The Effects of a Reorganization on (Executory) Contracts: A Comparative Law and Policy Study [United States, France, Germany and Switzerland]

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Abstract

This comparative law and policy study analyses the effects of reorganization proceedings on (executory) contracts.

The first purpose of this study is to explain the different options chosen by the United States, France, Germany and Switzerland for the "treatment of contracts" and examine in which way they comply with or differ from the recommendations of the UNCITRAL Legislative Guide on Insolvency Law (UNCITRAL Guide). This article focuses on three closely related issues: (1) the validity of ipso facto *clauses, (2) the assumption (continuation), and (3) the rejection of (executory) contracts by the debtor in possession or the trustee.*

The second objective of this essay is to determine if each option chosen by these legal systems and the UNCITRAL Guide is sound from a policy perspective. This study summarizes the main arguments developed by U.S. scholars on the (non-)efficiency of the U.S. Bankruptcy Code. It also criticizes this "contractual approach", principally because it violates the fundamental principle of the equality of distribution among the creditors.

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I. Introduction

Practitioners are facing a high degree of complexity in international insolvency proceedings, because they have to deal with numerous differences in policy and legislative treatment of insolvency. With the exception of Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings,[1] there is no comprehensive set of rules for international insolvency. In the EU, the unification of insolvency rules has failed since the Convention on Insolvency Proceedings of 23 November 1995[2] has not been signed by all members. Some efforts have been made recently to harmonize insolvency proceedings. For instance, the 2004 - UNCITRAL Legislative Guide on Insolvency Law (UNCITRAL Guide)[3] provides recommendations, in particular on the "treatment of contracts".[4]

The "treatment of contracts" is central to insolvency proceedings, especially in a reorganization. As indicated by the UNCITRAL Guide,[5] there are two major difficulties in drafting provisions in this matter:

First, contrary to all other assets of the insolvency estate, contracts are generally tied to liabilities or claims, so that the debtor-in-possession or the trustee must often assume and perform under the contract in order to enjoy rights that are potential valuable assets. Therefore, difficult decisions must be made on the "treatment of contracts" which could be valuable.

Second, contracts are of many types, which complicates the elaboration of a general provision. In addition, the debtor (in possession) may be a seller or a buyer, a lessor or a lessee, an employer or a worker, with the accompanying risk that the issues may differ in insolvency proceedings when viewed from different perspectives.

To reach a harmonization (or an unification) of insolvency proceedings, especially in the "treatment of contracts", the trends in the various legal systems must first be established. Therefore, I propose to examine the laws of the United States, France, Germany and Swit-

1 Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC).
2 *Available at* http://aei.pitt.edu/2840/ (last visited Nov. 24, 2011).
3 *Available at* http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf (last visited Nov. 24, 2011).
4 UNCITRAL Guide, Recommendations 69-86.
5 UNCITRAL Guide at 123, paras. 119-120.

zerland dealing with the "treatment of contracts" in reorganization proceedings. The focus will be on the United States "executory contracts" regime,[6] which is apparently used to some extent as a "Model law" for other legal systems. Indeed, France, Germany and Switzerland have recently modified (or will modify) their insolvency laws in order to further the reorganization of entities instead of bankruptcy. Briefly, the four legal systems provide the following rules:

United States. 11 U.S.C. § 365 gives three options to the trustee or the debtor in possession: assume and perform under the executory contract, reject the executory contract, or assign the executory contract to a third party who will perform under the contract.

France. Since January 1, 2006, COMMERCIAL CODE[7] arts. L. 620-1 - L. 628-7 provide for a "safeguard procedure" ("*procédure de sauvegarde*"), which seems to be directly inspired from Chapter 11 of the U.S. Bankruptcy Code.[8] The "safeguard procedure" has been recently modified in important aspects by the Order No 2008-1345 of December 18, 2008 Amending the Law on Enterprises in Financial Distress, which entered into force on February 15, 2009 (except art. 16, in force on January 1, 2009).[9] The doctrine qualifies the safeguard procedure as a "simplified judicial receivership" ("*redressement judiciaire allégé*").[10] [11] C. COM. arts. L. 622-13 and L. 627-2 focus on the effects of a safeguard procedure on executory contracts

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6 *See* 11 U.S.C. § 365.

7 CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE].

8 PHILIPPE DELEBECQUE & MICHEL GERMAIN, TRAITÉ DE DROIT COMMERCIAL, TOME 2, EFFETS DE COMMERCE – BANQUE, CONTRATS COMMERCIAUX, PROCÉDURES COLLECTIVES [COMMERCIAL LAW TREATISE, VOLUME 2, COMMERCIAL PAPER – BANK, COMMERCIAL CONTRACTS, INSOLVENCY PROCEEDINGS] 835 (Librairie Générale de Droit et de Jurisprudence, 17th ed. 2004); Roland Montfort & Laurent Jourdan, *"French Chapter: preventive measures in a cross-border context"*, *in* GLOBAL INSOLVENCY & RESTRUCTURING YEARBOOK 2006/07 at 5 (2006), *available at* http://www.iln.com/articles/pub_251.doc (last visited Nov. 24, 2011).

9 Ordonnance n° 2008-1345 du 18 décembre 2008 portant réforme du droit des entreprises en difficulté [Order No 2008-1345 of December 18, 2008 Amending the Law on Enterprises in Financial Distress], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Dec. 19, 2008, p. 19462.

10 *See* C. COM. arts. L. 631-1 - L 632-4.

11 Philippe Pétel, *Le nouveau droit des entreprises en difficulté* [*The New Law on Enterprises in Distress*], LA SEMAINE JURIDIQUE [JCP], ENTREPRISE ET AFFAIRES No. 42 at 1730, para. 37 (Oct. 20, 2005).

("*contrats en cours*"). The French regulation gives two options to the debtor in possession: assume and perform under the executory contract or reject the executory contract. Pursuant to C. COM. art. L. 642-7, in a liquidation procedure, the trustee is also authorized to assign the contract to a third party who will perform under the contract.

Germany. Insolvency Act[12] §§ 103-128, in connection with InsO § 279, deal with the effects of an "insolvency plan" ("*Insolvenzplan*")[13] on contracts. The German provisions only authorize the debtor in possession to assume and perform under the contract. The German law does not provide for a general right of the trustee or the debtor in possession to reject (executory) contracts, except in the cases of leases[14] or employment contracts.[15] Some types of contracts terminate automatically in the case of insolvency.

Switzerland. The Swiss reorganization procedure – called "*Nachlassverfahren*", "*Concordat*" or "*Concordato*" – is governed by the Federal Act on Debt Enforcement and Bankruptcy[16] arts. 293-332. A revision currently underway[17] should clarify in particular the effects

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[12] Insolvenzordnung [Inso] [Insolvency Act], Oct. 5, 1994, BUNDESGESETZBLATT [BGBL.] [FEDERAL LAW GAZETTE] I at 2866.

[13] *See* InsO §§ 217-285.

[14] *See* Inso §§ 109, 279.

[15] *See* Inso §§ 113, 279

[16] Bundesgesetz über Schuldbetreibung und Konkurs [SchKG], Loi fédérale sur la poursuite pour dettes et la faillite [LP], Legge federale sulla esecuzione e sul fallimento [LEF] [Federal Act on Debt Enforcement and Bankruptcy] Apr. 11, 1889, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 281.1.

[17] Botschaft zur Änderung des Bundesgesetzes über Schuldbetreibung und Konkurs (Sanierungsrecht), Message relatif à une modification de la loi fédérale sur la poursuite pour dettes et la faillite (droit de l'assainissement), Messaggio sulla modifica della legge federale sulla esecuzione e sul fallimento (procedura di risanamento) [Message regarding the Amendment of the Federal Act on Debt Enforcement and Bankruptcy (Financial Reorganization Law)] Sept. 8, 2010, BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6455 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5871 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5667 (2010); Bundesgesetz über Schuldbetreibung und Konkurs (SchKG) (Entwurf), Loi fédérale sur la poursuite pour dettes et la faillite (LP) (Projet), Legge federale sulla esecuzione e sul fallimento (LEF) (Disegno) [Federal Act on Debt Enforcement and Bankruptcy (LP) (Draft)], BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6507 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5921 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5717 (2010).

of a bankruptcy (and the effects of a reorganization procedure) on long-term contracts.[18] With the consent of the commissioner, the debtor in possession will also have the right to reject (executory) contracts during the automatic stay (called "*Nachlassstundung*", "*sursis concordataire*" or "*moratoria*").[19] Some types of contracts terminate automatically in the case of bankruptcy or insolvency. The draft does not provide the option to assume and assign the contract to a third party who will perform under the contract.

Major differences still exist between 11 U.S.C. § 365 and French, German and Swiss law. Moreover, even if the French and Swiss revisions were (or will be) enacted after the adoption of the UNCITRAL Guide, several provisions do not apply its recommendations on the "treatment of contracts".

The first purpose of this study is to explain the different options chosen by the United States, France, Germany and Switzerland for the "treatment of contracts" and examine in which way they comply with or differ from the recommendations of the UNCITRAL Guide. I will focus on three topics which are closely related:

(i) Automatic Termination, Acceleration or Similar Clauses or Statutory Provisions (*see infra* II/A);[20]

(ii) Continuation of (executory) contracts by the debtor in possession (*see infra* II/B);[21]

(iii) Rejection of (executory) contracts by the debtor in possession (*see infra* II/C).[22]

The second objective of this essay is to determine if each option chosen by these States and the UNCITRAL Guide is sound from a policy perspective. This study will summarize the main arguments developed by U.S. scholars on the (non-)efficiency of 11 U.S.C. § 365. I will argue that the three above-mentioned topics (validity of *ipso facto* clauses, assumption and rejection of (executory) contracts by the debtor in possession) are closely related and should be studied collectively. To conclude, I will propose the best options from a

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[18] *See* draft LP art. 211a.

[19] *See* draft LP art. 297a.

[20] *See* UNCITRAL Guide, Recommendations 70-71.

[21] *See* UNCITRAL Guide, Recommendations 72-82.

[22] *Id.*

policy perspective and examine which legal system is the more effective under this aspect.

II. Analysis of the "Treatment of Contracts" From a Comparative Law and a Policy Perspective

A. Automatic Termination, Acceleration or Similar Clauses and Statutory Provisions

1. Comparative Law Study of *Ipso Facto* Clauses

1.1. Overview

Many contracts provide that the counterparty has a right to terminate or accelerate the agreement, or even that the contract will terminate automatically,[23] in an event of default such as insolvency proceedings, the appointment of an insolvency representative, the fulfillment of the conditions for commencement of insolvency proceedings, or even a weakened financial position of the debtor.[24] These provisions are sometimes referred to as *ipso facto* clauses.[25]

As indicated by the UNCITRAL Guide,[26] there are two different approaches to the validity of *ipso facto* clauses in insolvency proceedings:

(i) The approach of making *ipso facto* clauses unenforceable followed by the United States and France (*see infra* 1.2).

