor.426 In succeeding cases the Court reiterated that railroad receivers had a "reasonable time" to decide whether to assume or reject leases and held that they had not assumed them so as to become liable for the stipulated rentals as first priority administration claims merely by operating the leased lines without producing enough income to

pay rent for periods of 14\textsuperscript{427} and 23\textsuperscript{428} months. In both cases the receivership court had promptly granted the lessor's first request to repossess. In a similar case where the receivers had earned and paid rent for five months but operated for another 15 months without earning rent, the Court held that the lessor was entitled to a priority claim for the receivers' "use and occupation" of its property at the stipulated rental rate only for the last month, during which the bondholders unsuccessfully opposed the lessor's attempt to repossess.\textsuperscript{429}

Lower federal court decisions in receivership cases fleshed out the skeleton somewhat. In an attempt to bring some precision to the "reasonable time" within which the receiver must exercise his option, some courts fixed a specific period within which he was to act\textsuperscript{430} and then in some instances extended such time at the receiver's request.\textsuperscript{431} If the receiver took no action within a reasonable time, however, that inaction did not alone constitute an assumption of the contract, and the receiver could thereafter reject it.\textsuperscript{432} "It is not the rule that the contract is binding on the receiver until renounced. In order for a receiver to become bound by a contract, he must positively indicate his intention to adopt it..."\textsuperscript{433} Indeed, some of the decisions allowed the receiver to perform under the contract for a time to determine whether it was profitable and then reject it. If the receiver later persuaded the court that his rejection was proper, he could collect for his performance at the contract rate without setoff by the other party of a prereceivership damage claim against the debtor.\textsuperscript{434}

\textsuperscript{427} Quincy, Mo. & Pac. R.R. v. Humphreys, 145 U.S. 82 (1892), discussed in Countryman, Part I, at 444.
\textsuperscript{428} St. Joseph & St. Louis R.R. v. Humphreys, 145 U.S. 105 (1892), discussed in note 24, Countryman, Part I.
\textsuperscript{429} United States Trust Co. v. Wabash W. Ry., 150 U.S. 287 (1893), discussed in Countryman, Part I, at 445.
\textsuperscript{430} Peabody Coal Co. v. Nixon, 226 F. 20 (8th Cir. 1915).
\textsuperscript{431} See Pacific W. Oil Co. v. McDuffie, 69 F.2d 208 (9th Cir.), cert. denied, 293 U.S. 568 (1934); Irving Trust Co. v. Densmore, 66 F.2d 21 (9th Cir. 1933).
\textsuperscript{433} Pacific W. Oil Co. v. McDuffie, 69 F.2d 208, 213 (9th Cir.), cert. denied, 293 U.S. 568 (1934). See also Peabody Coal Co. v. Nixon, 226 F. 20, 22 (8th Cir. 1915).
\textsuperscript{434} Butterworth v. Degnon Contracting Co., 214 F. 772 (2d Cir. 1914).
Not all receivers had the temerity to act unilaterally to reject contracts. Some sought court approval of the rejection and obtained it;435 others were directed to assume the contract.436 In other instances the application of the nonbankrupt party precipitated the court order to the receiver to reject437 or assume438 the contract.

Where the receiver assumed the contract, the cost of the receiver's performance was treated as a first priority administration expense.439 While in most cases the receiver presumably would not take better rights under the contract than those of the debtor, one court concluded, where a debtor had before receivership assigned the proceeds of its electricity supply contract with a city to secure loans, that both the supply contract and the security agreement covering the proceeds were executory. The receivers could therefore assume the supply contract and reject the security agreement and thus could retain, free from the security interest, any proceeds earned by the receivers' performance under the supply contract.440

435. Irving Trust Co. v. Densmore, 66 F.2d 21 (9th Cir. 1933); Peabody Coal Co. v. Nixon, 226 F. 20 (8th Cir. 1915); Kansas City S. Ry. v. Lusk, 224 F. 704 (8th Cir. 1915). See also Eames v. H.B. Clafflin Co., 220 F. 190, 192 (S.D.N.Y. 1915), where the receivers petitioned for instructions with respect to goods delivered after the receivership by the other party under a contract of sale and were directed either to assume the contract, retain the goods, and pay the contract price or to reject the contract, “in which case the sellers will be allowed to pursue such remedies . . . for their recovery as they may be advised.”


440. General Elec. Co. v. Whitney, 74 F. 664 (5th Cir. 1896). It did not appear whether the security agreement obligated the lenders to continue making advances. As argued earlier, if it did not, it was not an executory contract. See Countryman, Part I, at 453, 472.
Where the receiver rejected the contract, the other contracting party was given a general claim for damages for breach of contract. If the rejected contract was an unexpired lease, the lessor was also given a first priority claim for the reasonable value to the estate of the receiver's use and occupancy of the leased premises from the time the receiver was appointed until the time the property was surrendered to the lessor. This use and occupancy value was usually, but not invariably, taken to be the rental rate stipulated in the lease. But the receiver had to use the leased property in order to give the lessor such a first priority claim. Where the receiver merely collected rents from subtenants during the two months before he rejected the lease and turned those rents over to the lessor, for example, the lessor's claim for use and occupancy was denied. There are many ways to use leased property, however. Thus in one case a debtor had purchased a competitor's papermill on leased property, had taken an assignment of the lease, and had closed the mill to eliminate the competition before receivership. Subsequently the receiver neither took physical possession of the leased property nor did anything else with respect to the property for more than six years except to demand a release of rent claims when the lessor sought to repossess. Nevertheless, the lessor was allowed a priority claim for the receiver's use and occupancy of the property at the rental stipulated in the lease.

441. Samuels v. E.F. Drew & Co., 292 F. 734 (2d Cir. 1923); Texas Co. v. International & G.N. Ry., 250 F. 742 (5th Cir. 1918), cert. denied, 249 U.S. 613 (1918); Pennsylvania Steel Co. v. New York City Ry., 198 F. 721 (2d Cir. 1912). In the Samuels case, where receivers had rejected contracts to purchase goods, the other party's damages were measured by the difference between the contract price and the market price on the delivery date. In the Texas Co. case, which involved a contract to supply oil to the debtor railroad, the supplier also established a priority claim for oil supplied to the road prior to the receivership under the "six-month rule." See note 225 supra.


443. See North Kansas City Bridge & R.R. v. Leness, 82 F.2d 9 (8th Cir. 1936), and Carswell v. Farmers Loan & Trust Co., 74 F. 88 (6th Cir. 1898), where the value to the estate was found to be less than the stipulated rental.

444. See also Mathews v. Butte Mach. Co., 286 F. 801 (9th Cir. 1923), discussed in note 50, Countryman, Part I, where a receiver who allowed a lease of machinery to expire after his appointment without either assuming or rejecting it was held liable to the lessor at the stipulated rental from the date of his appointment until he surrendered the machinery.

445. Irving Trust Co. v. Densmore, 66 F.2d 21 (8th Cir. 1933).
from the time five years earlier when the receiver had refused to surrender possession unless the lessor's rent claims were released. From that time, the receiver had "appropriated the premises to the use of" other operating mills in his charge "in the way . . . which . . . was most useful" to the estate and thus had continued for the receivership "the same value" which the closed mill previously held for the debtor.446

The Second Circuit treated the lessor's use and occupancy claims differently, however, in a series of cases involving street railways. Where the lessor was obligated by the terms of its franchise to keep the lines in operation but was equipped only to collect rent and not to operate railways, the court indicated that the lessor's priority claim should be calculated differently if the receiver of the lessee operated for a period prior to rejection of the lease. Thus where the receiver in Pennsylvania Steel Co. v. New York City Ry.447 paid the stipulated rental during part of the period of his operation prior to rejection and later discovered that the net earnings from his operation were less than the amount paid, he could not recover the difference for the period for which he had paid. But for the period between the cessation of rental payment and the surrender of the properties, the receiver operated for the account of the lessor and was charged only for net earnings. Where the receiver in American Brake Shoe & Foundry Co. v. New York Rys.448 operated the lines and paid no rental prior to rejection (the lessor was not itself able to take over operations earlier), the receiver was charged only for the net earnings of his operations. Subsequently the court concluded that Pennsylvania Steel had not established a "rigid rule" with respect to a receiver who for a time paid the stipulated rental. Such a receiver who later discovered that net earnings were more than the rental paid had to account to a lessor who was willing and able to operate for both the difference for the period during which he had paid rent and the full net earnings for operations between the cessation of rental payment and the surrender of the properties.449

446. Dayton Hydraulic Co. v. Felsenthal, 116 F. 961, 967, 969 (6th Cir. 1902).
447. 225 F. 734 (2d Cir.), rehearing denied, 227 F. 1021 (1915).
448. 282 F. 523 (2d Cir. 1922).
The straight bankruptcy cases arising prior to the 1938 amendments to the Bankruptcy Act added little to what was developed in the above receivership cases. One court dismissed the lessor's contention that the bankruptcy trustee of the tenant who assumed and sold a lease had thereby discharged the guarantors of the tenant's obligation under the lease. The trustee's assignment alone did not discharge the tenant of his covenant to pay rent, and even assuming that a later bankruptcy discharge would cover the tenant's liability, section 16 of the Act provided (and still does) that the liability of a guarantor is unaffected by the discharge of his principal. Another court concluded, where the bankruptcy receiver sold a lease, that a security deposit posted by the bankrupt tenant remained available for rent unpaid before the receivership.