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[23] *See* under Swiss law: Daniel Staehelin, *Vertragsklauseln für den Insolvenzfall* [*Contract Provisions on Insolvency*], AKTUELLE JURISTISCHE PRAXIS/ PRATIQUE JURIDIQUE ACTUELLE [AJP/PJA] 363, 373-374 (2004); EMILE TAILLENS, DES EFFETS DE LA FAILLITE SUR LES CONTRATS DU DÉBITEUR [THE EFFECTS OF BANKRUPTCY ON THE DEBTOR'S CONTRACTS] para. 87 (Impr. Klausfelder 1950); Nicolas Jeandin, *Les effets de la faillite sur le contrat de durée* [*The Effects of Bankruptcy on the Long-Term Contract*], *in* PUBLICATION DE LA SOCIÉTÉ GENEVOISE DE DROIT ET DE LÉGISLATION À L'OCCASION DU 125e ANNIVERSAIRE DE LA SEMAINE JUDICIAIRE: LE CONTRAT DANS TOUS SES ÉTATS 71, 92-93 (François Bellanger, François Chaix, Christine Chappuis & Anne Héritier Lachat eds., Stämpfli 2004).

[24] UNCITRAL Guide at 122, para. 114.

[25] *Id.*

[26] UNCITRAL Guide at 122-123, paras. 115-116.

(ii) The approach of upholding *ipso facto* clauses followed by Germany (but this issue is highly controversial) and Switzerland (*see infra* 1.3).

1.2. The Approach of Making *Ipso Facto* Clauses Unenforceable

a) Invalidation of Termination Clauses

In the United States, under the former Bankruptcy Act, an anti-assignment clause was not valid, but an *ipso facto* clause was enforceable.[27] However, ambiguous contractual clauses and covenants in leases providing for the termination of the lease in case of the lessee's bankruptcy were universally interpreted in favor of the lessee's estate.[28] *Ipso facto* clauses were widely used when they were legal.[29] Since the enactment of the Bankruptcy Code of 1978,[30] 11 U.S.C.

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[27] 1 COLLIER BANKRUPTCY MANUAL ¶365.07 (3d ed. Rev. 2010), *available at* LexisNexis.

[28] 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07. Queens Blvd. Wine & Liquor Corp. v. Blum, 503 F.2d 202, 207 (2d Cir. 1974) (the termination clause of the lease does not operate on the grounds that it would be grossly inequitable and contrary to the salutary purpose of Chapter XI); *In re* Clerc Chemical Corp., 52 F. Supp. 109, 110 (D.N.J. 1943) , *aff'd*, 142 F.2d 672 (3d Cir. 1944) (termination provision is to be strictly construed; the termination clause in the lease at issue refers to the individual lessee's bankruptcy, so that it does not apply upon debtor corporation's petition for bankruptcy); *In re* Murray Realty Co., 35 F. Supp. 417, 419-420 (N.D.N.Y. 1940) (termination provision, which refers to the insolvency or bankruptcy of the lessee or "of any successor", does not apply to the assignee of the original tenant); *In re* Ehrhardt, 19 F.2d 406, 407 (W.D. Pa. 1927) (the nonpayment of a small amount of taxes is insufficient to warrant forfeiture, and the right of enforcing forfeiture must not be unconscionable); *In re* Gutman, 197 F. 472, 476 (S.D. Ga. 1912) (although the contract provides that the tenant cannot assign the lease, a transfer of the lease from the tenant to the trustee by operation of the bankruptcy law (U.S.) does not avoid the lease). *See also In re* D. H. Overmyer Co., 510 F.2d 329, 332-333 (2d Cir. 1975) (although permitting termination of the lease in a Chapter 11 proceeding on the facts of the case, suggests that the court has broad equitable powers to permit the lessee to stay in possession notwithstanding a default in the payment of rent or even termination before the date of filing).

[29] Yeon-Koo Che & Alan Schwartz, *Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance*, 15 J.L. ECON & ORG 441, 461, n.20 (1999).

[30] H.R. REP. No. 95-595, at 348 (1977). *See also* CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 854 (Thomson Reuters/Foundation Press, 2d ed. 2009).

§ 365(e)(1) expressly invalidates *ipso facto* clauses.[31] Consequently, the debtor in possession or the trustee may assume or assign an executory contract notwithstanding an *ipso facto* clause. Due to the broad language of this provision, an *ipso facto* clause conditioned on the debtor's insolvency or financial condition, or on the appointment of a trustee or receiver, is unenforceable because it is most likely to operate in the vicinity of a reorganization or bankruptcy case.[32]

The French Code de Commerce also expressly invalidates *ipso facto* clauses. Indeed, C. COM. art. L. 622-13 I para. 1 provides that, notwithstanding any legal rule or contractual term to the contrary, the indivisibility, termination or rescission of the contract shall not result from the commencement of safeguard proceedings alone. (Former) Act No. 85-98 of January 25, 1985 Relating to the Judicial Receivership or Liquidation of Enterprises[33] art. 37 para. 5 (6) already invalidated *ipso facto* clauses in case of judicial receivership. The latter Act consolidated case law and other statutes providing for a continuation of contracts – including those concluded *intuitu personae* – after the commencement of the judicial receivership proceedings.[34]

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[31] Pursuant to 11 U.S.C. § 365(e)(1), "[n]otwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on— (A) the insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under this title; or (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement."

[32] 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07. *See, e.g., In re* Bulldog Trucking, Inc., 173 B.R. 517, 533-534 (W.D.N.C. 1994).

[33] Loi n° 85-98 du 25 janvier 1985 relative au redressement et à la liquidation judiciaire des entreprises [Act No. 85-98 of January 25, 1985 Relating to the Judicial Receivership or Liquidation of Enterprises], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Jan. 28, 1985, p. 1097.

[34] Cour de cassation [Cass.] [supreme court for judicial matters] com., Dec. 8, 1987, RECUEIL DALLOZ *JURISPRUDENCE* [D.] 1988, 52, note F. Derrida; Jean-François Montredon, *La théorie générale du contrat à l'épreuve du nouveau droit des procédures collectives* [*The Contract General Theory Under the Test of the New Law of Insolvency Proceedings*], LA SEMAINE JURIDIQUE [JCP], ÉDITION ENTREPRISE II No. 15156 at 268, para. 59 (1988); Clotilde Brunetti-Pons, *La spécificité du régime des contrats en cours dans les procédures collectives* [*The Specificity of Executory Contracts System in Insolvency Procee-*

Statutory *ipso facto* clauses are also invalid, i.e., this rule prevails even if another statute provides for the contrary (e.g., pursuant to CODE CIVIL[35] art. 2003, an agency terminates (automatically) by the insolvency, either of the principal, or of the agent).[36] The Cour de cassation extends this invalidity to clauses providing for an automatic termination or a rescission in the event of a suspension of payments, i.e., even before the commencement of a judicial receivership (or safeguard) procedure.[37]

In the United States, even if *ipso facto* clause are unenforceable,[38] practitioners' guides still recommend the parties continue using such *ipso facto* clauses in contracts for several reasons:[39]

The clause as ordinarily written applies to a broad range of events or conditions which may appear without the filing of a petition under the Bankruptcy Code.

Under 11 U.S.C. § 365(e)(1), *ipso facto* clauses are unenforceable " . . . at any time after the commencement of the case . . . " Therefore, after the case is closed, such clauses shall be fully enforceable against the (reorganized) debtor in the event of a new default, unless

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dings], 53 (4) REVUE TRIMESTRIELLE DE DROIT COMMERCIAL (DALLOZ) [RTD COM.] 783, paras. 2, 10 & n.14 (Oct.-Dec. 2000); Fernand Derrida, *La notion de contrat en cours à l'ouverture de la procédure de redressement judiciaire* [*The Notion of Executory Contract at the Commencement of a Judicial Receivership*], REVUE DE JURISPRUDENCE DE DROIT DES AFFAIRES [RJDA] 399, para 11 (1993); Philippe Pétel, *Le sort des contrats conclus avec l'entreprise en difficulté* [*The Fate of Contracts Concluded With a Undertaking in Financial Distress*], LA SEMAINE JURIDIQUE [JCP], ÉDITION NOTARIALE I at 125, para. 6 (1992); Thierry Montéran, *L'influence des procédures collectives sur la poursuite et la fin des contrats* [*The Effect of Insolvency Proceedings on the Continuation and the Termination of Contracts*], GAZETTE DU PALAIS [GAZ. PAL.] 2716, 2716-2717 (Sept. – Oct. 2003).

[35] CODE CIVIL [C. CIV.] [CIVIL CODE].

[36] Montredon, *supra* note 34, para. 59; Pétel, *supra* note 34, para. 6. For the previous system pursuant to CODE CIVIL art. 2003, *see* J. Alméras, *Du sort du mandat après faillite du mandant ou du mandataire* [*The Fate of Agency After Bankruptcy of the Principal or the Agent*], REVUE GÉNÉRALE DES FAILLITES 79, 79 et seq. (1936).

[37] Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 2, 1993, BULLETIN DES ARRÊTS DE LA COUR DE CASSATION, CHAMBRES CIVILES [BULL. CIV.] IV, No. 87.

[38] *See* 11 U.S.C. § 365(e)(1).

[39] *See* 4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶68.12 (2010), *available at* LexisNexis.

the debtor becomes the subject of a new Bankruptcy Code case. 11 U.S.C. § 365(e)(1) does not invalidate a *ipso facto* clause *in toto*, but merely makes it unenforceable during a Bankruptcy Code case.[40]

11 U.S.C. § 365(e)(1) only refers to *ipso facto* clauses dealing with the insolvency of the debtor and not to such clauses that apply to the insolvency of the guarantor. Properly drafted *ipso facto* clauses should therefore also refer to the insolvency of the guarantor. Indeed, the guarantor is often a corporate parent or affiliate of the debtor, so there is a significant chance that the guarantor will also be insolvent when the debtor files for bankruptcy and that the termination clause may be invoked.

Even if this possibility is remote, 11 U.S.C. § 365(e)(1) may be amended or revised in the future and (again) give effect to *ipso facto* clauses.

b) Exceptions to the Invalidation of Termination Clauses

In the United States, pursuant to 11 U.S.C. § 365(e)(2),[41] the invalidation of *ipso facto* clauses[42] does not apply to:

(i) Contracts or leases that are nonassignable under applicable (state) nonbankrutpcy law, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, when the excused party does not consent to such an assumption or assignment. In particular, contracts for personal services (e.g., contingent fee contracts)[43] are nonassignable un-

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[40] H.R. REP. No. 95-595, at 349 (1977).

[41] Pursuant to 11 U.S.C. § 365(e)(2), "[p]aragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if— (A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (ii) such party does not consent to such assumption or assignment; or (B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."

[42] *See* 11 U.S.C. § 365(e)(1).

[43] *See In re* Tonry, 724 F.2d 467, 469 (5th Cir. 1984).

der applicable nonbankrutpcy law.[44] However, the language of this provision is too broad and it seems that its intent is to authorize termination only when substituted performance from a third party – such as a Chapter 7 trustee or an unrelated party– would occur.[45] Thus, 11 U.S.C. § 365(e)(2) does not prevent the original debtor (debtor in possession in a reorganization proceeding) assuming a contract for personal services.[46]

(ii) Contracts to make a loan or extend financial accommodations or debt financing to or for the benefit of the debtor or to issue a security of the debtor may be terminated and, in the case of loans, the counterparty may accelerate the obligation to reimburse.[47] However, the termination is not automatic:[48] the effect of the automatic stay, which applies to attempts to terminate any kind of executory contracts or leases including those described in 11 U.S.C. § 365(e)(2),[49] should simply be to preserve the *status quo* until the court decides whether 11 U.S.C.