Other cases made it clear that where the trustee assumed contracts for the sale of goods he took them *cum onere*, subject to the requirements of giving the buyer credit for prebankruptcy advances on the purchase price and holding the proceeds of his own performance subject to the bankrupt's pre-bankruptcy assignments of the contract's proceeds to secure a bank loan. Uncertainties remained, however, as to whether the trustee had assumed or rejected the lease. For example, one trustee reported inability to sell "wild cat" oil leases and the estate was closed without further action. A receiver later appointed for the corporate bankrupt by a state court sold one of the leases, and the purchaser struck oil four years later. Notwithstanding the sale of the lease, the bankruptcy case was reopened, and a new trustee was allowed to recover the property on a finding that his predecessor had not "abandoned" the

---

450. Under then prevailing law it probably did not. See Countryman, Part I, at 446.
453. *In re Sherwoods*, 210 F. 754 (2d Cir. 1913). Since this application exhausted the deposit, the court did not consider whether the deposit might also be charged with the receiver's obligation to the lessor for the period of his occupation of the premises, an obligation which the court described as one for use and occupancy without considering whether the receiver had assumed the lease by selling it with the approval of the bankruptcy court.
lease. 456

A number of decisions established the consequences of a rejection of a lease or contract. Thus it was assumed in a case where the issue was not decided that after rejection of a lease the “leasehold remained the bankrupt's.” 457 Where the bankruptcy trustee rejected a contract to sell goods, the buyer was left with a damage claim for breach of contract. 458 The trustee who rejected a lease, however, was liable for the reasonable value (usually but not always the rental price stipulated in the lease) of the use of the premises prior to rejection and surrender. 459 And where an electricity supplier was enjoined

456. Stanolind Oil & Gas Co. v. Logan, 92 F.2d 28 (5th Cir. 1937), cert. denied, 302 U.S. 763 (1938) and 303 U.S. 636 (1938). The lessor apparently should have followed the practice adopted in Gate City Clay Co. v. Dickey, 39 F.2d 581 (8th Cir. 1930), where the court, on petition of the lessor, directed the trustee to reject the lease.

457. Green v. Finnigan Realty Co., 70 F.2d 465, 466 (5th Cir. 1934).

458. In re Lathrap, 61 F.2d 37 (9th Cir. 1932).

459. Jensen v. Sparkes, 53 F.2d 433 (9th Cir. 1931); In re Millard's, Inc, 41 F.2d 498 (7th Cir. 1930); In re Colburn, 16 F.2d 780 (1st Cir. 1926); Gardner v. Gleason, 259 F. 755 (1st Cir. 1919); Wilson v. Pennsylvania Trust Co., 114 F. 742 (3d Cir. 1902); In re Nathanson, 24 F.2d 760 (D. Mass. 1927); In re Adams Cloak, Suit & Fur House, 199 F. 337 (D. Mass. 1912); In re Winfield Mfg. Co., 137 F. 984 (E.D. Pa. 1905); In re T.L. Kelly Dry-Goods Co., 102 F. 747 (E.D. Wis. 1900). See also In re Benguiat, 20 F. Supp. 504 (S.D. Calif. 1937), where the lessor exercised an option to terminate because of the tenant's bankruptcy. Where the lessor held a security deposit exceeding his claim against the bankrupt for prebankruptcy rent, he was held entitled in Jensen v. Sparkes, supra, to satisfy his claim for use and occupancy out of the balance of the deposit—a result which seems unobjectionable only if there were enough assets to pay all other first priority administration expenses in full. Cf. In re Sherwoods, discussed in text accompanying note 453 supra.

460. The value was fixed at less than the stipulated rental in Crook v. Zorn, 100 F.2d 792 (5th Cir.), cert. denied, 307 U.S. 630 (1939); Green v. Finnigan Realty Co., 70 F.2d 465 (5th Cir. 1934); In re McNeice, 287 F. 708 (9th Cir. 1923). It was fixed at more than the stipulated rental in In re Grignard Lithographic Co., 155 F. 699 (E.D.N.Y. 1907). But see In re Grignard Lithographing Co., 158 F. 557 (E.D. N.Y. 1907).

In Crook v. Zorn, supra, the court fixed the value at less than the stipulated rental because the trustee used only a part of the premises leased for a retail business and then only for storage purposes. Cf. In re Millard's, 41 F.2d 498 (7th Cir. 1930).

461. In re Chakos, 24 F.2d 482 (7th Cir. 1923). Where the trustee made no use of the leased premises prior to rejection, no allowance for use and occupancy was made, but the lessor was held entitled to subrents collected by the trustee. In re McCrory Stores Corp., 89 F.2d 517 (2d Cir. 1937); In re No Care Elec. Radiator Corp., 3 F. Supp. 331 (S.D.N.Y. 1933). In Meehan v. King, 54 F.2d 761 (1st Cir. 1932), where the lease expired two months after the tenant's bankruptcy without affirmation or rejection and without any use of the premises by the receiver, a claim for use and occupancy was denied. But the court then
from suspending service because of the bankrupt's prebankruptcy defaults while a bankruptcy composition was being effected, the supplier was allowed a priority claim at the prevailing retail rate rather than at the lower contract rate for all the electricity supplied to the receivers, who had neither rejected nor assumed the contract.\textsuperscript{462}

The 1938 amendments to the Bankruptcy Act, so far as here relevant, were primarily concerned with making claims for future rent provable and dischargeable but were also directed toward eliminating some of the uncertainty as to whether the trustee had assumed or rejected any executory contract. New section 63a(9) expressly made provable "claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property." However, that section limited the allowability of a landlord's claim under a real estate lease to an amount not to exceed the rent reserved by the lease for the year following the date of either surrender of the premises to the landlord or his reentry, plus the rent unpaid and accrued up to that date.\textsuperscript{463} New section 63c provided that "[n]otwithstanding any State law to the contrary, the rejection of an executory contract or unexpired lease . . . shall

\textsuperscript{462} Odell v. Bedford Co., 224 F. 996 (E.D.N.Y. 1915).

\textsuperscript{463} 11 U.S.C. § 103(a)(9) (1970). The limitation on allowability does not affect dischargeability of the full claim. Under § 17a, 11 U.S.C. § 35(a) (1970), provable claims, with exceptions not pertinent here, are discharged "whether allowable in full or in part."
constitute a breach of such contract or lease as of the date of the filing" of a petition under the Bankruptcy Act.\footnote{464} New section 70b, as once later amended,\footnote{465} provided in part:

The trustee shall assume or reject an executory contract, including an unexpired lease of real property, within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later, but the court may for cause shown extend or reduce the time. Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected. If a trustee is not appointed, any such contract or lease shall be deemed to be rejected within thirty days after the date of the order directing that a trustee be not appointed.\footnote{466} A trustee shall file, within sixty days after adjudication or within thirty days after he has qualified, whichever is later, unless the court for cause shown extends or reduces the time, a statement under oath showing which, if any, of the contracts of the bankrupt are executory in whole or in part, including unexpired leases of real property, and which, if any, have been rejected by the trustee. . . . A trustee who elects to assume a contract or lease of the bankrupt and who subsequently, with the approval of the court and upon such terms and conditions as the court may fix after hearing upon notice to the other party to the contract or lease, assigns the contract or lease to a third person, is not liable for breaches occurring after the assignment.

The draftsmen of these provisions explained that the first sentence of section 70b\footnote{467} was included because it was "considered advisable to impose upon the trustee the duty to act" and "it requires the trustee to make a decision" within the time specified unless the court altered that time. The requirement of the last sentence that the trustee obtain court approval of the assignment of an assumed contract was said to be imposed to "relieve against the unfairness which may occur in a case where the trustee, after adopting the executory contract or lease, assigns it to an irresponsible or undesirable person."\footnote{468}

Actually, the amendments did little to clarify the manner of the trustee's assumption or rejection of a contract. Although the trustee may either assume or reject the contract within the time specified by section 70b, the Act neither prescribes any form for the manifestation of his action nor indicates whether court approval is required for assumption or rejection, as distin-
guished from assignment, of a contract. Indeed, the fourth sentence of section 70b by requiring the trustee to file with the court a statement indicating any contracts rejected within the prescribed time may be taken to indicate that the trustee may act on his own. Only one point seems clear. If the trustee does nothing within the time fixed by section 70b, as that time may be reduced or extended by the court, he is deemed to have rejected the contract. This provision of section 70b has been treated as establishing a rejection without more in several cases—including one where the trustee of a bankrupt lessor had accepted rent from the lessee for "several months after adjudication."

As matters have transpired, however, the nonbankrupt contracting party cannot with safety rely on the apparently firm assurance of this provision. The Fifth Circuit Court of Appeals has ruled that the bankruptcy court may, pursuant to Rule 6(b) of the Federal Rules of Civil Procedure, extend the time for the trustee to act without notice to the other contracting party. The Fifth and the Eighth Circuit Courts of Appeals have concluded, moreover, that the nonbankrupt contracting party has waived his right to insist on automatic rejection within the section 70b time limits by assuring the referee and trustee that he would cooperate in the sale of a lease, by consenting to assignment of a lease and accepting rental payments from the prospective assignee, and by accepting rental payments first from a Chapter X trustee until adjudication.

469. Since this sentence speaks only of rejection and since assumption of contracts involves the creation of first priority administration expenses, it is argued in 4A W. Collier, BANKRUPTCY ¶ 70.43[5], at 529–31 (14th ed. 1972), that court approval should be required for assumption but not for rejection. But Nastromo, Inc. v. Fahrenkrog, 385 F.2d 82 (8th Cir. 1968), finds an effective assumption by the trustee without court approval.


475. Larkins v. Sills, 377 F.2d 1 (5th Cir. 1967).

476. Entin v. Stevens, 323 F.2d 894 (8th Cir. 1963). The same conduct was held also to constitute a waiver of the option to terminate the lease because of the filing of a Chapter X petition.
more than a year later and thereafter from the bankruptcy trustee. The Third Circuit Court of Appeals has said that "the sense of [the section] is that rejection is to be inferred unless assumption is satisfactorily proved." The court found a rejection of a contract to manufacture and sell goods where the trustee of the seller negotiated a new contract to sell to the buyer certain tools and dies which, by the terms of the original contract, were to have become the property of the buyer on completion of the manufacture and delivery of the goods.

While one court has indorsed the suggestion that court approval is required where the trustee assumes a contract, another has rejected the suggestion while conceding that it would be better practice for the trustee to obtain such approval. And another, erroneously treating a conditional sale contract as an executory contract, found that the trustee of the vendee assumed it by taking possession of the property covered by the contract and selling it.

New Bankruptcy Rule 607, which was approved by the Supreme Court and became effective October 1, 1973, provides merely an exhortation that the trustee gain court approval of an assumption of a contract:

Within 30 days after the qualification of the trustee, unless the court for cause shown extends or reduces the time, the trustee shall file a statement showing any executory contracts of the bankrupt, including unexpired leases, which the trustee has assumed. Whenever practicable, the trustee shall obtain approval of the court before he assumes a contract. Any such contract not assumed within 60 days after qualification of the trustee, or within such further or reduced time as the court

477. Ten-Six Olive, Inc. v. Curby, 208 F.2d 117 (8th Cir. 1953). The same conduct was held also to constitute a waiver of the option to terminate the lease because of the filing of a Chapter X petition. As indicated in text accompanying notes 545-46 infra this case and Entin v. Stevens, note 476 supra, are in error in assuming that the time limits of § 70b, 11 U.S.C. § 110(b) (1970), are applicable in Chapter X cases.


479. See note 469 supra.


483. The Bankruptcy Rules of Procedure were promulgated by the Supreme Court pursuant to 28 U.S.C. § 2075 (1970) and were reported to Congress on April 24, 1973. Congress did not object to the rules, and they became effective October 1, 1973.
may allow within such 60-day period, shall be deemed to be rejected. If a trustee does not qualify, any such contract shall be deemed to be rejected at the expiration of 60 days after the date of an order directing that a trustee be not appointed, or at such earlier or later time as the court may fix within such 60-day period. On application by the trustee for authority to assign any contract he has assumed pursuant to this rule, the court shall determine the matter after hearing on notice to the other party to the contract.\footnote{484}

The 1938 amendments to the Act have made no change in the rule that a trustee who rejects or is deemed to have rejected a lease is subject to a first priority claim for the value to the estate of his use and occupancy of the premises until they are surrendered to the lessor. But this rule does not apply where the lessor has agreed to permit the trustee to occupy the premises rent free while he sells the assets located therein because of the lessor's interest in negotiating a new lease with the purchaser of those assets.\footnote{485} It continues to be true, moreover, that the "contractual rental agreed on . . . is presumed to be an appropriate figure" for the use and occupancy allowance. And it has been held that in determining whether this presumption has been overcome the referee "should not consider that the trustee has used only for storage purposes property that had been occupied by a going business"\footnote{486} and that the allowance should not be limited to what the referee "feels the estate can 'afford to pay'—to do so would be to confer on general creditors an advantage obtained after bankruptcy at the expense of" the lessor.\footnote{487} Indeed, the presumption that the contractual rental is ap-

\footnote{484. The Advisory Committee's Note to the rule indicates that the additional 30 days after qualification of the trustee and his report of contracts assumed is given "in order to afford creditors an additional opportunity to evaluate the situation in respect to contracts not assumed and to apply to the court for an order approving assumption of any additional contracts that appear to be advantageous to the estate." The Note also points out that any extension of the 60-day period must be sought before that period has expired and that under proposed Rule 906(b), which will replace Federal Rule of Civil Procedure 6(b) in bankruptcy cases, extension after the time has expired is not permissible "for the purpose of rendering a contract amenable to assumption after it has once been deemed rejected." \textit{Rules of Bankruptcy Procedure}, House Document No. 93-87, 93d Cong., 1st Sess. 38, 185 (1973).

Under proposed Bankruptcy Rule 906(b), however, the time could be extended before it had expired without notice to the other contracting party. \textit{Id.} at 54. \textit{Cf.} text accompanying note 473 \textit{supra}.}

\footnote{485. \textit{Aylward v. Broadway Valentine Center, 390 F.2d 556 (8th Cir. 1968).}}

\footnote{486. \textit{Cf. note 460 \textit{supra}.}}

\footnote{487. \textit{Diversified Servs., Inc. v. Harralsen, 369 F.2d 93, 95 (5th Cir. 1966). See also Zoconick v. McKee, 310 F.2d 12 (5th Cir. 1962), allow-
propriate may be overcome because the value to the estate exceeds the contractual rate.488 In addition to the lessor's claim for use and occupancy of that portion of the premises used by the trustee, the lessor is entitled to recover postbankruptcy rents collected from subtenants by the trustee.489

Where an ipso facto clause provided that on the filing of a bankruptcy petition by the tenant the lease "shall expire ipso facto ... and come to an end," one court dismissed as entitled to "scant consideration" the trustee's argument that such a termination of the lease defeated the landlord's provable claim for loss of future rents under section 63a(9).490 The lease in this case specifically provided that the lessor would have such a claim if the lease were "terminated."491 Although recognizing this claim by the lessor, the court held that the lessee's security deposit must be applied against the limited amount of the claim allowed under section 63a(9) rather than against the excess of the claim proved but not allowed under the section.492 Applying a claim for use and occupancy at the contract rate after the lessor exercised an option to terminate because of the tenant's bankruptcy.

488. S. & W. Holding Co. v. Kuriansky, 317 F.2d 666 (2d Cir. 1963). In Kuriansky the lessor had no claim for loss of future rents, and only a small part of the security deposit held by the lessor was needed to cover its claim for prebankruptcy rent. The court held it proper to apply the balance of the deposit in satisfaction of the claim against the trustee for use and occupancy. See also In re Pal-Playwell, Inc., 334 F.2d 389 (2d Cir. 1964), where the lessor's right to apply the security deposit to his claim against the trustee for use and occupancy was erroneously treated as a right to set off "mutual debts" under § 68, 11 U.S.C. § 108 (1970). See In re Plywood Co., 425 F.2d 151 (3d Cir. 1970). On the other hand, In re Plywood Co., 304 F. Supp. 219 (E.D. Pa. 1950), held it improper to apply the security deposit to the priority claim for use and occupancy where the lessor's claims for prebankruptcy rent and loss of future rent exceed the amount of the deposit. Cf. notes 453 and 459 supra.

489. Fort Lauderdale v. Freeman, 217 F.2d 600, 602 (5th Cir. 1954). In this case the court found that the lessor had effectively cancelled the lease for nonpayment of rent and that the trustee "did not attempt to adopt it." Id.


492. Under the formula prescribed in the lease, the difference between the present value of future rent reserved in the lease and the present rental value of the balance of the term, the lessor proved damages of $40,000. But under the limitation of § 63a(9), 11 U.S.C. § 103(a) (9) (1970), only one year's rent as reserved in the lease ($22,700) plus the unpaid rent accrued on the date the trustee surrendered possession ($3,300) was allowable. See text accompanying note 463 supra. Thus by requiring application of the $3,000 deposit after arriving at the statutory limitation rather than before, the allowable claim ($26,000) was reduced to $23,000.
other court, operating under a similar statutory limitation on allowance imposed by former section 63a(7),493 held both that the trustee's power to reject a mining lease was not subject to a provision in the lease allowing the lessor to terminate on six months' notice and that the lessor's contractual lien on all property on the premises was limited to securing so much of his claim as was allowable.494 Without regard to the allowability limitation of section 63a(9), however, several courts have concluded that if the money deposited by the tenant is characterized as advance payment of the last year's rent rather than as a security deposit, the "title" to the money has passed to the lessor and he may keep it as against the trustee. This "title passage" has been upheld even where the tenant had become a bankrupt two, three495 and even 14 years496 before expiration of the lease term and subsequently the trustee rejected the lease or the lessor exercised an option to terminate it.

The last sentence of section 70b exonerates the trustee from liability for breaches occurring after he makes a court approved assignment of an assumed contract.497 Although this

---

494. Rocky Mountain Fuel Co. v. Whiteside, 110 F.2d 778 (10th Cir. 1940). At a time when the landlord's claim for loss of future rent occasioned by the trustee's rejection of a lease was not provable and hence not dischargeable, his statutory lien for such rent was held enforceable in bankruptcy. Britton v. Western Iowa Co., 9 F.2d 488 (8th Cir. 1925).
495. Zaconick v. McKee, 310 F.2d 12 (5th Cir. 1962); Sline Properties, Inc. v. Colvin, 190 F.2d 401 (4th Cir. 1951).
496. Aylward v. Broadway Valentine Center, Inc., 390 F.2d 556 (8th Cir. 1968).
497. 11 U.S.C. § 110(b) (1970). See text accompanying note 465 supra. New Bankruptcy Rule 607 (see text accompanying note 483 supra) deals only with the procedure for notice and hearing to the other party to the contract. The Advisory Committee's Note explains that to the extent § 70b relieves the trustee from liability it "states a rule of substan-
provision has not yet been dealt with in the straight bankruptcy cases, an opportunity may have been missed. In In re Wil-Low Cafeteria, Inc.\textsuperscript{498} a debtor in possession under section 77B negotiated a new agreement with its lessor which reduced the amount of rent payable under its lease. The reorganization court approved both the agreement and the debtor's assumption of the lease as modified. Thereafter, and shortly before the effective date of the 1938 amendments,\textsuperscript{499} the reorganization effort aborted and the debtor was adjudicated a bankrupt. The bankruptcy trustee sold the lease, but the purchaser soon defaulted. After expiration of the term, the lessor filed a priority claim for the balance of the unpaid rent which was rejected by the court without mention of section 70b. While the court viewed the arrangement negotiated by the debtor in possession as a modification of the original lease rather than as a new lease and considered the bankruptcy trustee bound by the adoption of that lease by the debtor in possession, it concluded that there was only "privity of estate but not privity of contract"\textsuperscript{500} between the lessor and the trustee so that the trustee's liability for rent ceased on transfer of the lease to the purchaser.

Further consequences of assumption or rejection of an executory contract include the following: The trustee who assumes an executory contract to sell a bankrupt motor carrier's operating certificate takes the contract subject to the lien of a pre-bankruptcy federal tax levy on the buyer.\textsuperscript{501} But where the trustee rejects an executory contract and negotiates a new one with the other contracting party, he takes the proceeds of the new contract free of a security interest which encumbered the proceeds of the old one.\textsuperscript{502} If the trustee is deemed to have rejected a partially performed construction contract by doing nothing for the time specified in section 70b\textsuperscript{503} he may have a

\textsuperscript{498} 111 F.2d 83 (2d Cir. 1940).
499. The 1938 Act was to "govern proceedings so far as practicable in cases pending when it takes effect." 52 Stat. 940 (1938).