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[44] BENJAMIN WEINTRAUB & ALAN N. RESNICK, BANKRUPTCY LAW MANUAL (The Warren, Gorham & Lamont Bankruptcy Series, 4th ed. 1996).

[45] 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07; 2 NORTON BANKR. L. & PRAC. 3D § 46:22 (Oct., 2010), *available at* Westlaw NRTN-BLP; Calvin v. Siegal (*In re* Siegal), 190 B.R. 639, 644 (Bankr. D. Ariz. 1996); *In re* Cardinal Industries, Inc., 116 Bankr. 964, 979 (Bankr. S.D. Ohio 1990), both cases quoting H.R.REP. No. 96-1195, Section 27(b), at 12 (1980): "This amendment [of 11 U.S.C. § 365(c)(1)] makes it clear that the prohibition against a trustee's power to assume an executory contract does not apply where it is the debtor that is in possession and the performance to be given or received under a personal service contract will be the same as if no petition had been filed because of the personal service nature of the contract."

[46] *See* Calvin v. Siegal (*In re* Siegal), 190 B.R. 639, 644-645 (Bankr. D. Ariz. 1996).

[47] 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07.

[48] Foothill Capital Corp. v. Official Unsecured Creditors' Committee, 246 B.R. 296, 304 (E.D. Mich. 2000); 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07.

[49] Calvin v. Siegal (*In re* Siegal), 190 B.R. 639, 640 n.1 (Bankr. D. Ariz. 1996); *In re* Edwards Mobile Home Sales, Inc., 119 B.R. 857, 860 (Bankr. M.D. Fla. 1990); *In re* Computer Communs., 824 F.2d 725, 730 (9th Cir. 1987); 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07. *But see In re* Tonry, 724 F.2d 467, 469 (5th Cir. 1984) (attorney's contingent fee contracts are not part of the bankruptcy estate).

§ 365(e)(2) is applicable.[50] If so, the automatic stay should be vacated.[51]

Special provisions also protect contractual rights to terminate swap agreements,[52] certain securities contracts,[53] commodities contracts and forward contracts,[54] and repurchase agreements.[55] [56]

1.3. The Approach of Upholding *Ipso Facto* Clauses

In German insolvency law ("Inso"), pursuant to InsO § 119, agreements excluding or limiting the application of the provisions on (executory) contracts[57] in advance shall be invalid. Pursuant to InsO § 279, this rule is also applicable in an insolvency plan. In other words, the parties are not authorized to exclude expressly (directly) the trustee's[58] or the debtor in possession's[59] right to assume the contract. However, the issue of the (in)validity of *ipso facto* clauses is highly controversial, because it permits parties to exclude (indirectly) the right of the trustee or the debtor in possession to assume the contract.[60] German case law does not yet provide any clear guide-

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50 1 COLLIER BANKRUPTCY MANUAL, *supra* note 27, ¶365.07.
51 *Id.*
52 *See* 11 U.S.C. § 560.
53 *See* 11 U.S.C. § 555.
54 *See* 11 U.S.C. § 556.
55 *See* 11 U.S.C. § 559.
56 WEINTRAUB & RESNICK, *supra* note 44, ¶7.10[7] n.98.
57 *See* InsO §§ 103-118.
58 *See* InsO § 103.
59 *See* Inso § 279. More precisely, the debtor in possession shall exercise his rights under InsO §§ 103-128 with the assent of the trustee.
60 Scholars upholding *ipso facto* clauses: SVEN WORTBERG, LÖSUNGSKLAUSELN UND INSOLVENZ [TERMINATION CLAUSES AND INSOLVENCY] 63-65, 70-71, 76, 78-79, 100-101, 107-109, 112-115, 130, 132-140, 148-151, 167, 173, 189-190 (Peter Lang 2003); MATTHIAS WÖLLNER, DIE WIRKSAMKEIT VERTRAGLICHER LÖSUNGSKLAUSELN IM INSOLVENZFALL [THE VALIDITY OF CONTRACTUAL TERMINATION CLAUSES IN CASE OF INSOLVENCY] 90-91, 125, 136, 164, 172, 191, 209, 215, 218, 226-227, 283, 291, 293-294 (Nomos 2009); Ulrich Graf & Irene Wunsch, *Gegenseitige Verträge im Insolvenzverfahren* [*Bilateral Contracts in Insolvency Proceedings*], ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 2117, 2118 (2002); MICHAEL HUBER, InsO § 119, paras. 28 et seq., *in* MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG, BAND 2, §§ 103-269 [MÜNCHENER KOMMENTAR ON THE INSOLVENCY ACT, VOLUME 2, §§ 103-269] (Hans-Peter Kirchhof, Hans-Jürgen Lwowski & Rolf Stürner eds., Verlag C. H. Beck, 2d ed. 2008).

lines on this controversial issue,[61] but tends to uphold *ipso facto* clauses.[62]

Under the Swiss law, the parties shall not exclude (directly) the trustee's, the liquidators'[63] or the debtor in possession's[64] (mandatory) right to assume a contract.[65] However, pursuant to the principle of

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Scholars invalidating *ipso facto* clauses: KROTH, InsO § 119, para. 12, *in* INSOLVENZORDNUNG (INSO), KOMMENTAR [INSOLVENCY ACT (INSO), COMMENTARY] (Eberhard Braun ed., Verlag C. H. Beck, 4th ed. 2010); WOLFGANG MAROTZKE, InsO § 119, paras. 1, 3-5, *in* INSOLVENZORDNUNG [INSOLVENCY ACT] (Gerhart Kreft ed., C.F. Müller Verlag, 5th ed. 2008); LUDWIG HÄSEMEYER, INSOLVENZRECHT [INSOLVENCY LAW] paras. 20.10 a, 20.10 b (Carl Heymanns Verlag, 4th ed. 2007).

61 BURGHARD WEGENER, Inso § 119, para. 3, *in* FK-INSO FRANKFURTER KOMMENTAR ZUR INSOLVENZORDNUNG [FK-INSO FRANKFURTER KOMMENTAR ON THE INSOLVENCY ACT] (Klaus Wimmer ed., Luchterhand 2009); WORTBERG, *supra* note 60, at 91.

62 Oberlandsgericht München [OLG] [Higher Regional Court Munich] Apr. 26, 2006, NEUE JURISTISCHE ONLINE-ZEITSCHRIFT [NJOZ] 3489, 2006; Bundesgerichtshof [BGH] [Federal Court of Justice] Sept. 26, 1985, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 1509, 1985; WÖLLNER, *supra* note 60, at 283, 291.

63 *See* LP art. 211 para. 2.

64 *See* LP arts. 306 para. 2 cl. 2, 310 para. 2. More precisely, it results from LP arts. 306 para. 2 cl. 2 and 310 para. 2 that the debtor in possession shall exercise his rights with the assent of the trustee during the automatic stay.

65 KURT AMONN & FRIDOLIN WALTHER, GRUNDRISS DES SCHULDBETREIBUNGS- UND KONKURSRECHTS [DEBT ENFORCEMENT AND BANKRUPTCY LAW COMPENDIUM] § 1 para. 20 (Stämpfli, 8th ed. 2008); Staehelin, *supra* note 23, at 366; ROLAND FISCHER, LIZENZVERTRÄGE IM KONKURS, GESETZLICHE REGELUNG UND VERTRAGLICHE GESTALTUNGSMÖGLICHKEITEN [LICENSE AGREEMENTS IN BANKRUPTCY, STATUTORY RULES AND CONTRACT DRAFTING OPTIONS] 297 (Stämpfli 2008); DIETER ZOBL & THOMAS WERLEN, 1992 ISDA-MASTER AGREEMENT, UNTER BESONDERER BERÜCKSICHTIGUNG DER SWAPGESCHÄFTE [1992 ISDA-MASTER AGREEMENT, WITH A FOCUS ON SWAP TRANSACTIONS] 119 (Schulthess 1995). *Contra* Daniel Hunkeler, *Wirkungen der Konkurseröffnung auf zweiseitige Verträge, insbesondere auf Werkverträge (ausgewählte Einzelfragen)* [*Effects of the Adjudication of Bankruptcy on Bilateral Contracts, in particular on Construction Contracts (Selected Issues)*], BAURECHT/DROIT DE LA CONSTRUCTION [BR/DC] 57, 59 (2002); Karl Spühler, *Möglichkeiten eines Konkursverwalters bei zweiseitigen Verträgen* [*Trustee's Options in Bilateral Contracts*], *in* NEUERE TENDENZEN IM GESELLSCHAFTSRECHT, FESTSCHRIFT FÜR PETER FORSTMOSER 673, 678-679 (Hans C. von der Crone, Rolf H. Weber, Roger Zäch & Dieter Zobl eds., Schulthess 2003).

freedom of contract,[66] the parties are authorized to agree on *ipso facto* clauses applicable in case of bankruptcy[67] or reorganization

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[66] Bundesgesetz betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches (Fünfter Teil: Obligationenrecht) (Das Obligationenrecht) [OR], Loi fédérale complétant le code civil suisse (Livre cinquième: Droit des obligations) (Code des obligations) [CO], Legge federale di complemento del Codice civile svizzero (Libro quinto: Diritto delle obbligazioni) (Codice delle obbligazioni) [CO] [Federal Act Supplementing the Swiss Civil Code (Fifth Book: Obligations Law) (Code of Obligations)] Mar. 30, 1911, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 220, art. 19 para. 1.

[67] Franco Lorandi, *Mietverträge im Konkurs des Mieters* [*Leases in Lessee's Bankruptcy*], MIETRECHTSPRAXIS [MP] 1, 4-5 (1998) [hereinafter Lorandi, *Lessee's Bankruptcy*]; Franco Lorandi, *Arbeitsverträge im Konkurs des Arbeitgebers* [*Labour Contracts in Employer's Bankruptcy*], 96 SCHWEIZERISCHE JURISTEN-ZEITUNG/REVUE SUISSE DE JURISPRUDENCE [SJZ/RSJ] 150, 152 (2000) [hereinafter Lorandi, *Employer's Bankruptcy*]; WALTER A. STOFFEL & ISABELLE CHABLOZ, VOIES D'EXÉCUTION, POURSUITE POUR DETTES, EXÉCUTION DE JUGEMENTS ET FAILLITE EN DROIT SUISSE [ENFORCEMENT PROCEEDINGS, DEBT ENFORCEMENT, ENFORCEMENT OF JUDGMENTS AND BANKRUPTCY IN SWISS LAW] § 10 para. 104 (Stämpfli, 2d ed. 2010); Dieter Zobl, *Das Eintrittsrecht der Konkursmasse in synallagmatische Verträge und die Vertragsfreiheit* [*The Estate's Right to Assume in Bilateral Contracts and the Freedom of Contract*], *in* RECHT UND RECHTSDURCHSETZUNG, FESTSCHRIFT FÜR HANS ULRICH WALDER ZUM 65. GEBURTSTAG 533, 533 et seq. (Isaak Meier, Hans Michael Riemer & Peter Weimar eds., Schulthess 1994); ZOBL & WERLEN, *supra* note 65, at 119; Staehelin, *supra* note 23, at 367-368; Hunkeler, *supra* note 65, at 59; MARTIN PLENIO, DAS ERFÜLLUNGSRECHT DER KONKURSVERWALTUNG UND SCHULDRECHTLICHE VERTRÄGE IM KONKURS [THE TRUSTEE'S RIGHT TO ASSUME AND CONTRACTS IN BANKRUPTCY] 124 et seq. (Haupt Verlag 2003); FISCHER, *supra* note 65, at 297, 322 et seq., 353 et seq.; TAILLENS, *supra* note 23, para. 87; PHILIPP WEYDMANN, ZWEISEITIGE VERTRÄGE IM KONKURS EINER VERTRAGSPARTEI [BILATERAL CONTRACTS IN A PARTY'S BANKRUPTCY] 35 (F. Renggli 1958); Sylvain Marchand, *Contrats et insolvabilité* [*Contracts and Insolvency*], *in* ACTUALITÉ DU DROIT DES CONTRATS, LE CONTRAT À LA CROISÉE DES CHEMINS 15, 38 (Martina Braun ed., Litec - JurisClasseur (LexisNexis) 2008); Isaak Meier, *Laufende Verträge in Konkurs- und Nachlassverfahren* [*Executory Contracts in Bankruptcy and Reorganization Proceedings*], 70 BLÄTTER FÜR SCHULDBETREIBUNG UND KONKURS/BULLETIN DES PRÉPOSÉS AUX POURSUITES ET FAILLITES [BLSCHK] 85, 103 et seq. (2006) [hereinafter Meier, *Executory Contracts*]; Jeandin, *supra* note 23, at 92-93; RENATE SCHWOB, LP art. 211, paras. 13, 27-28, *in* BASLER KOMMENTAR, BUNDESGESETZ ÜBER SCHULDBETREIBUNG UND KONKURS II, ART. 159-352 SCHKG, ART. 1-47 GSCHG, ART. 51-58 AVIG [BASLER KOMMENTAR, FEDERAL ACT ON DEBT ENFORCEMENT AND BANKRUPTCY II, ART. 159-352 LP, ART. 1-47 GSCHG, ART. 51-58 AVIG] (Adrian Staehelin,