500. \textit{In re Wil-Low Cafeteria, Inc.}, 111 F.2d 83, 85 (2d Cir. 1940).

501. Kirby v. United States, 329 F.2d 735 (10th Cir. 1964).

502. \textit{In re Luscombe Eng'r Co.}, 268 F.2d 683 (3d Cir. 1959). In a different transaction in the same case, another nonbankrupt party had terminated a contract burdened with a security interest because of the bankrupt's prebankruptcy defaults. The trustee's new contract with this party was also held to be free of the security interest. See text at notes 440 and 455 \textit{supra}.

claim in quasi contract for the value of the work performed by 
the bankrupt less the damages incurred by the other party as a 
consequence of the rejection, but he cannot recover damages 
from the other party on the basis that he was prevented from 
completing performance.  

B. REHABILITATION PROCEEDINGS  

Since its revision in 1935 section 77b has provided that a 
plan of railroad reorganization may reject contracts execu-
tory in whole or in part, including unexpired leases, and that the 
term “creditor” includes “the holder of a claim under a contract 
executory in whole or in part including an unexpired lease.” 
While there is no express grant of authority to the trustee to 
adopt or reject such contracts, the section also provides that 
adoption by the trustee shall not preclude rejection in a reorgan-
ization plan and that if such a contract is rejected or “not . . . 
adopted” by the trustee, or is rejected by a reorganization plan, 
any person injured “by such nonadoption or rejection” shall 
be deemed a creditor for all purposes of section 77 “to the ext-
ent of the actual damage or injury determined in accordance 
with principles obtaining in equity proceedings.” 

These provisions have received remarkably little interpre-
tation. In a case involving the rejection of a 999-year street 
railway lease by the section 77 trustee 969 years before it expira-
tion, the Supreme Court held the language last quoted to mean 
that the lessor’s damage claim was confined not to the 
difference between the rent reserved and the earnings of the 
leased properties calculated up to the latest practicable date in 
the section 77 proceeding but to the “present value of the rent 
reserved less the present rental value of the remainder of the 
term” to the extent that the lessor could establish those figures 
“to reasonable certainty.” Although the lessor later tried to 
establish the figures for the next 40 years following rejection, 
he succeeded only as to 11 years, three in which evidence of ac-
tual post-rejection earnings was available and eight more to 
which were assigned the average annual earnings of a period 
running from 11 years before to three years after rejection. To 
dispel the trustee’s argument that earnings during the excluded  

---

958 years of the term might be sufficient to wipe out the damage thus projected for 11 years, the Court announced that "it is fair to assume the parties thought the annual rent reserved and rental value were the same" when the lease was executed and that "until something else is shown, courts are entirely justified in assuming that for the long years ahead the rent and the rental value are the same."507

The Second Circuit Court of Appeals has continued to follow the uncertain course it originally charted for railroad reorganizations in equity receivership cases.508 Where a section 77c trustor rejects a lease but thereafter continues to pay rent at the contract rate while operating the leased line at a deficit for the account of the lessor under section 77c(6),510 the court has held him entitled to recover from the lessor both the rental paid and the deficit incurred.511 Another court has held that, while section 77b512 provides that adoption of an executory contract by the trustee does not preclude rejection of it in a reorganization plan, section 77o,513 requiring Interstate Commerce Commission approval for abandonment of a line, would require Commission approval for a plan to reject a trackage agreement assumed by the trustee.514

When the Commission approved a plan providing for the rejection of leased lines unless the lessor consented to a reduction of the rental, the Supreme Court in the Chicago, Milwaukee case515 held that such action was proper as an exercise of sound "business judgment." Although the lines had been operated at a profit in recent years, the Court reasoned that the Commission's action was proper if it was necessary to work out a fair and equitable plan. The Court also held that the plan could properly defer the date for computing damages in the event of rejection to the date of rejection and that, at least

508. See text accompanying notes 447-49 supra.
510. Id. § 205(c)(6). See note 409 supra.
513. Id. § 205(a).
where rent at the contractual rate had been paid during the section 77 proceeding, section 77c(6)\textsuperscript{516} did not require that operation of the lines by the trustees prior to rejection should be for the account of the lessors so as to entitle them to the net earnings produced by the trustees' operation. Whatever may be the rule when a trustee rejects a lease prior to confirmation,\textsuperscript{517} if the rejection occurs in a confirmed plan the Commission can conclude that the lessor receives fair and equitable treatment vis-à-vis other creditors where it receives a return of the leased lines, the stipulated rental until rejection and a general claim for damages for loss of future rents.

As enacted in 1934\textsuperscript{518} and until superseded by Chapter X in 1938, former section 77B contained more detailed provisions with respect to rejection of executory contracts than does section 77.\textsuperscript{519} Section 77B(c)(5) provided that the judge “may direct the rejection of contracts of the debtor executory in whole or in part” and section 77B(b)(6) provided that the reorganization plan “may reject contracts of the debtor which are executory in whole or in part, including unexpired leases . . . .”\textsuperscript{520} Section 77B(b) also defined “creditors” to include “all holders of claims . . . including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act” and provided that if

an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section,\textsuperscript{521} any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor.

Regardless of the lessor's status as a "creditor," however, his claim “for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease”\textsuperscript{522} was limited to an amount not

\begin{itemize}
\item \textsuperscript{517} See text accompanying notes 508-11 supra.
\item \textsuperscript{518} 48 Stat. 912 (1934).
\item \textsuperscript{519} 11 U.S.C. § 205 (1970).
\item \textsuperscript{520} There was an exception in § 77b(b)(6), although none in § 77B(c)(5), for “contracts in the public authority.” See note 409 supra.
\item \textsuperscript{521} Section 77B(a) authorized the filing of a § 77B petition in a pending straight bankruptcy case.
\item \textsuperscript{522} Section 77B(b). In view of the attention that the Supreme Court later gave to this language, it is important to note that present § 63a(9), 11 U.S.C. § 103(a)(9) (1970), differs only in referring to claims
\end{itemize}
to exceed the rent without acceleration reserved by the lease for the three years next succeeding the date of surrender of the premises to, or reentry by, the landlord plus unpaid rent accrued to that date.

The Supreme Court promptly undertook the construction of this language as it related to the claims of landlords. Where a section 77B petition was filed in a pending straight bankruptcy case in which the bankruptcy trustee had already rejected the lease, the Court viewed the section as changing the prior law to give the lessor a provable and hence a dischargeable damage claim based solely on the rejection of the lease even though it contained no covenant for damages or indemnity. The lessor had such a claim despite the fact that following rejection he had reentered and relet the premises under such circumstances as to amount to a surrender of the leasehold which terminated the tenant’s liability for future rent under applicable state law. The Court reasoned that section 77B(b) contemplated both surrender and reentry. Moreover, since the landlord’s claim “necessarily is the difference between the rental value of the remainder of the term and the rent reserved, both discounted to present worth,” he must be allowed to obtain possession and avail himself of the present rental value for which he must give credit in computing his damages.523

In another case where a straight bankruptcy trustee had rejected a lease before the section 77B petition was filed, the lessor had immediately reentered and terminated the leasehold un-
der a provision of the lease which contained a covenant by the lessee to indemnify the lessor against all loss of rent resulting from such termination. Rejecting the lessor's argument that all damages proved in excess of the statutory limitation were allowable as a claim subordinated to other creditors but with priority over stockholders under the reorganization plan, the Court read the limitation on the lessor's claim under the covenant to be a complete limitation on any allowance in the section 77B case. The Court held, moreover, that the limitation as so read did not violate the due process clause of the fifth amendment.  

Where section 77B trustees had for nine months been operating the debtor's street railway system on 55 leased lines without assuming or rejecting the leases, the Court held that the trustees were not required to pay the lessors' taxes, which were part of the stipulated rentals. The remedy of the lessors was described in language reminiscent of the equity practice:

Notwithstanding the fact that § 77B gives no specific authority to trustees in reorganization to reject burdensome leases or contracts, it is well settled that they have that right and are accorded a reasonable time within which to exercise it. If, in the opinion of the [lessors], a reasonable time has expired those companies are not without redress. They may declare a forfeiture of the leases . . . for nonperformance on the part of the trustees, or they may apply to the District Court to compel an election by the trustees, to affirm or disaffirm. In the meantime, if the situation were such as to permit a proper calculation of the amount due for use and occupation, it would be proper for the court to order the trustees to pay a reasonable sum to be treated as a payment for use and occupation in the event that the leases . . . are disaffirmed or, on account of rent, in the event they are affirmed. But this record [due to intermingling of properties and of accounts] furnishes no basis for such a calculation . . . . Moreover, since the [lessors] are simple contract creditors, an overpayment to any one of them might work a preference as against other such creditors . . . .

524. Keuhner v. Irving Trust Co., 299 U.S. 445 (1937). Where the leased premises were all sublet and the § 77B trustee never had possession, the "surrender" which established the beginning of the three-year period was held to occur when the landlord was notified of the rejection of the lease by the trustee. In re United Cigar Stores Co., 86 F.2d 629 (2d Cir. 1936), cert. denied, 300 U.S. 679 (1937).