proceedings,[68] so that it allows the parties to deny (indirectly) the trustee's, liquidators' or debtor in possession's (mandatory) right to assume the contract. Even though *ipso facto* clauses are enforceable in such proceedings, the principle of freedom of contract is subject to certain limitations:[69]

First, *ipso facto* clauses shall comply with the mandatory substantive law.[70] For instance, the termination of an employment contract concluded for a fixed period of time[71] cannot be made dependant upon the fulfillment of a condition subsequent[72] if the time of fulfillment of this condition is uncertain or depends unilaterally on the intent of the employer.[73] Therefore, if the adjudication of reorganization proceedings is not imminent at the time of the conclusion of the em-

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Thomas Bauer & Daniel Staehelin eds., Helbing Lichtenhahn, 2d ed. 2010). *But see* Meier, *Executory Contracts*, *supra* note 67, at 112-113; Mark A. Reutter, *Urheberrechte und Urheberrechtsverträge in der Zwangsvollstreckung* [*Copyrights and Copyright Contracts*], *in* URHEBERVERTRAGSRECHT 331, 437-438 (Magda Streuli-Youssef ed., Schulthess 2006) (the latter author admits the validity of contractual termination clauses in a party's bankruptcy provided that these clauses do not remove assets from the estate). *Unclear* PIERRE-ROBERT GILLIÉRON, LP art. 211, para. 56, *in* COMMENTAIRE DE LA LOI FÉDÉRALE SUR LA POURSUITE POUR DETTES ET LA FAILLITE, ARTICLES 159-270 [COMMENTARY ON THE FEDERAL ACT ON DEBT ENFORCEMENT AND BANKRUPTCY, ARTICLES 159-270] (Payot 2001). *Contra* URS BÜRGI, LP art. 211, para. 8, *in* KURZKOMMENTAR SCHKG SCHULDBETREIBUNGS- UND KONKURSGESETZ [KURZKOMMENTAR LP ACT ON DEBT ENFORCEMENT AND BANKRUPTCY] (Daniel Hunkeler ed., Helbing Lichtenhahn 2009); Isaak Meier, *Konkursrecht, Neuerungen des revidierten Rechts und aktuelle Fragen aus Lehre und Praxis* [*Bankruptcy Law, Innovations of the Revised Law and Current Issues in the Doctrine and the Practice*], 115 Zeitschrift für Schweizerisches Recht/Revue de droit suisse [ZSR/RDS] I at 277, 304 (1996) [hereinafter Meier, *Bankruptcy Law*] (according to Meier, the contracting parties are not allowed to agree on a clause which does not concern them, but which primarily involves the estate).

[68] Franco Lorandi, *Dauerschuldverhältnisse im Nachlassverfahren* [*Long-Term Contracts in Reorganization Proceedings*], AKTUELLE JURISTISCHE PRAXIS/PRATIQUE JURIDIQUE ACTUELLE [AJP/PJA] 1209, 1215-1216 (2004) [hereinafter Lorandi, *Long-Term Contracts*]; Lorandi, *Lessee's Bankruptcy*, *supra* note 67, at 5; Spühler, *supra* note 65, at 679-682.

[69] Marchand, *supra* note 67, at 38.

[70] Lorandi, *Long-Term Contracts*, *supra* note 68, at 1215 n.93; Staehelin, *supra* note 23, at 366; Marchand, *supra* note 67, at 38; Spühler, *supra* note 65, at 677.

[71] *See* CO art. 334.

[72] *See* CO art. 154.

[73] Lorandi, *Long-Term Contracts*, *supra* note 68, at 1215 n.93; Staehelin, *supra* note 23, at 366; Marchand, *supra* note 67, at 38; Spühler, *supra* note 65, at 677.

ployment contract, the parties are not allowed to provide for an automatic termination (i.e., without a notification of termination to the employee) in case of the employer's reorganization.[74]

Second, *ipso facto* clauses shall comply with the mandatory rules on the formation of the estate.[75] Indeed, the statutory rights of creditors to claim certain assets against the estate[76] are exclusive.[77] Therefore, as confirmed by LP art. 212, the counterparty is not authorized to invoke the fulfillment of a condition subsequent with a retroactive effect[78] in order to claim assets against the estate on which the for-

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[74] Lorandi, *Long-Term Contracts*, *supra* note 68, at 1215 n.93; Staehelin, *supra* note 23, at 366; Marchand, *supra* note 67, at 39; Jeandin, *supra* note 23, at 93. *But see* ROLAND BACHMANN, DAS ARBEITSVERHÄLTNIS IM KONKURS DES ARBEITGEBERS [THE EMPLOYMENT CONTRACT IN THE EMPLOYER'S BANKRUPTCY] 152 et seq (Stämpfli 2005).

[75] *See* LP art. 197.

[76] *See* LP arts. 201, 202, 203; CO art. 401; Bundesgesetz über die kollektiven Kapitalanlagen (Kollektivanlagengesetz) [KAG], Loi fédérale sur les placements collectifs de capitaux (Loi sur les placements collectifs) [LPCC], Legge federale sugli investimenti collettivi di capitale (Legge sugli investimenti collettivi) [LICol] [Federal Act on Collective Investment Schemes (Collective Investment Schemes Act)] Jun. 23, 2006, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 951.31, art. 35 para. 1; Bundesgesetz über Bucheffekten (Bucheffektengesetz) [BEG], Loi fédérale sur les titres intermédiés [LTI], Legge federale sui titoli contabili (Legge sui titoli contabili) [LTCo] [Federal Act on Securities Accounting] Oct. 3, 2008, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 957.1, arts. 17-18, in connection with Bundesgesetz über die Banken und Sparkassen (Bankengesetz) [BankG], Loi fédérale sur les banques et les caisses d'épargne (Loi sur les banques) [LB], Legge federale sulle banche e le casse di risparmio (Legge sulle banche) [LBCR] [Federal Act on Banks and Savings Banks (Banking Act)] Nov. 8, 1934, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 952.0, art. 37d.

[77] Marchand, *supra* note 67, at 39.

[78] *See* CO art. 154 para. 2.

mer lost his property right with the adjudication of bankruptcy[79] or the confirmation of a reorganization with assignment of assets.[80]

German law[81] and the Swiss law[82] also provide that certain types of contracts – mostly concluded *intuitu personae*[83] – terminate automat-

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79 Marchand, *supra* note 67, at 39. *See also* (in German law) Bundesgerichtshof [BGH] [Federal Court of Justice] Nov. 11, 1993, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 40, 1994.

80 LP art. 197 para. 1 provides that all seizable assets owned by the debtor at the time of the commencement of the bankruptcy proceedings, irrespective of where they are situated, form one sole estate (the bankruptcy estate) destined for the satisfaction of the creditors. *See* STEPHEN V. BERTI, SWISS DEBT ENFORCEMENT AND BANKRUPTCY LAW, ENGLISH TRANSLATION OF THE AMENDED FEDERAL STATUTE ON DEBT ENFORCEMENT AND BANKRUPTCY (SCHKG), WITH AN INTRODUCTION TO SWISS DEBT ENFORCEMENT AND BANKRUPTCY LAW 72 (Schulthess & Kluwer 1997). This provision is similarly applicable when a reorganization with assignment of assets (*see* LP arts. 317-331) is confirmed (but not during the automatic stay). *See* Bundesgericht [BGer] [Federal Supreme Court] Feb. 4, 2008, 134 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 273; Tribunal fédéral [TF] [Federal Supreme Court] Jul. 11, 1980, 106 ARRÊTS DU TRIBUNAL FÉDÉRAL SUISSE [ATF] Ib 357; Tribunal fédéral [TF] [Federal Supreme Court] Dec. 22, 1959, 85 ATF III 203; Tribunal fédéral [TF] [Federal Supreme Court] Apr. 22, 1959, 85 ATF I 186; Kantonsgericht des Kantons Graubünden [Cantonal Court of the Canton of Graubünden] Jan. 16, 2002, DIE PRAXIS DES KANTONSGERICHTS VON GRAUBÜNDEN [PKG] No. 33 at 204 (2002); Cour civile du Canton de Neuchâtel [Civil Court of the Canton of Neuchâtel] Oct. 6, 1980, RECUEIL DE JURISPRUDENCE NEUCHÂTELOISE [RJN] 236 (1980-1981); AMONN & WALTHER, *supra* note 65, § 55 para. 22. In a comparative law perspective, the situation is different in an U.S. Chapter 11 reorganization: similarly to Switzerland (*see* LP art. 197 para. 1), the filing of the bankruptcy petition creates an "estate" (*see* 11 U.S.C. § 541(a)). However, unless the court orders the appointment of a trustee, the debtor in possession retains and uses the assets of the estate. Thus, (during the automatic stay) the assets are no longer the debtor's property (*see* 11 U.S.C. §§ 1101(1), 1107, 1108, 1115(b)). *See* MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON & STEVE H. NICKLES, BUSINESS REORGANIZATION IN BANKRUPTCY, CASES AND MATERIALS 11 n.14 (Thomson/West, 3d ed. 2006).

81 *See* InsO §§ 115-118.

82 *See* CO arts. 250 para. 2, 297a, 405 para. 1, 418s para. 1, 470 para. 3, 518 para. 3, 529 para. 2; Bundesgesetz über den Versicherungsvertrag (Versicherungsvertragsgesetz) [VVG], Loi fédérale sur le contrat d'assurance (Loi sur le contrat d'assurance) [LCA], Legge federale sul contratto d'assicurazione (Legge sul contratto d'assicurazione) [LCA] [Federal Act on the Insurance Contract] Apr. 2, 1908, SYSTEMATISCHE SAMMLUNG DES BUNDESRECHTS [SR], RECUEIL SYSTÉMATIQUE DU DROIT FÉDÉRAL [RS], RACCOLTA SISTEMATICA DEL

ically in case of bankruptcy or insolvency. Thus, contrary to French law,[84] these rules are still applicable (at least) in bankruptcy and insolvency proceedings. In Germany, these provisions are also applicable in an insolvency plan.[85] In Switzerland, it is unclear whether these provisions are also applicable in a reorganization procedure and, if applicable, at which stage of the procedure (filing of the petition, granting of an automatic stay, or confirmation of the plan?) and for which kind of reorganization (ordinary reorganization and/or reorganization with assignment of assets?).[86]

2. Analysis of *Ipso Facto* Clauses From a Policy Perspective

The previous comparative law study[87] showed two opposing approaches: United States and France invalidate *ipso facto* clauses, whereas Germany[88] and Switzerland uphold such clauses in bankruptcy and reorganization proceedings. In the United States and France, policy makers offer two reasons for the invalidity of *ipso facto* clauses: a) 11 U.S.C. § 365(e)(1) enhances the bankrupt estate,[89] and b) it furthers the debtor's rehabilitation.[90] The

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DIRITTO FEDERALE [SR] [SYSTEMATIC COMPILATION OF FEDERAL LAW] 221.229.1, arts. 37 para. 1, 55 para. 1.

83 HUBERT STÖCKLI, DAS SYNALLAGMA IM VERTRAGSRECHT, BEGRÜNDUNG/ ABWICKLUNG/STÖRUNGEN [SYNALLAGMA IN CONTRACT LAW, FOUNDATIONS/ LIQUIDATION/FRUSTRATION] para. 569 (Schulthess 2008).

84 *See supra* p. 9.

85 *See* InsO § 279.

86 For more details *see* FABRICE ROBERT-TISSOT, LES EFFETS DU CONCORDAT SUR LES OBLIGATIONS, ANALYSE EN PARTICULIER DES EFFETS DU CONCORDAT SUR LES CONTRATS [THE EFFECTS OF A REORGANIZATION ON OBLIGATIONS, IN PARTICULAR, ANALYSIS OF THE EFFECTS OF A REORGANIZATION ON CONTRACTS] paras. 969-989 (Schulthess 2010).

87 *See supra* pp. 6 et seq.

88 However, this issue is very controversial in Germany (*see supra* p. 13).

89 *See* in the United States: Che & Schwartz, *supra* note 29, at 442, 462, n.2. These autors refer to the REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION, OCTOBER 20, 1997, VOLUME I, 464 (1997): "The trustee should elect to commit the estate to perform and receive performance . . . only if such actions are likely to yield a net benefit to the estate, i.e., the value of the non-debtor's remaining performance exceeds the estate's costs of taking over the debtor's remaining obligations."

90 *See* in the United States: Che & Schwartz, *supra* note 29, at 442, 462, n.3. These autors refer to the "REPORT OF THE SENATE COMMITTEE" (recte: REPORT OF THE COMMITTEE ON THE JUDICIARY TOGETHER WITH SEPARATE SUPPLEMENTAL, AND SEPARATE ADDITIONAL VIEWS [INCLUDING COST

UNCITRAL Guide recommends the invalidation of *ipso facto* clauses with the exception of certain types of contracts, such as contracts to lend money and, in particular, financial contracts. According to the UNCITRAL Guide, any negative impact of such a policy could be balanced " . . . by providing compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the contract continuing to be performed after commencement of insolvency proceedings . . . "[91] However, the UNCITRAL Guide does not clearly state whether this (non secured) compensation should be reduced to a dividend or paid in full (i.e., binding the estate). Given these opposing views on the (in)validity of *ipso facto* clauses in bankruptcy and reorganization proceedings, these clauses should be examined from a policy perspective.

Yeon-Koo Che & Alan Schwartz[92] argue that *ipso facto* clauses are socially desirable for the following reasons:

First, the buyer (debtor) has a greater incentive to exert effort with an *ipso facto* clause than without one. Indeed, this type of clause functions as a commitment device by which the debtor can credibly promise to his counterparties that he will make an optimal effort: if the efforts of the debtor are not sufficient and lead to insolvency, a rationally anticipating seller would invoke the *ipso facto* clause, not perform its obligation (that would allow it to collect the agreed price in a solvency state but not in case of insolvency) and exit the contract (*ex post* consequences). To the contrary, if *ipso facto* clauses are invalid, the insolvent debtor will not exert effort when the expected marginal return from effort is less than the effort cost. Therefore, *ipso facto* clauses improve the debtor's incentive to invest and to

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ESTIMATE OF THE CONGRESSIONAL BUDGET OFFICE], H.R. REP. NO. 95-595, at 348 (1977)), which explains the goal of section 365(e)(1) as follows: "Subsection (e) invalidates ipso facto or bankruptcy clauses. These clauses, protected under present law, . . . permit the other contracting party to terminate the contract . . . in the event of bankruptcy. This frequently hampers rehabilitation efforts. If the trustee may assume . . . the contract . . . , then the contract . . . may be utilized to assist in the debtor's rehabilitation or liquidation."
See in France: Brunetti-Pons, *supra* note 34, para. 10; Derrida, *supra* note 34, para. 2.

[91] UNCITRAL Guide at 123, para. 118.

[92] Che & Schwartz, *supra* note 29, at 441 et seq. *See also* Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 Yale L.J. 1807, 1844-1847 (1998).

commit, i.e., the latter will make more efforts to avoid bankruptcy or reorganization proceedings.[93]

Second, with the validation of *ipso facto* clauses, the buyer (debtor) will also get a better deal in the solvency state since the seller will only charge the contract price and no risk premium (for the case of insolvency). In other words, it implies that some projects cannot be financed unless an *ipso facto* clause is present (*ex ante* consequences).[94]

Third, according to Yeon-Koo Che & Alan Schwartz,[95] the most efficient outcome in the insolvency state (like in the solvency state) is that efficient trade should occur if and only if the insolvency return exceeds the seller's cost. Therefore, on the assumption that the insolvent debtor commonly has considerable bargaining power *ex post* because his creditors have high coalition costs,[96] the invalidation of *ipso facto* clauses, coupled with the risk that the court may err in finding expectation damages, could lead to an *ex post* inefficient outcome, if the insolvent debtor uses the threat of an excessive damage award to induce the counterparty to perform, though the latter's cost exceeds the project return. To the contrary, if the counterparty is free to exit (i.e., without paying any damage to the debtor) pursuant to an *ipso facto* clause, the debtor cannot behave opportunistically in a bankruptcy (or a reorganization).[97]

In my view, the continuation of certain (executory) contracts (e.g., supply contracts, leases, employment contracts) is extremely important to the insolvent debtor to continue running its business as a going concern. The debtor is under time and cash pressure[98] and potential contractors might exploit this situation during the negotiation of new deals and behave opportunistically.[99] Therefore, the right of the debtor to assume (executory) contracts – which is recognized by the four legal systems[100] – is critical to the success of a reorgani-

[93] Che & Schwartz, *supra* note 29, at 447-448, 454, 461-462.

[94] *Id.* at 447-448, 461.

[95] *Id.* at 452.

[96] *Id.* at 450.

[97] *Id.* at 453, 461-462.

[98] *See* Jesse M. Fried, *Executory Contracts and Performance Decisions*, 46 DUKE L.J. 517, 534 (1996).

[99] *See* George G. Triantis, *The Effects of Insolvency and Bankruptcy on Contract Performance and Adjustment*, 43 University of Toronto Law Journal 679, 706.

[100] *See infra* pp. 25 et seq.

zation. However, the validity of *ipso facto* clauses might prevent the debtor in possession from exercising this central right.[101] In other words, there is a clear tension between the validity of *ipso facto* clauses and the right to assume a (executory) contract.

It is true that the invalidation of *ipso facto* clauses might alter the debtor's pre-bankruptcy incentives to invest and commit:[102] the debtor might take excessive risks because it will expect to benefit from a possible "bailout" if insolvency occurs, i.e., the cost of breach to the counterparty will be incompletely internalized. In other words, there is an asymmetry of payoffs: if such excessive risks reduce the cost of performance, the promisor retains all the resulting gains, whereas, if the cost of performance increases, the promisor's losses are limited by the cost of the breach, which is lowered in the case of insolvency (in such a case, the promisee does not recover full expectation damages, but only a fraction of the damages award, i.e., the promisee is undercompensated).[103] However, insolvency proceedings also entail high reputation and litigation costs, which increase the cost of breach.[104] Especially in a case of reorganization, where the debtor (in possession) might continue his business in the future and have repeated interactions with his creditors (e.g., suppliers), it is doubtful that he would prefer to incur such costs instead of performing the contract and preserve a cooperative relationship. It is more commonly the above-mentioned time and cash pressure that pushes the unfortunate debtor to insolvency.

As indicated in connection with the treatment of pre-petition claims when the trustee or the debtor in possession continues a (executory) contract[105] and the right of the trustee or the debtor in possession to reject a (executory) contract,[106] the court should declare the filing of

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[101] *See* Triantis, *supra* note 99, at 706.

[102] *See supra* p. 20.

[103] *See* Triantis, *supra* note 99, at 685-686, 692. This author mentions however that reputation costs " . . . lose some of their effect when the firm is insolvent because of the shorter life expectancy of the firm and the resulting incentive for end-period behaviour." In my opinion, this statement is true only in bankruptcy cases, where the firm is liquidated. To the contrary, in reorganization proceedings, the firm may survive to the insolvency proceedings and promote long-term relationships with its creditors.

[104] *Id.* at 686, 703-704. *See also* Fried, *supra* note 98, at 536.

[105] *See infra* p. 45.

[106] *See infra* p. 57.

a bankruptcy as abusive in the rare cases where the non-performance of the contract was the sole objective of filing (i.e., where the debtor behaves opportunistically).

Furthermore, the counterparty is protected under contract law: in the United States,[107] in France,[108] in Germany,[109] and in Switzerland,[110] when the other party fears that the debtor becomes insolvent, the former has a right to adequate assurance of performance from the latter before the counterparty performs his own obligations. A similar right is also provided by the United Nations Convention on Contracts for the International Sale of Goods.[111]

In the United States[112] and in Switzerland,[113] the counterparty is also sufficiently protected from the opportunistic behavior of the insolvent debtor under bankruptcy law: the counterparty has a right to require that the trustee provide adequate assurance for future performance before the counterparty performs his own obligations. Furthermore, all four legal systems (i.e., United States, France, Germany and Switzerland) provide a (supplementary) protection to the counterparty: in the event of the continuation of a (executory) contract, (at

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[107] UNIFORM COMMERCIAL CODE [UCC] § 2-609 (West 2010). *See* Che & Schwartz, *supra* note 29, n.20 ("Insolvency has been the paradigm example of a reasonable ground for being insecure about a contracting party's ability to perform . . . ").

[108] C. CIV. art. 1613.

[109] BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, REICHSGESETZBLATT [RGBL.] [REICH LAW GAZETTE] 195, §§ 321, 490 para. 1.

[110] CO arts. 83, 266h, 316, 337a, 392 para. 3.