525. Philadelphia Co. v. Dipple, 312 U.S. 168, 174 (1941). While the Court cited no precedent for the "well settled" authority of § 77B trustees to reject executory contracts and leases, lower courts had held: (1) While a debtor in possession for 28 days must account to the lessor for subrents collected, he had not yet had a reasonable time to elect whether to assume or reject. Central Manhattan Properties v. D.A. Schulte, Inc., 91 F.2d 728 (2d Cir.), cert. denied, 302 U.S. 743 (1937). (2) After a debtor in possession had continued operation of one of a chain of restaurants on leased property for slightly over a month, the debtor,
One court ignored this "reasonable time" standard of the Supreme Court and held that the later enacted 60-day time limit of section 70b526 was applicable to a section 77B reorganization so that a trustee who neither assumed nor rejected a lease within that time was deemed to have rejected it.527 Another court, however, dealing with an executory contract to purchase electric power with respect to which the section 77B court had given the trustees three months to decide whether to assume or reject, held that although the trustees had not assumed the contract by letting that time expire it was error to reserve jurisdiction to determine the question of assumption or rejection later in an order confirming a reorganization plan that neither assumed nor rejected the contract. Since "a claim under an executory contract does not arise . . . until the contract has been rejected," rejection should occur not later than confirmation of the plan so that the plan might provide for the claim thus created.528

on the lessor's application for permission to repossess, would be ordered within five days either to pay for use and occupation at the contract rate or to vacate the premises and promptly bring before the court the matter of adoption or rejection of the lease. In re Chase Commissary Corp., 11 F. Supp. 288 (S.D.N.Y. 1935). (3) Before a reorganization plan had been filed, the court could order the rejection of a lease on the petition of the debtor in possession and over the objection of the lessor. In re Cheney Bros., 12 F. Supp. 605 (D. Conn. 1935). See also In re 211 East Del. Place Bldg. Corp., 76 F.2d 834 (7th Cir. 1935). Cf. In re Connecticut Co., 95 F.2d 311 (2d Cir.), cert. denied, 304 U.S. 581 (1938), holding that where the debtor in possession agreed with the lessor to rescind a lease the lessor had a first priority claim both for the rent stipulated in the lease up to the date of rescission and for the use and occupancy thereafter until surrender of the premises to the lessor. 526. 11 U.S.C. § 110(b) (1970).

While a use and occupancy allowance might also be made to a vendor under an executory land contract, In re Charles Nelson Co., 27 F. Supp. 673 (N.D. Calif. 1939), denied such an allowance on a finding that the § 77B trustee had not used the property during the period fixed by the court for him to decide whether to assume or reject the contract.

527. Wiemeyer v. Koch, 152 F.2d 230 (8th Cir. 1945).

Mohonk Realty Corp. v. Wise Shoe Stores, Inc.\textsuperscript{529} directly confronted the problem of the manner and consequences of assumption or rejection of a lease in a section 77B proceeding. There the debtor in possession under section 77B paid the rental stipulated in the lease while the case was pending, and the confirmed plan neither expressly assumed nor rejected the lease but nonetheless provided that the debtor would assign it to a successor corporation. The lease was so assigned and the case was closed. Later, the lessor moved to re-open the case and to modify the plan to require that the successor corporation assume the debtor's obligations under the lease. The court agreed with the lessor that the mere assignment of the lease to the successor corporation "created privity of estate between it and [the lessor], but no privity of contract" so that the successor corporation was bound to pay the stipulated rental as long as it remained in possession "but it could move out at any time, free of liability to the landlord."\textsuperscript{530} However, the court found no abuse of discretion in the refusal of the section 77B court to reopen the case inasmuch as the lessor had received notice of the proceeding, had entered an appearance, and had received notice of the confirmation hearing but had entered no objection. Although in the absence of a rejection of the lease the lessor could file no claim in the section 77B case, he was "entitled to insist that his lease be either rejected or fully assumed under the plan and he must appear in the reorganization court at the confirmation hearing or before, in order to assure adequate protection for his interests."\textsuperscript{531}

Shortly after this decision the lessor's worst fears were realized. The successor corporation to which the debtor had assigned the lease paid the rent for a few months and then itself assigned the lease and surrendered possession to another. When the lessor sued the successor corporation in a state court for rent accruing after the second assignment, it recovered a summary judgment which was promptly reversed on appeal. The appellate court said that the lessor at trial might invoke provisions in the lease providing that the original lessee disclose to the lessor any proposed assignee, that the lessor would then

\textsuperscript{529} 111 F.2d 287 (2d Cir.), cert. denied, 311 U.S. 654 (1940), discussed in note 252 supra.

\textsuperscript{530} Id. at 288.

\textsuperscript{531} Id. at 290. The court did not consider whether the provision in the plan for assignment of the lease could be treated as an assumption of the lease, but resolution of that question apparently would not affect the liability of the successor corporation.
have had the privilege of proposing his own assignee on terms no less favorable than those offered by the lessee's proposed assignee and that if the lessor had thereafter accepted the lessee's proposed assignee the assignee would assume the lease. But here the successor corporation had not assumed the lease, and the lessor had recognized its right to possession and had accepted rent from it. Thus the successor corporation "has cogent argument that only privity of estate arose."\textsuperscript{532}

Apparently the lessor was left with no recourse save against the original debtor, a now defunct corporate shell.\textsuperscript{533} And for the nonbankrupt party to an executory contract other than a lease who permitted a similar assignment of the contract, the consequences would be even more grim. With neither "privity of estate" nor "privity of contract," such a party has no contractual claim against the successor corporation even for benefits received from him by that corporation.\textsuperscript{534} Where the successor corporation in another section 77B proceeding did assume the obligations of an executory contract to share expenses with tenants in common under an oil lease and the contract was neither assumed nor rejected in the section 77B proceeding, however, the successor was held liable thereon to the cotenants.\textsuperscript{535}

\begin{footnotes}
\item[533] Even the lessor's recourse against the original debtor is unclear. Section 77B(h) provided that the "final decree shall discharge the debtor from its debts and liabilities" except as provided in the plan. A determination whether this discharge would cover the lessor involves a choice between the somewhat inconsistent provisions of § 77B(b) that the term "creditors" should include "all holders of claims . . . including claims under executory contracts" and that it was on the rejection of the contract that any person injured thereby is to "be deemed to be a creditor."
\item[534] A. CORBIN, CONTRACTS § 906 (1951). Cf. Uniform Commercial Code § 2-210. Under the law of contracts an assignee of a contract who does not assume its obligations is not liable to the other contracting party, but if he does assume the contract he remains liable even though he thereafter disposes of it. Both \textit{In re Wil-Low Cafeterias, Inc.}, 111 F.2d 83 (2d Cir. 1940), discussed in text accompanying note 502 supra, and the last sentence of § 70b, 11 U.S.C. § 110(b) (1970), (see text accompanying note 465 supra) indicate that the trustee who "assumes" a contract under the Bankruptcy Act incurs a lesser obligation. The trustee incurs liability to the other contracting party by the assumption but terminates that liability where he properly disposes of the contract.
\item[535] Arkansas Fuel Oil Co. v. Pace, 203 Ark. 52, 155 S.W.2d 886 (1941). \textit{See also} Black v. Richfield Oil Corp., 146 F.2d 801 (9th Cir. 1944), \textit{cert. denied}, 325 U.S. 867 (1945), where the successor corporation assumed all contracts which had been assumed by the trustee in the § 77B case. For reasons indicated in note 533 supra, it is unclear
\end{footnotes}
Chapters X, XI, XII and XIII were adopted in 1938 and contain nearly identical provisions which treat executory contracts in a manner now familiar. The Chapter X provisions may be taken to establish the pattern. An "executory contract" is defined to include unexpired leases of real property. On the approval of a petition, the judge may permit the rejection of any executory contract except a contract "in the public authority" after notice to the parties to such contracts and to such other parties in interest as the judge may designate. The plan may also provide for rejection of executory contracts except contracts in the public authority. If an executory contract is rejected by a plan or with the permission of the court in a Chapter X case, or by a trustee or receiver in bankruptcy or a receiver in equity in a prior pending proceeding, "any person injured by such rejection shall, for the purposes of this chapter and of the plan, its acceptance and confirmation, be deemed a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of realty or for damages or indemnity under a covenant contained in the lease is provable but is limited to an amount not to exceed the rent reserved by the lease for three years following the date of surrender to

whether the original debtor, again a defunct corporate shell, also remained liable on the contract. Perhaps a § 77B debtor contemplating the acquisition of future assets and intending to dispose of a contract without assuming or rejecting it as debtor in possession should seek to effect a novation under the plan. See 4 A. CORBIN, CONTRACTS § 866 (1951).


537. See note 409 supra.

538. Section 116(1), 11 U.S.C. § 616(1) (1970). The provisions of the other chapters vary in three respects: (1) there is no concept of approval of the petition as a prerequisite to rejection, (2) the authority is conferred on the court (which includes the referee) rather than the judge, and (3) there is no exception for contracts in the public authority. Sections 313(1), 413(1), 613(1), 11 U.S.C. §§ 713(1), 813(1), 1013(1) (1970). The statutory provisions for notice and hearing are perpetuated in Chapter XIII Rule 13-604, which took effect October 1, 1973, and in proposed Chapter X Rule 10-606 and proposed Chapter XI Rule 11-63, both of which have been circulated to the bench and bar for comment but which have not yet been submitted to the Supreme Court for approval.


The only reference to the assumption of contracts was added in 1967 and provides that, where the proceeding aborts and straight bankruptcy follows, any contract “entered into or assumed” in the chapter case “and which is executory in whole or in part” at the time bankruptcy is ordered shall be deemed to be rejected unless expressly assumed within 60 days of the bankruptcy or of the qualification of the bankruptcy trustee, whichever is later, unless the court for cause shown extends or reduces the time.\(^\text{542}\) Thus far the courts have considered only some of these provisions and, with one exception,\(^\text{543}\) only in cases arising under Chapters X and XI.

These provisions indicate that the court may permit the re-

---


\(^{542}\) Section 238b, 11 U.S.C. § 736(b) (1970). Identical provisions were added to Chapters XI and XII in 1967, Sections 378b, 483b, 11 U.S.C. §§ 778(b), 883(b) (1970). Bankruptcy Rule 122(10), which applies whenever a Chapter X, XI, XII or XIII case is converted to a straight bankruptcy case, provides:

Rule 607 [see text accompanying note 483 supra] shall govern the assumption, rejection, and assignment of contracts entered into or assumed by a trustee, receiver, or debtor in possession acting in the superseded chapter case which are executory in whole or in part at the time of the entry of the order directing the case to continue as a bankruptcy case .... However, if a trustee had been selected and qualified in a pending straight bankruptcy case before the abortive conversion to a chapter case, the time limits prescribed by Rule 607 will begin to run from the entry of the order sending the case back to straight bankruptcy.