[111] *See* United Nations Convention on Contracts for the International Sale of Goods [CISG], Apr. 11, 1980, 1489 U.N.T.S. 3, arts. 71, 72. *See also* Oberlandesgericht Hamm [OLG] [Higher Regional Court of Hamm] Jun. 20, 1983, RECHT DER INTERNATIONALEN WIRTSCHAFT, AUSSENWIRTSCHAFTSDIENST DES BETRIEBS-BERATERS [RIW] 952, 1983 (a serious deficiency in the creditworthiness of the other party may occur in case of bankruptcy ("Konkurs") or insolvency ("Zahlungsunfähigkeit")).

[112] *See* 11 U.S.C. § 365(b)(1)(C). *See also In re* Everest Crossing, LLC (Bankr. D.Mass. 2010) (not reported in B.R., 2010); *In re* Fleming Companies, Inc., 499 F.3d 300, 305 (3rd Cir. 2007); *In re* Texas Health Enterprises Inc., 72 Fed. Appx. 122, 126 (2003); *In re* PRK Enterprises, Inc., 235 B.R. 597, 603 (Bankr. E.D.Tex. 1999); *In re* Prime Motor Inns, Inc., 166 B.R. 993, 997 (Bankr. S.D. Fla. 1994); *In re* Carlisle Homes, 103 B.R. 524, 538 (Bankr. D.N.J. 1988); Matter of U.L. Radio Corp., 19 B.R. 537, 542 (Bankr. S.D. N.Y. 1982); *In re* General Oil Distributors, Inc., 18 B.R. 654, 658 (Bankr. E.D.N.Y. 1982).

[113] *See* LP art. 211 para. 2 sentence 2.

least)[114] the future claims of the counterparty are treated as administrative expenses, i.e., the "estate"[115] becomes liable for performance of the contract. Thus, even if an *ipso facto* clause is unenforceable and the seller has to perform its obligation during the automatic stay, the seller will collect the agreed price (at least for its future claims).[116] In other words, if the seller has not yet performed its obligation(s) at the time of the commencement of the insolvency proceedings, it does not face a supplementary risk other than in the case of solvency. The "only" differences are the time of payment and, in extraordinary circumstances, the extent to which the claim is paid: indeed, administrative expenses are not paid at once in all cases and, in extraordinary circumstances, could not be entirely covered by the value of the assets of the debtor. The non-debtor might also not charge a supplementary risk premium to the debtor in a legal system where *ipso facto* clauses are unenforceable, for the risks are similar for the non-debtor in a solvency or insolvency case. Therefore, the *ex ante* efficiency of enforcing *ipso facto* clauses is limited.

If the non-debtor regrets the deal, because his costs exceed the expected returns from the project, he might decide to breach the contract. However, like in an ordinary case (i.e., a solvency case), the non-debtor will have to pay (full) damages to the debtor in possession, for the insolvency of the latter should not allow the counterparty to get rid of a bad bargain. Thus, in my opinion, eventual *ex post* efficiency considerations (i.e., according to Yeon-Koo Che & Alan Schwartz, in all cases the insolvency return should exceed the seller's cost)[117] should not prevent the legislator from invalidating *ipso facto* clauses. Furthermore, in an insolvency context, efficiency considerations should not be limited to the *inter parte* outcome, but should also take into consideration the interests of "other constituencies", in particular the interests of the other creditors and/or the interests of the "community" to preserve the existence of the debtor in posses-

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[114] *See infra* pp. 36 et seq.

[115] The term "estate" is not genuine in all circumstances. For instance, whereas an estate is created in all circumstances (bankruptcy or reorganization proceedings) in the United States, an estate is formed in Switzerland only after the issuance of the commencement order in bankruptcy proceedings or after the confirmation of the plan in a reorganization with assignment of assets, but not during the automatic stay in a reorganization. *See supra* n.80.

[116] *See infra* pp. 34 et seq.

[117] Che & Schwartz, *supra* note 29, at 452.

sion as a going concern.[118] Indeed, as indicated by Pilgram,[119] the enforcement of *ipso facto* clauses could be inefficient, for it would only advantage the non-debtor, but cause significant losses for the other creditors. It could be even advantageous to the counterparty to save the debtor from bankruptcy, for the reorganized company could be a potential client in the future.[120]

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[118] *See* Elizabeth Warren, *Bankruptcy Policy in an Imperfect World*, 92 Mich. L. Rev. 336, 354-355 (1993); Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 789-793, 798-804 (1987); Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 Wash. U. L.Q. 1031, 1031 et seq. (1994); Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 Nw. U. L. Rev. 919, 960-961 (1991). *But see* Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 103 (1984); Schwartz, *supra* note 92, at 1816-1819 (1997-1998) (the Bankruptcy Code should only enhance the collective return for creditors with current claims and, for efficiency reasons, should not attempt to protect communities).

[119] *See* THOMAS PILGRAM, ÖKONOMISCHE ANALYSE DER BUNDESDEUTSCHEN INSOLVENZORDNUNG [ECONOMIC ANALYSIS OF THE GERMAN FEDERAL INSOLVENCY ACT] 131 (Peter Lang 1999). *But see* WORTBERG, *supra* note 60, at 132; WÖLLNER, *supra* note 60, at 170-171 (these authors mention that it is the worst case scenario; to the contrary, one could also envisage that the invalidity of *ipso facto* clauses could cause the insolvency of the counterparty, whereas under certain circumstances the reorganization of the debtor has never been planned).

[120] However, one could argue that it is the role of the non-debtor to take such a decision by waiving his right to invoke the *ipso facto* clause. Thus, in my opinion, there must be a trade-off between giving this discretionary right to the non-debtor on one side (enforcement of *ipso facto* clauses) and furthering the reorganization of the debtor as a going concern on the other side (invalidation of *ipso facto* clauses).

B. Continuation of (Executory) Contracts

1. Comparative Law Study of the Continuation of (Executory) Contracts

1.1. Overview

Contrary to the (in)validity of *ipso facto* clauses[121] and the rejection of a (executory) contract,[122] all four legal systems recognize the right of the "estate"[123] to continue (executory) contracts:

United States. Subject to certain express limitations,[124] a bankruptcy trustee or a debtor in possession,[125] subject to court approval, may assume any executory contract or unexpired lease.[126] The court's approval of such a decision is mandatory rather than optional.[127] Under the "Countryman" definition,[128] adopted by several courts,[129]

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[121] *See supra* pp. 6 et seq.
[122] *See infra* pp. 46 et seq.
[123] *See supra* n.115.
[124] *See* 11 U.S.C. § 365(b) (assumption of contracts or leases with outstanding defaults), § 365(c) (certain contracts and leases are not subject to assumption and assignment), § 365(d) (the exercise of the right is subject to time restrictions and other conditions), §§ 765, 766 (commodity-broker-liquidation cases).
[125] *See* U.S., Dept. of Air Force v. Carolina Parachute Corp., 907 F.2d 1469, 1472 (4th Cir. 1990).
[126] *See* 11 U.S.C. § 365(a). *See also* 8B C.J.S. § 912 (2006).
[127] *See* Counties Contracting and Const. Co. v. Constitution Life Ins. Co., 855 F.2d 1054, 1060 (3d Cir. 1988); *In re* Harris Management Co., Inc., 791 F.2d 1412, 1414-1415 (9th Cir. 1986); *In re* Airlift International, Inc., 761 F.2d 1503, 1509 (11th Cir. 1985); *In re* Whitcomb & Keller Mortgage Co., 715 F.2d 375, 380 (7th Cir. 1983); *In re* Kelly Lyn Franchise Company, Inc., 26 Bankr. 441, 445 (Bankr. Tenn. 1983).
[128] Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973).
[129] *In re* General DataComm Industries, Inc., 407 F.3d 616, 627 (3d Cir. 2005), *cert. denied*, 546 U.S. 1031 (2005); *In re* Sunterra Corp., 361 F.3d 257, 264 (4th Cir. 2004); *In re* Southern Pacific Funding Corp., 268 F.3d 712, 715 (9th Cir. 2001); *In re* Liljeberg Enterprises, Inc., 304 F.3d 410, 436 (5th Cir. 2002); *In re* Columbia Gas System Inc., 50 F.3d 233, 238 (3d Cir. 1995); *In re* Qintex Entertainment, Inc., 950 F.2d 1492, 1495 (9th Cir. 1991); Sharon Steel Corp. v. National Fuel Gas Distribution Corp., 872 F.2d 36, 39 (3d Cir. 1989); *In re* Sun City Investments, Inc., 89 B.R. 245, 248 (Bankr. M.D. Fla. 1988); *In re* Santos Borrero, 75 B.R. 141, 142 (Bankr. D. Puerto Rico 1987); *In re* Speck, 798 F.2d 279, 279 (8th Cir. 1986); *In re* Sun Belt Elec. Constructors, Inc., 56 B.R. 686, 688 (Bankr. N.D. Ga. 1986); Gloria Mfg. Corp. v. International Ladies' Gar-

an executory contract is one " . . . under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." As an alternative to strict adherence to this definition, a more flexible result-oriented and functional approach has also been suggested: the primary focus of this approach is not the form of the contract, but rather the consequences of assumption (and rejection) of the agreement in terms of the benefit to the estate and the protection of the creditors.[130] Some scholars have questioned the merits of the threshold concept of "executoriness".[131]

France. Under the so-called "*droit d'option*" ("option right") doctrine, the trustee,[132] the debtor in possession (with the assent of the court nominee),[133] or the liquidator (in liquidation proceedings),[134] may assume an executory contract ("*contrat en cours*"). Under French case law and doctrine, an executory contract is a contract whose principal obligations are not performed at the time of the commencement of the insolvency proceedings.[135]

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ment Workers' Union, 734 F.2d 1020, 1021-1022 (4th Cir. 1984); *In re* Sun Ray Bakery, Inc., 5 B.R. 670, 671-672 (Bankr. Mass. 1980).

[130] *In re* Fox, 83 B.R. 290, 296 et seq. (Bankr. E.D. Pa. 1988); *In re* Arrow Air, Inc., 60 B.R. 117, 120 et seq. (Bankr. S.D. Fla. 1986); *In re* Norquist, 43 B.R. 224, 226 et seq. (Bankr. Wash. 1984); *In re* Booth, 19 B.R. 53, 54 et seq. (Bankr. Utah 1982).

[131] *See* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. COLO. L. REV. 845, 889 et seq. (1988); Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 282 et seq. (1989).

[132] *See* C. COM. art. L. 622-13 II.

[133] *See* C. COM. art. L. 627-2.

[134] *See* C. COM. art. L. 641-10 para. 2. *See also* Jocelyne Vallansan, *Sauvegarde, redressement et liquidation judiciaire – Continuation des contrats en cours* [*Safeguard, Receivership and Liquidation Proceedings – Continuation of Executory Contracts*], JURISCLASSEUR COMMERCIAL, FASC. 2335 para. 62 (Sept. 1, 2006).

[135] Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 2, 1993, BULLETIN DES ARRÊTS DE LA COUR DE CASSATION, CHAMBRES CIVILES [BULL. CIV.] IV, No. 89. *See also* Vallansan, *supra* note 134, para. 11.

Germany. Subject to certain express limitations,[136] the trustee (in insolvency proceedings) or the debtor in possession (in an insolvency plan, with the assent of the trustee) may assume any contract.[137] The right to continue a contract under Inso §§ 103 and 279 supposes that both parties have not yet performed the contract at the time of the commencement of the insolvency proceedings.[138]

Switzerland. Subject to certain express limitations,[139] the trustee (in bankruptcy proceedings), the liquidators (after the confirmation of a plan with assignment of assets) or the debtor in possession (during the automatic stay, with the assent of the trustee) may assume any contract.[140] The right to continue a contract under LP arts. 211 para. 2 and 306 para. 2 cl. 2, 310 para. 2 supposes that both parties have not yet performed the contract at the time of the commencement of the bankruptcy or reorganization (i.e., granting of an automatic stay) proceedings[141] or at the time of the confirmation of a plan with assignment of assets.[142]

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[136] *See* Inso § 104 (fixed-date transactions and financial futures), InsO §§ 115-118 (automatic termination of certain types of contracts – mostly concluded *intuitu personae* – in case of insolvency).

[137] Inso §§ 103, 279.

[138] Graf & Wunsch, *supra* note 60, at 2118, 2121.

[139] *See in particular* LP art. 211 para. 2bis (fixed-date transactions, financial futures, swaps and option transactions); CO arts. 250 para. 2, 297a, 405 para. 1, 418s para. 1, 470 para. 3, 518 para. 3, 529 para. 2; LCA arts. 37 para. 1, 55 para. 1 (automatic termination of certain types of contracts – mostly concluded *intuitu personae* – in case of bankruptcy or insolvency).

[140] LP arts. 211 para. 2, 306 para. 2 cl. 2, 310 para. 2.

[141] *See* under LP art. 211 para. 2: PLENIO, *supra* note 67, at 31; AMONN & WALTHER, *supra* note 65, § 42 para 34; FISCHER, *supra* note 65, at 159; JEAN-CLAUDE DUBACHER, CLOSE-OUT BESTIMMUNGEN UND DAS EINTRITTSRECHT DER KONKURSVERWALTUNG, EIN RECHTSVERGLEICH ZWISCHEN DER SCHWEIZ, DEUTSCHLAND UND ÖSTERREICH [CLOSE-OUT CLAUSES AND THE TRUSTEE'S RIGHT TO ASSUME, A COMPARATIVE LAW STUDY BETWEEN SWITZERLAND, GERMANY AND AUSTRIA] 48 (Schulthess 1999); ROLF PETER, ZWEISEITIGE VERTRÄGE IM KONKURS [BILATERAL CONTRACTS IN BANKRUPTCY] 20 (Buchdr. Weinfelden 1955). *See also* Bundesgericht [BGer] [Federal Supreme Court] Oct. 26, 1978, 104 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 84; Bundesgericht [BGer] [Federal Supreme Court] Sept. 29, 1906, 32 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] II 528.
See under LP arts. 306 para. 2 cl. 2, 310 para. 2: ROBERT-TISSOT, *supra* note 86, paras. 556-557.

[142] ROBERT-TISSOT, *supra* note 86, paras. 819-821.

1.2. Rights and Duties Pending Continuation (or Rejection) of (Executory) Contracts

The counterparty faces uncertainty at the time of the commencement of the insolvency proceedings, for it has to determine whether the insolvency representative is required to take action within a specified period of time[143] and whether the contract will be performed prior to continuation (or rejection).[144] The situation differs significantly in each legal system:

United States. In a Chapter 7 liquidation case, the trustee shall assume (or reject) an executory contract or unexpired lease of residential real property or unexpired lease of personal property within 60 days following the order for relief,[145] or obtain an extension of time from the court, or the contract or lease will be deemed rejected.[146] In Chapters 9, 11, 12, or 13 cases, the trustee or debtor in possession[147] may assume (or reject) an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan. However, on the request of any party to such contract or lease, the court may set an earlier time within which the trustee or the debtor in possession[148] shall decide.[149] In the case of a conversion of a Chapter 11 case to Chapter 7 by the bankruptcy court, the 60-day period to assume (or reject) begins running on the date of conversion.[150]

The treatment of unexpired leases of non-residential real property in which the debtor is lessee is the following: In Chapters 7, 9, 11, 12,

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143 *See* UNCITRAL Guide at 124, para. 122.

144 *See* UNCITRAL Guide at 126-127, para. 131.

145 The filing of a voluntary petition constitutes an order for relief (11 U.S.C. §§ 301, 302). In an involuntary case, the order for relief is entered after the petitioners prevail by default or trial (11 U.S.C. § 303(h)). *See* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:14, n.2.

146 11 U.S.C. § 365(d)(1). *See also In re* Office Products of America, Inc., 136 B.R. 675, 686 (Bankr. W.D. Tex. 1992); Matter of Biopolymers, Inc., 136 B.R. 28, 29-30 (Bankr. D. Conn. 1992); *In re* ABC Books & School Supplies, 121 B.R. 329, 331 (Bankr. S.D. Ohio 1990).

147 *See* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:13.

148 *Id.*

149 11 U.S.C. § 365(d)(2).

150 *In re* Tompkins, 95 B.R. 722, 723-724 (B.A.P. 9th Cir. 1989); *In re* Fleishman, 138 B.R. 641, 647 (Bankr. D. Mass. 1992).

or 13 cases,[151] the trustee or the debtor in possession[152] shall timely perform all the obligations of the debtor arising from and after the order for relief under these types of leases, until the lease is assumed (or rejected).[153] For cases filed on or after October 17, 2005[154] these types of leases are deemed rejected and the trustee shall immediately surrender the non-residential real property to the lessor unless the lease is assumed within 120 days after the order for relief or the date of the entry of an order confirming a plan. Prior to its expiration, the 120-day period may be extended by the court for 90 days on the motion of the trustee or lessor for cause. Thereafter, any further extension requires the prior written consent of the lessor in each instance.[155]

France. Once the counterparty has sent a formal notice to the trustee (or to the debtor in possession or the liquidator),[156] the latter shall decide on the continuation or the rejection of the (executory) contract within a month; in the absence of a decision within this time limit, the contract terminates automatically.[157] The one-month period to assume (or reject) begins running on the date of the receipt of the

[151] *See* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:13.
[152] *Id.*
[153] 11 U.S.C. § 365(d)(3). This provision seems to apply similarly to unexpired leases of residential real property and executory contracts other than leases. *See* N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 531 (1984) ("If the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services . . . , which, depending on the circumstances of a particular contract, may be what is specified in the contract . . . "). *See also In re* Mammoth Mart, Inc., 536 F.2d 950, 954-955 (1st Cir. 1976). *But see* David Hahn, *The Internal Logic of Assumption of Executory Contract*, *in* BAR-ILAN UNIVERSITY PUBLIC LAW AND LEGAL THEORY, WORKING PAPER NO. 13-10, MAY, 2010, n. 72 (2010) *available at* http://ssrn.com/abstract=1600424 (last visited Nov. 24, 2011) (this working paper is quoted with the author's consent).
[154] *See* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, §§ 46:13, 46:36. For cases filed before October 17, 2005, if the trustee or the debtor in possession does not assume (or reject) the unexpired lease of non-residential real property in which the debtor is lessee within 60 days of order of relief or timely obtain an extension of time by the court, the lease will be deemed rejected, and the trustee or the debtor in possession shall immediately surrender the premises (former 11 U.S.C. § 365(d)(4)).
[155] 11 U.S.C. § 365(d)(4).
[156] Vallansan, *supra* note 134, para. 73.
[157] C. COM. art. L. 622-13 III cl. 1.

notice by the trustee.[158] Before this time limit expires, the supervisory judge may grant the trustee a shorter time limit or (more often)[159] an extension, which shall not exceed two months, to make a decision.[160] When the counterparty has formally notified the trustee, the rejection by the latter entails the automatic termination of the contract, without a previous establishment of such an effect to be made by the supervisory judge.[161] To the contrary, when the counterparty has not sent a formal notice, the rejection of the contract by the trustee does not entail the automatic termination of the contract on the trustee's initiative, but confers on the counterparty the right to request that the court pronounce such a termination.[162] Claims arising from and after the issuance of the commencement order, until the exercice of the "option right", shall not be paid (in full) as they fall due pursuant to C. COM. art. L. 622-17 I,[163] but shall be submitted as pre-petition claims pursuant to C. COM. art. L. 622-24 para. 5:[164] in particular, creditors whose claims arose from a successive performance contract shall file the total amount of their claim under the conditions provided for by a Conseil d'Etat decree, i.e., within two months from the publication of the issuance of the commencement order in the "*bulletin officiel des annonces civiles et commerciales*" (BODDAC).[165]

Germany. Inso §§ 103 et seq. do not impose a specific time limit for the trustee (or the debtor in possession) to assume a contract. How-

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158 Vallansan, *supra* note 134, para. 74.

159 *Id.*

160 C. COM. art. L. 622-13 III cl. 1.

161 Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 18, 2003, BULLETIN DES ARRÊTS DE LA COUR DE CASSATION, CHAMBRES CIVILES [BULL. CIV.] IV, No. 47.

162 Cour de cassation [Cass.] [supreme court for judicial matters] com., May 19, 2004, JURISDATA 2004-023811. *See also* Emmanuelle Le Corre-Broly, *Les modifications apportées au droit commun de la continuation des contrats en cours* [*The Modifications to the Law of the Continuation of Executory Contracts*], RECUEIL DALLOZ 663, paras. 6-7.

163 Vallansan, *supra* note 134, para. 130.

164 *Id.*

165 Décret n° 2005-1677 du 28 décembre 2005 pris en application de la loi n° 2005-845 du 26 juillet 2005 de sauvegarde des entreprises [Decree No. 2005-1677 of December 28, 2005 Implementing the Act No. 2005-845 of July 26, 2005 on the Safeguard of Enterprises], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Dec. 29, 2005, n° 66, art. 97.

ever, the counterparty may clarify the situation: if the other party requires the trustee to exercise the right to opt (for the continuation or the non-continuation of the contract), the trustee shall immediately inform the other party whether the continuation of the contract will be sought.[166] If the trustee does not give his statement, he shall no longer insist on the continuation of the contract.[167] "Immediately" means without undue delay under BGB § 121 para. 1.[168] In previous case law, courts applied the so-called "*Erlöschenstheorie*" ("termination theory") according to which the obligations under a contract extinguished *ipso iure* at the time of the commencement of the bankruptcy proceedings, but, in the event of a continuation of the contract by the trustee, these obligations arose newly *ex nunc* and bound the estate under Inso § 55 para. 1 cl. 2.[169] This (criticized)[170] theory was modified in a decision rendered in April 25, 2002:[171] the claims of the counterparty do not extinguish with the commencement of insolvency proceedings, but the respective obligations are not enforceable until the trustee (or the debtor in possession) decides whether to continue the contract (this period of time is described as a "*Schwebephase*",[172] i.e., as a "pending stage"). If the trustee decides not to continue the contract, then the respective obligations expire.[173]

Switzerland. LP 211 para. 2 does not require that the trustee (or the liquidators in a reorganization with assignment of assets) opt (for the continuation or the non-continuation of the contract) within a specific time limit.[174] However, the trustee shall take a decision within a

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166 Inso § 103 para. 2, sentence 2

167 Inso § 103 para. 2, sentence 3.

168 BURGHARD WEGENER, Inso § 103, para. 83, *in* FK-INSO FRANKFURTER KOMMENTAR ZUR INSOLVENZORDNUNG [FK-INSO FRANKFURTER KOMMENTAR ON THE INSOLVENCY ACT] (Klaus Wimmer ed., Luchterhand 2009).