\(^{543}\) In re Freeman, 49 F. Supp. 163 (S.D. Ga. 1943), reached the unremarkable conclusion that an unexpired lease of real estate is an executory contract as defined in § 406(4), 11 U.S.C. § 806(4) (1970), and thus may be rejected in a Chapter XII case of the lessor. The court held inapplicable to a Chapter XII proceeding a provision in § 70b, 11 C.S.C. § 110(b) (1970), the “unless a lease of real property expressly otherwise provides, a rejection of the lease or of any covenant therein by the trustee of the lessor does not deprive the lessee of his estate.” The most controversial aspect of the decision is its assumption that the quoted provision means that the tenant may remain in possession after rejection by payment of a reasonable rental fixed by the court. See, e.g., Creedon & Zinman, Landlord's Bankruptcy: Laissez Les Lessees, 26 Bus. Law. 1391, 1405 (1971). The restrictions imposed under the Emergency Price Control Act of 1942 on the eviction of tenants were also held inapplicable to eviction of the tenant after rejection of the lease. Cf. Cullen v. Bowles, 148 F.2d 621 (2d Cir. 1945), holding a Chapter X trustee subject to the rent ceilings imposed under that Act. See note 401 supra.
jection of executory contracts at any time and that the confirmed plan may also reject such contracts. As either form of rejection requires court approval, moreover, most courts considering the matter have concluded that the 60-day time limit of section 70b and its provision that any contract not assumed within that time shall be deemed rejected are inapplicable in chapter proceedings. As one court has put it, the provisions in Chapter X “clearly indicate Congress intended that before an executory contract should be rejected, a judicial hear-

545. See text accompanying note 465 supra.
546. In re Imperial “400” Nat’l, Inc., 429 F.2d 680 (3d Cir. 1970); Texas Importing Co. v. Banco Popular de Puerto Rico, 360 F.2d 582 (5th Cir. 1966); Title Ins. & Guar. Co. v. Hart, 160 F.2d 961 (9th Cir.), cert. denied, 322 U.S. 761 (1947); In re Flying W Airways, Inc., 328 F. Supp. 1256 (E.D. Pa. 1971); In re M & S Amusement Enterprises, Inc., 122 F. Supp. 364 (D. Del. 1954); In re Childs Co., 64 F. Supp. 282 (S.D. N.Y. 1944). See also In re Alfar Dairy, Inc., 438 F.2d 1258 (5th Cir.), cert. denied, 409 U.S. 1048 (1972); In re American Nat’l Trust, 426 F.2d 1059 (7th Cir. 1970). The Supreme Court decision that the forfeiture provisions of § 70b are applicable in a Chapter X case originally contained a statement that “Congress has made § 70 applicable to reorganization proceedings under Ch. X.” By a later order (Sup. Ct. J. 276 (Oct. Term, 1944)), the opinion was amended to read: “Congress has made the forfeiture provision of § 70 applicable to reorganization proceedings under Ch. X.” Finn v. Meighan, 325 U.S. 300, 302 (1945), discussed in text accompanying note 396 supra.

One court has long assumed that the time limits of § 70b, and the consequence of the trustee’s failure to assume within that time, are applicable in chapter proceedings. Ten-Six Olive, Inc. v. Curby, 208 F.2d 117 (8th Cir. 1953), discussed in text accompanying note 477 supra. See also Wiemeyer v. Koch, 152 F.2d 230 (8th Cir. 1945), discussed in text accompanying note 527 supra. But that court has more recently noted that it may be in error. Enin v. Stevens, 323 F.2d 894, 899 (8th Cir. 1963), discussed in text accompanying note 476 supra. See also Stauduhar v. Limbach Co., 308 F. Supp. 696 (E.D. Wis. 1970); In re Capital Serv., Inc., 136 F. Supp. 430 (S.D. Cal. 1955); In re Schenectady Ry., 93 F. Supp. 67 (N.D.N.Y. 1950).

Bank of Am. Nat’l Trust & Savings Ass’n v. Smith, 336 F.2d 528 (9th Cir. 1964), held that contracts for the sale of goods had not been assumed where the receiver in a Chapter XI case manufactured goods and filled prepetition and postpetition orders under such contracts. In response to an argument that the receivers had not obtained court approval for rejection of the contracts as required by § 313(1), 11 U.S.C. § 731(1) (1970), the court noted that the Chapter XI proceeding had aborted after two months and the debtor had been adjudicated a bankrupt. Thereafter, the proceedings were to be conducted as if the debtor had been adjudicated a bankrupt on the date of the filing of the Chapter XI petition so that, presumably, the time period specified in § 70b began running with the filing of the Chapter XI petition and the contracts were deemed rejected because not assumed within that time. See also In re Robertson, 41 F. Supp. 665 (W.D. Ark. 1941). Cf. text accompanying note 542 supra.
ing and inquiry, at which interested parties might be heard, should be held, and . . . an executory contract [can] be rejected only with permission of the court . . . .”\textsuperscript{547}

That court also concluded that while Chapter X like the other chapters does not expressly impose the same requirements for assumption of executory contracts, “we think by necessary implication it requires judicial approval for such . . . assumption” since otherwise a trustee, without authorization by the court, . . . could bar the court from exercising its statutory power to authorize the rejection . . . . Assumption . . . of executory contracts may have an important bearing on the financial status of the debtor, and should not be implied from conduct of the trustee or debtor in possession, but should be the result only of judicial consideration.

Hence, a confirmed plan could reject an unexpired lease even though the trustee had not complied with a court order directing him to report to the court within two months on the advisability of rejecting any executory contracts, and after expiration of that time\textsuperscript{548} had given written notice to the lessor that he had “elected to ratify the lease.” The lessor’s remedy, the court said, would have been to “petition the court for an order of affirmative assumption or rejection . . . .”\textsuperscript{549}

\textsuperscript{547} Texas Importing Co. v. Banco Popular de Puerto Rico, 360 F.2d 582, 584 (5th Cir. 1966).

\textsuperscript{548} See also In re Rochester Shipbuilding Corp., 32 F. Supp. 98 (W.D.N.Y. 1940), discussed in note 50, Countryman, Part I, holding that a Chapter X trustee did not adopt a time charter by failing to reject it within the time fixed by the court. In re the Sire Plan, Inc., 221 F. Supp. 68 (S.D.N.Y. 1963), modified sub nom. Fifty-Seven Associates v. Joseph, 322 F.2d 120 (2d Cir. 1963), was a case in which the Chapter X court gave the trustee three and one-half months to file recommendations for assumption or rejection of executory contracts and later extended the time an additional 23 days. Almost a month after the expiration of the extended time, the chapter court ordered that the leased premises be surrendered to the holder of a mortgage on the leasehold by the end of the next month with permission to the lessor to terminate the lease unless it received all arrearages of rent within a week thereafter and rent payments were kept current. The trustees, who had been collecting subrents, were ordered to pay to the lessor an amount for use and occupancy prior to their surrender of the premises which was less than the stipulated rental. The trustees were also given six months to initiate an action to challenge the validity of the leasehold mortgage with provision that if they were successful the mortgagee would have a lien on the leasehold for any payments it had made in excess of subrents collected by it to avoid termination of the lease.

\textsuperscript{549} Texas Importing Co. v. Banco Popular de Puerto Rico, 360 F.2d 582, 585 (5th Cir. 1966). Cf. In re Greenpoint Metallic Bed Co., 113 F.2d 881 (2d Cir. 1940), discussed in text accompanying note 250 supra. The decision in Texas Importing that court approval is required before
CONTRACTS IN BANKRUPTCY

Other courts, however, have found without directly addressing the question, that the trustee or debtor in possession has assumed an executory contract in circumstances revealing no court approval, or at least no approval on notice and hearing to the other party to the contract. Regardless of the problematic manner of assumption, where the chapter trustee does assume a contract he takes it subject to the debtor's earlier assignment of a security interest in the proceeds thereof and subject to the right of the other contracting party to credit the books of the debtor for merchandise returned and for advance payments made under the contract.

Where the chapter trustee rejects a contract, the other contracting party has a claim for damages, not a claim for restitution of part of the purchase price paid. The rejection of a Chapter X trustee can assume an executory contract is extensively criticized in Comment, Chapter X Trustee Adoption of Executory Contracts: The Bankruptcy Act Speaks Through Its Silence, 115 U. Pa. L. Rev. 937 (1967).

In re Italian Cook Oil Corp., 190 F.2d 994 (3d Cir. 1951) (Chapter X trustees assumed a contract for the sale of goods by making deliveries thereunder); Di Lauro v. Electronics Wholesalers, Inc., 239 A.2d 162 (App. D.C. 1968) (Chapter X trustee assumed a contract for the sale of goods by filling prepetition orders placed thereunder). See also In re Public Ledger, Inc., 161 F.2d 762 (3d Cir. 1947), discussed in text accompanying note 289 supra.

Title Ins. & Guar. Co. v. Hart, 160 F.2d 961 (9th Cir.), cert. denied, 322 U.S. 761 (1947) (Chapter X court had approved the trustee's assumption of a lease by directing him to exercise an option to renew it). Cf. In re Grayson Shops, Inc., 252 F. Supp. 145 (S.D.N.Y. 1966) (debtor in possession had assumed a lease by assigning it pursuant to a stipulation with the lessor which the court had approved).

In re Italian Cook Oil Corp., 190 F.2d 994 (3d Cir. 1951). Cf. Bank of Am. Nat'l Trust & Sav. Ass'n v. Smith, 336 F.2d 538 (9th Cir. 1964), discussed in note 546 supra, where the court's holding that the contract had been rejected defeated the claim of a bank that its prepetition security interest in the proceeds of the contract reached the proceeds of the receiver's performance. See also text accompanying notes 440, 455 & 486, supra.


King v. Baer, 482 F.2d 552 (10th Cir.), cert. denied, 94 S. Ct. 577 (1973); In re American Nat'l Trust, 426 F.2d 1059 (7th Cir. 1970); Workman v. Harrison, 292 F.2d 693 (10th Cir. 1960).

King v. Baer, 482 F.2d 552 (10th Cir.), cert. denied, 94 S. Ct. 577 (1973). Rejection may have other consequences for the other contracting party. Beneficial Fin. Co. v. Ray, 328 F.2d 55 (5th Cir.), cert. denied, 379 U.S. 827 (1964), affirmed a Chapter X court's approval of the trustee's rejection of a contract under which the debtor had assigned chattel paper to a finance company. The court found that the contract was executory because it merely made the finance company the debtor's agent for collection of all its present and after-acquired
lease may give the lessor a first priority claim for use and occupancy of the property, but only to the extent that it was used for the benefit of the estate. Moreover, there are statutory limits on the amount of a lessor's damage claim for loss of future rent, and other limitations may be found. Where an ipso facto clause provided for termination of a lease on the filing of a Chapter XI petition and for the retention by the lessor of a security deposit equal to three months' rent as "liquidated damages," for example, the parties were held to have limited their damages at the amount of the deposit so that the lessor could have no additional claim for loss of future rent. And a lessor with an option to terminate on the filing of a Chapter X petition who both exercised the option and accepted a surrender of the premises was held to have terminated all liability for future rent and thus to have forfeited his right to retain a security deposit.

chattel paper. When the trustee later sued the finance company in a state court for negligence and breach of fiduciary duty, the prior decision was held to foreclose the finance company by collateral estoppel from again asserting that there had been a sale of the chattel paper rather than an agency contract. Ray v. Beneficial Fin. Co., 92 N.J. Super. 519, 224 A.2d 143 (1966).

556. In re Plywood Co., 425 F.2d 151 (3d Cir. 1970). In both straight bankruptcy and rehabilitation cases there is a small complication typified by the tenant whose rent is payable in advance on the first of each month and who, for example, defaults on April 1 and files a petition under the Bankruptcy Act on April 11. Since the full rent for April was payable before the bankruptcy, it arguably represents a claim against the bankrupt (entitled to a fifth priority under § 64a(5), 11 U.S.C. § 104(a)(5) (1970), but not in Chapter X, where § 64a is made inapplicable by § 102), with the first priority use and occupancy claim to run from May 1. On the other hand, the claim for April could be apportioned, one-third against the bankrupt and two-thirds against the trustee. The prevailing but not unanimous view is that the claim should be apportioned. See In re Fredrick Meats, Inc., CCH Bankr. L. Rep. ¶ 64,982 (9th Cir. 1973); In re Universal Medical Servs., Inc., 357 F. Supp. 1137 (E.D. Pa. 1973), and cases cited.

557. 120 Wall Associates v. Schilling, 266 F.2d 548 (2d Cir. 1959) (although two floors leased, use and occupancy only for the one floor used); American A. & B. Coal Corp. v. Leonardo Arrivabene, S.A., 280 F.2d 119 (2d Cir. 1960), discussed in note 50, Countryman, Part I (no use and occupancy, consisting of demurrage under time charters, where vessels not used).

558. See text accompanying note 541 supra.


560. Floro Realty & Inv. Co. v. Steem Elec. Corp., 128 F.2d 338 (8th Cir. 1942). The lessor who did not exercise his option to terminate on the filing of a straight bankruptcy petition, but who also accepted a surrender of the premises, fared no better in Ten-Six Olive, Inc. v.
In the absence of very careful advance planning, the latest opportunity for assumption or rejection of an executory contract, at least in a Chapter XI case, is the time of confirmation. In In re Grayson-Robinson Stores, Inc.\(^{561}\) an executory contract to purchase stock came belatedly to light in a Chapter XI proceeding because of the debtor's failure to include it in the list of executory contracts required to be filed with the petition.\(^ {562}\) The question of rejection of the contract came on for hearing after the plan had been confirmed, and the referee permitted the rejection because he found no time limits upon his section 313(1)\(^ {563}\) authorization to permit rejection of executory contracts. The referee's allowance of the rejection was reversed on the ground that he had lost jurisdiction. Although the referee had purported to retain jurisdiction in the confirmation order, no provision for such retention was contained in the plan as required after confirmation by section 368.\(^ {564}\) Sections 369 and 370\(^ {565}\) provide that the court shall in any event retain jurisdiction until final allowance of and distribution to all properly filed claims "affected by the plan," but the court held that "affected by" meant "provided for"\(^ {566}\) and found that the plan provided for distribution only to claims arising from the rejection of executory contracts "prior to confirmation." Section 367\(^ {567}\)


\(^{564}\) Id. § 768. Where jurisdiction is so retained the court can permit the issuance of certificates of indebtedness by § 344, 11 U.S.C. § 744 (1970), and can dismiss the case or adjudicate the debtor a bankrupt for default under the plan by § 377, 11 U.S.C. § 777 (1970).


\(^{566}\) Confirmation of a Chapter XI plan discharges all dischargeable debts "provided for" by the plan except as provided in the plan or in the confirmation order. Section 371, 11 U.S.C. § 771 (1970).

provides that, except as otherwise provided in sections 369 and 370, the case shall be dismissed on confirmation of the plan, and section 372 provides that on consummation of the plan the court shall enter a final decree closing the estate. While the latter provision indicates that some jurisdiction remains after dismissal and until final decree, the court held that such residual jurisdiction did not extend to postconfirmation rejection of executory contracts. The court reasoned that the other contracting party would become a creditor too late to be provided for in the plan and too late for other creditors to be aware of his existence when voting on the plan.

Even where an executory contract is effectively rejected so that the other contracting party becomes a creditor, the rejection may occur after the time for filing claims has expired. At a time when Chapter XI required claims to be filed within six months of the date first set for the first creditors' meeting, held that where the referee permitted the

568. Id. §§ 769, 770.
569. Id. § 772.

Except for a provision barring claims which were barred by the expiration of the six-month period of § 57n before a Chapter XI petition was filed in a straight bankruptcy case, Chapter XI originally was also silent as to the time for filing claims, and claims were paid on the basis of the debtor's schedules. In 1963, § 355, 11 U.S.C. § 755(a) (1970), was added to make § 57n applicable. In 1967, § 355 was amended to require filing of claims at any time before confirmation except that (1) any claims scheduled by the debtor can be filed 30 days after notice of confirmation but cannot be allowed in an amount in excess of the amount scheduled, and (2) a claim arising from the rejection of an executory contract can be filed within such time as the court may direct. Cf. proposed Chapter X Rule 10-401, Chapter XI Rule 11-33 and Chapter XII Rule 13-302.

572. See note 571 supra.
573. 396 F.2d 62 (2d Cir. 1968).
debtor in possession under Chapter XI to reject leases after that time had expired the referee had power to allow the lessors 10 days to file their claims. Shortly after the referee's action, Congress amended Chapter XI to provide this power.574

Because there is no provision in the chapters as there is in straight bankruptcy that an executory contract not assumed within a specified time shall be deemed rejected, there is a possibility as there was under former section 77B576 that a chapter case may be closed with some such contracts neither assumed nor rejected. It is clear under the chapters,576 moreover, that the other contracting party is not a "creditor" until his contract is rejected.577 Thus where there has been no assumption or rejection in a chapter case the claim of the other contracting party is not discharged.578 This conclusion has been reached by

574. See note 571 supra. The court also held that claims for damages arising out of the defaults of the debtor in possession prior to rejection of the lease were not entitled to priority as administration expenses. Cf. In re Greenpoint Metallic Bed Co., 113 F.2d 881 (2d Cir. 1940), discussed in text accompanying note 248 supra.

575. See text accompanying notes 528-35 supra.

576. It was not clear under former § 77B. See note 533 supra.

577. If the other contracting party was a lessor with an ipso facto clause or an option to terminate entitling him to treat the initiation of the chapter case as a breach of a covenant for damages or indemnity, and if he properly asserted his rights, see In re Union-Fern, Inc., 205 F. Supp. 947 (N.D.N.Y. 1962), he would have a claim as a creditor without a rejection. See note 523 supra; Kuehner v. Irving Trust Co., 299 U.S. 445 (1937), discussed in text accompanying note 524 supra. Such a lessor would also have a claim for use and occupancy before the premises were surrendered to him. Ghoti Estates v. Freda's Capri Restaurant, 332 Mass. 17, 123 N.E.2d 232 (1954).

578. Under Chapter X the confirmed plan is binding "upon all creditors." Section 224(1), 11 U.S.C. § 624(1) (1970). After confirmation the property of the debtor either in its own hands or in the hands of a successor corporation is "free and clear of the claims . . . of creditors." Section 226, 11 U.S.C. § 626 (1970). The final decree discharges the debtor except as provided in the plan or confirming order or in the order directing transfer or retention of the property. Section 228, 11 U.S.C. § 628 (1970).


Under Chapter XII the confirmed plan is binding "upon all creditors." Section 473(1), 11 U.S.C. § 873(1) (1970). The property dealt with by the plan after confirmation, in the hands of the debtor or a successor, is "free and clear of all debts affected by" the plan except as provided in the plan, the confirmation order or the order directing transfer or retention of the property. Section 474, 11 U.S.C. § 874 (1970). Confirmation of the plan discharges the debtor from all dischargeable "debts and liabilities" provided for by the plan except as
all courts which have considered the matter.579

The courts have also concluded that where the contract is neither assumed nor rejected the other contracting party is not entitled to participate in the distribution under the plan.580 Both the decisions to this effect and the decisions dismissing the other contracting party's contention that a contract is rejected in a chapter case if the trustee does not assume it within the time specified in section 70b581 suggest that the other contracting party should obtain court-approved action on his contract before confirmation of a plan. The cases holding that nonaction means nondischargeability, moreover, suggest that the debtor may also have an interest in obtaining such action.

There have been no chapter cases dealing with the liability of one to whom an assumed contract is assigned.582 Neither have the courts considered whether there is any reason for not applying in chapter cases the last sentence of section 70b583 which exonerates the trustee from liability where an assumed contract is assigned to another with the approval of the court.


Under Chapter XIII the confirmed plan is binding on all "creditors." Section 657, 11 U.S.C. § 1057 (1970). And the Chapter XIII discharge covers all dischargeable "debts and liabilities" provided for by the plan and all nondischargeable debts held by creditors who have accepted the plan. Sections 660, 661, 11 U.S.C. §§ 1060, 1061 (1970).

579. In re Afar Dairy, Inc., 458 F.2d 1258 (5th Cir.), cert. denied, 409 U.S. 1048 (1972); United States Metal Prods. Co. v. United States, 302 F. Supp. 1263 (E.D.N.Y. 1969), discussed in text accompanying note 346 supra; Columbia Prods. Corp. v. Coronation Diamonds, Inc., 276 App. Div. 1083, 95 N.Y.S.2d 898 (1950). Cf. In re Warrack Medical Center Hosp., 282 F. Supp. 988 (N.D. Calif. 1968), where the Chapter XI debtor, a secured creditor and an unsecured creditor entered an agreement by which the unsecured creditor subordinated his claim to the secured creditor. Because the agreement was not rejected in the Chapter XI case, the court held that the secured creditor could take the distribution to which the unsecured creditor was otherwise entitled under the plan. It should be noted both that this contract was fully executed by the secured creditor when it made a loan to the debtor and that the debtor had no obligation to the unsecured creditor under this contract. The contract was therefore not executory within the meaning of the Act so that it could not have been rejected. See note 86, Countryman, Part I. But the case seems correctly decided quite apart from that point.


582. See text accompanying notes 529-35 supra for such cases under former § 77B.

But in approving the assignment by a debtor in possession of a sublease to his lessor, one Chapter XI court has found it unnecessary to determine whether the lessor was assuming the debtor's covenants under the sublease. The subtenant had no complaint, the court said, because the debtor could not by the assignment relieve himself of his obligations under the sublease and would remain liable as before if the lessor-assignee did not perform.\footnote{In re Grayson Shops, Inc., 252 F. Supp. 145 (S.D.N.Y. 1966).} Presumably, when the court spoke of the "debtor" it did not refer to the debtor in possession under Chapter XI, who has all of the title and powers of a trustee.\footnote{Section 342, 11 U.S.C. § 742 (1970).} In the absence of a novation, the debtor apparently would remain liable on the sublease whether or not the assignee-lessor was also liable;\footnote{See note 535 supra.} the subtenant was apparently not a creditor whose claim would be discharged in the Chapter XI case. While the court did not mention section 70b, its decision does serve to emphasize the limited protection given by the last sentence of the section even if applied in chapter cases. By exonerating the "trustee" from liability for postassignment breaches where an assumed contract is assigned with approval of the court, the section operates only to preclude a first priority claim against the estate for such breaches and to protect the trustee (or debtor in possession) in his capacity as such from liability for such breaches. It does not seem to protect the debtor in chapter cases, or the bankrupt in straight bankruptcy cases, from liability for postassignment breaches not covered by his discharge.

V. CONCLUSIONS

Except for the decisions, erroneous but of little consequence, which treat conditional sale contracts as executory contracts,\footnote{See Countryman, Part I, at 488-91.} the courts seem to have experienced little difficulty in fashioning a definition of executory contracts that is both workable and consistent with the apparent policy of those provisions of the Bankruptcy Act dealing with such contracts. There is, therefore, no urgent need for a statutory definition.

In a few other respects, however, statutory amendments do seem desirable. Priority treatment for unfunded pensions of employees who have retired before the employer's bankruptcy\footnote{See text accompanying notes 260-73, 290 supra.} should be expressly forbidden. The privileged treat-
ment that enables railway and airline labor forces to preserve the status quo in section 77 and Chapter X and XI cases should be eliminated to the extent that it can be done by relieving the rehabilitation proceeding of the cumbersome procedures of the Railway Labor Act.

Amendments would be desirable also to make clear that the doctrine of anticipatory breach, other provisions of non-bankruptcy law and express provisions in contracts and leases, should not be available to enable the other contracting party to deprive the trustee of this option under the Bankruptcy Act to assume or reject executory contracts. The trustee should also be given a reasonable time to cure prebankruptcy and postbankruptcy defaults without regard to whether the debtor had such a right under the contract or under nonbankruptcy law.

While the time fixed by section 70b within which the trustee is to exercise his option is not appropriate for rehabilitation cases, some adaptation of the section's further provision that any contract not assumed within an appropriate time shall be deemed rejected would eliminate the problems which arise from the apparently inadvertent failure either to assume or reject executory contracts in rehabilitation cases. A provision that in rehabilitation cases any executory contract not assumed with the approval of the court by the time of confirmation of a plan shall be deemed rejected and a requirement that the plan make provision for all claims arising from executory contracts rejected or deemed rejected would eliminate such problems. The debtor or a successor could then make a deliberate judgment whether to retain liability on the contract. If it was concluded that liability should be retained, the confirmed plan could assume the contract and expressly require the debtor or a successor to assume it also. To this end the last sentence of section 70b should be amended to require that, unless expressly waived by the other contracting party, any person taking an assignment of an assumed contract from the trustee in either a

---

589. See text accompanying notes 291-302 supra.
590. See text accompanying notes 375-445 supra.
591. See text accompanying notes 334-74 supra.
592. Most courts have recognized this. See note 546 supra and accompanying text.
593. See text accompanying notes 528-35, 561-70, 578-81 supra.
594. An amendment of § 70b, 11 U.S.C. § 110(b) (1970), to require court approval of the assumption of an executory contract in straight bankruptcy cases also would eliminate some uncertainties and avoid some inadvertent assumptions.
straight bankruptcy or a rehabilitation case must also assume the debtor's obligations thereunder. The section should further provide that in any event the debtor's liability ends with assignment of the contract to another.

These proposed amendments all assume no basic change in the treatment of executory contracts under the Bankruptcy Act, including the Act's treatment of rejection as a breach of contract as of the date of the petition. The consequences of such a rejection, however, are found for the most part in nonbankruptcy law, and at least two changes should be made.

One change is necessary to protect the interests of a purchaser under a land contract. Presently the trustee of the bankrupt vendor can reject such a contract and leave the purchaser with only a general claim for damages merely because applicable nonbankruptcy law does not require the vendor to account for payments theretofore made by the purchaser. There is no apparent reason why the purchaser should be treated differently from one who has given a purchase money mortgage, although under the analysis proposed the purchase money mortgage is not an executory contract which the trustee of the bankrupt vendor-mortgagee can reject. The unfairness to the purchaser under the land contract could be eliminated, as earlier suggested, either by an amendment requiring recognition of the purchaser's equity in the bankruptcy case even though it is not recognized by nonbankruptcy law or by an amendment forbidding rejection of executory land contracts by the trustee of the vendor where the purchaser is not in default on his payments.

The second change is necessary because the Bankruptcy Act in its present form deals only with claims which can be converted to money. While unliquidated and contingent contract claims are provable under section 63a(4) and (8), they are allowable under section 57d only if they can be liquidated or reasonably estimated without unduly delaying administration of the estate. And if they are not allowed for this reason, section 63d provides that they shall not be deemed provable and

595. See Countryman, Part I, at 473.
596. See Countryman, Part I, at 471.
597. I am indebted to George M. Treister, of the Los Angeles bar, for this suggestion.
599. Id. § 93(d).
600. Id. § 103(d).
hence are not dischargeable under section 17a.\(^\text{601}\) Under non-bankruptcy law, however, some contractual claims are provided an equitable remedy because of the difficulties of proving monetary damages—specific performance of a land contract\(^\text{602}\) and an injunction to enforce a covenant not to compete\(^\text{603}\) are ready examples.

In the few cases where it was sought, either in receivership or under the Bankruptcy Act, the courts have refused specific performance of land contracts because to grant it would be to prefer the nonbankrupt party over other creditors contrary to the general policy of equal treatment for creditors in receivership and bankruptcy.\(^\text{604}\) At least where individual debtors or bankrupts are involved, it is unlikely also that the courts would grant injunctive enforcement of a covenant not to compete. To do so would be contrary to the policy of the Bankruptcy Act to give the debtor a fresh start and to free his future earnings from prebankruptcy claims not specifically made nondischargeable.\(^\text{605}\)

But these policies of the Act would be frustrated if the courts were to decide that the difficulties of establishing monetary damages, which inspired the use of equitable remedies apart from bankruptcy, meant that a claim for monetary damage based on breach of a land contract or a covenant not to compete was not allowable in bankruptcy and hence not provable or dischargeable. There is no reason why the measure of difficulty should be the same for both purposes, and section 57d\(^\text{606}\) certainly suggests a nonrigorous approach by its language about "liquidation or reasonable estimation." Liberality might be further encouraged, however, if section 63a\(^\text{607}\) were amended

---

601. Id. § 35(a).
602. 5 A. CORBIN, CONTRACTS § 1143 (1964).
603. Id. § 1210.
605. See Countryman, The Use of State Law in Bankruptcy Cases (Part I), 47 N.Y.U.L. Rev. 407, 449–55 (1972). Heyl v. Emory & Kaufman, Ltd., 204 F.2d 137 (5th Cir. 1953), held that while a private sale by an insurance agent of a list of expirations of fire and casualty policies might carry an undertaking by him to refrain from soliciting those listed for policy renewals, a sale of the list by his bankruptcy trustee carries no such undertaking. See also In re Meyers, 308 F. 407 (7th Cir. 1913), which modified an order for the sale of the bankrupt's medical practice to make it clear that the sale carried no undertaking by the bankrupt not to continue practice.
607. Id. § 103(a).
to specify that unliquidated and contingent contractual claims may be provable, even though by applicable nonbankruptcy law an equitable remedy is provided, because of the difficulty of establishing monetary damages with precision.608

---

608. This problem could arise, and the proposed amendment would be equally applicable, in cases where the contract was not executory because fully performed by the nonbankrupt party.