169 Bundesgerichtshof [BGH] [Federal Court of Justice] Feb. 27, 1997, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 688, 1997; BGH May 4, 1995, ZIP 926, 1995; BGH Dec. 20, 1988, ZIP 171, 1989; BGH Feb. 11, 1988, ZIP 322, 1988. *See also* Graf & Wunsch, *supra* note 60, at 2119.

170 *See* Graf & Wunsch, *supra* note 60, at 2120.

171 Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 25, 2002, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 1093, 2002. *See also* Graf & Wunsch, *supra* note 60, at 2120-2122.

172 *See* Graf & Wunsch, *supra* note 60, at 2120.

173 *Id.*

174 AMONN & WALTHER, *supra* note 65, § 42 para 35; PLENIO, *supra* note 67, at 45; VINCENT JEANNERET, LP art. 211, para. 31, *in* COMMENTAIRE ROMAND,

reasonable time limit,[175] or even promptly.[176] The counterparty may also fix a "reasonable time limit" for the trustee to exercise the right to opt (for the continuation or the non-continuation of the contract).[177] The duration of this time limit should not be fixed in accordance with the general rules on the default of an obligee,[178] but should be subject to the special circumstances of the case, in particular the complexity of the procedure, the difficulties related to the performance of the contract, and the situation of the counterparty.[179]

POURSUITE ET FAILLITE, COMMENTAIRE DE LA LOI FÉDÉRALE SUR LA POURSUITE POUR DETTES ET LA FAILLITE AINSI QUE DES ARTICLES 166 À 175 DE LA LOI FÉDÉRALE SUR LE DROIT INTERNATIONAL PRIVÉ [COMMENTAIRE ROMAND, DEBT ENFORCEMENT AND BANKRUPTCY, COMMENTARY ON THE FEDERAL ACT ON DEBT ENFORCEMENT AND BANKRUPTCY AND ON ARTICLES 166 TO 175 OF THE FEDERAL ACT ON PRIVATE INTERNATIONAL LAW] (Louis Dallèves, Bénédict Foëx & Nicolas Jeandin eds., Helbing & Lichtenhahn 2005); LOUIS DALLÈVES, POURSUITE POUR DETTES ET FAILLITE, LES EFFETS DE LA FAILLITE SUR LES CONTRATS [DEBT ENFORCEMENT AND BANKRUPTCY, THE EFFECTS OF BANKRUPTCY ON CONTRACTS], *in* FICHES JURIDIQUES SUISSES [FJS] [SWISS LEGAL INDEX CARDS] n° 1003a, at 4 (F.S.J. 1987); TAILLENS, *supra* note 23, para 107; Roger Giroud, *Weiterbestand oder Erlöschen des Autrages bei Konkurs und im Nachlassvertrag mit Vermögensabtretung* [*Continuation or Termination of the Mandate in Bankruptcy and in a Reorganization with Assignment of Assets*], *in* SCHWEIZERISCHES UND INTERNATIONALES ZWANGSVOLLSTRECKUNGSRECHT, FESTSCHRIFT FÜR KARL SPÜHLER ZUM 70. GEBURTSTAG 117, para. 15 (Hans Michael Riemer, Moritz Kuhn, Dominik Vock & Myriam A. Gehri eds., Schulthess 2005); Spühler, *supra* note 65, at 676; BÜRGI, LP 211, para 3, *supra* note 67.

[175] FISCHER, *supra* note 65, at 210-211.

[176] HANS FRITZSCHE & HANS ULRICH WALDER-BOHNER, SCHULDBETREIBUNG UND KONKURS NACH SCHWEIZERISCHEM RECHT – KONKURSRECHT, ARREST, MIETE UND PACHT, PAULIANISCHE ANFECHTUNG, NACHLASSVERTRAG UND NOTSTUNDUNG, BESONDERE ORDNUNGEN (BAND II) [DEBT ENFORCEMENT AND BANKRUPTCY UNDER SWISS LAW – BANKRUPTCY, FREEZING ORDERS, LEASES AND USUFRUCTUARY LEASES, AVOIDANCE ACTIONS, REORGANIZATION AND EMERGENCY MORATORIUM, SPECIFIC REGIMES (VOLUME II)] § 42 para 18 (Schulthess 1993); BÜRGI, LP 211, para 3, *supra* note 67; Adrian Staehelin, *Konkurs und Sanierung des Arbeitgebers* [*Bankruptcy and Financial Reorganization of the Employer*], *in* Mitteilungen des Instituts für schweizerisches Arbeitsrechts [ArbR] 71, 77 (2000).

[177] Kantonsgericht des Kantons Zug [Cantonal Court of the Canton of Zug] Sept. 17, 1952, RECHENSCHAFTSBERICHT DES OBERGERICHTES (DES KANTONS ZUG) [ROBG.-ZG] at 68 (1951/1952); PLENIO, *supra* note 67, at 45; DALLÈVES, *supra* note 174, at 4; FISCHER, *supra* note 65, at 211.

[178] *See* CO art. 107 para. 1.

[179] PLENIO, *supra* note 67, at 46; WEYDMANN, *supra* note 67, at 31-32. *Contra* (CO art. 107 para 1 is applicable): JEANNERET, LP art. 211, para. 31, *supra*

The respective obligations are not enforceable until the trustee (or the liquidators in a reorganization with assignment of assets) decides whether to continue the contract (this period of time is also described as a "*Schwebezustand*",[180] i.e., as a "pending stage"). Contrary to German law,[181] when the trustee decides not to continue the contract, the respective obligations do not expire.[182]

1.3. Effects of the Continuation of a (Executory) Contract

The (solvent) counterparty needs also to be protected in insolvency proceedings in the event of a continuation of the contract. Indeed, the counterparty faces the risk of being required to perform its obligations ("*pacta sunt servanda*"), but not being paid in full because of the current insolvency of the debtor. Therefore, in the United States[183] and in Switzerland,[184] the counterparty has a right to require that the trustee provides adequate assurance for future performance before the counterparty performs its obligations. Furthermore, all four legal systems provide a (supplementary) protection to the counterparty:

United States. If the trustee (in bankruptcy proceedings) or the debtor in possession (in a reorganization) assumes an executory contract, the liabilities incurred in performing the contract will be treated as

note 174; DALLÈVES, *supra* note 174, at 4; TAILLENS, *supra* note 23, para 106 et seq.; GILLIÉRON, LP 211, para 16, *supra* note 67.

[180] JOLANTA KREN, KONKURSERÖFFNUNG UND SCHULDRECHTLICHE VERTRÄGE, EINE DOGMATISCHE ANALYSE DER WIRKUNGEN DER KONKURSERÖFFNUNG AUF DIE IM OBLIGATIONENRECHT GEREGELTEN SCHULDRECHTLICHEN VERTRÄGE [COMMENCEMENT OF THE BANKRUPTCY PROCEEDINGS AND CONTRACTS – A DOGMATIC ANALYSIS ON THE EFFECTS OF THE COMMENCEMENT OF BANKRUPTCY PROCEEDINGS ON CONTRACTS RULED IN THE CODE OF OBLIGATIONS] 1 (Stämpfli 1989); WEYDMANN, *supra* note 67, at 41.

[181] *See supra* p. 32.

[182] Tribunal fédéral [TF] [Federal Supreme Court] Feb. 6, 2006, 4C.252/2005, LA SEMAINE JUDICIAIRE [SJ] I 365 (2006); Bundesgericht [BGer] [Federal Supreme Court] Oct. 26, 1978, 104 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 84; Meier, *Executory Contracts*, *supra* note 67, at 92, 97, 107, 113; WEYDMANN, *supra* note 67, at 41-42; FISCHER, *supra* note 65, at 176, 178, 185.

[183] *See* 11 U.S.C. § 365(b)(1)(c).

[184] *See* LP art. 211 para. 2.

administrative expenses, i.e., the estate becomes liable for the performance of the whole contract.[185]

France. In a receivership procedure, if the trustee or the debtor in possession (with the assent of the court nominee) assumes an executory contract, (only)[186] the claims arising from and after the issuance of the commencement order shall be paid (in full) as they fall due.[187] When they are not paid as they fall due, these claims will benefit from a payment preference, i.e., these claims will be paid before the pre-petition claims,[188] in the order of payment set for by the COMMERCIAL CODE.[189]

Germany. When the trustee (in insolvency proceedings) or the debtor in possession (in an insolvency plan, with the assent of the trustee) assumes a contract, the estate becomes liable (only)[190] for the amount of the counterparty's claims arising for services rendered from or after the issuance of the commencement order.[191]

Switzerland. When the trustee (in bankruptcy proceedings) or the liquidators (after the confirmation of a plan with assignment of assets, i.e., during the liquidation procedure) assume(s) a contract, the estate becomes liable (only)[192] for the claims arising from and after the issuance of the commencement order (in bankruptcy proceedings) or from and after the confirmation of the plan (in a reorganization with assignment of assets).[193] When the debtor in possession assumes a contract with the assent of the trustee during the automatic stay, the claims arising during the automatic stay shall be sufficiently secured in an ordinary reorganization (unless individual creditors waive security for their claims),[194] or bind the estate in a reorganiza-

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[185] 11 U.S.C. § 365(a)(b)(1)(A).

[186] *See infra* pp. 36 et seq.

[187] C. COM. arts. L. 622-13 I para. 2 sentence 2, L. 622-17 I, L. 627-2. *See also* Vallansan, *supra* note 134, para. 113.

[188] C. COM. art. L. 622-17 II. *See also* Vallansan, *supra* note 134, para. 114.

[189] C. COM. art. L. 622-17 III. *See also* Vallansan, *supra* note 134, para. 114.

[190] *See infra* pp. 36 et seq.

[191] Inso §§ 55 para. 1 cl. 2, 105, 279.

[192] *See infra* pp. 36 et seq.

[193] LP arts. 211 para. 2, 262 para. 1.

[194] LP art. 306 para. 2 cl. 2.

tion with assignment of assets or subsequent bankruptcy proceedings.[195]

Therefore, when the trustee (in an U.S. Bankruptcy, in a French safegard procedure, in German insolvency proceedings, or in a Swiss bankruptcy), the liquidators (in Switzerland, after the confirmation of a plan with assignment of assets) or the debtor in possession with the assent of the trustee (in an U.S. reorganization, in a German insolvency plan, or in a Swiss reorganization) or a French court nominee (in a French safegard procedure), decide(s) to perform the contract, (at least)[196] the future claims of the counterparty are treated as administrative expenses, i.e., the "estate"[197] becomes liable for the performance of the contract. Thus, even if the seller has to perform its obligation during the automatic stay, it will collect the agreed price (at least for its future claims).[198]

1.4. Effects of the Continuation of a (Executory) Contract When the Debtor Is In Breach

In the four legal systems,[199] the claims of the counterparty are treated as administrative expenses in the event of the continuation of a (executory) contract, i.e., the "estate"[200] becomes liable for the performance of the contract. However, when the debtor is in breach, the effects of such a continuation of a (executory) contract differ among these legal systems. Indeed, especially in long-term contracts, the issue arises whether the whole contract or only the claims that arise from and after the commencement of the insolvency proceedings shall bind the estate:

United States. When the trustee (in bankruptcy proceedings) or the debtor in possession (in a reorganization) assumes an executory contract, the estate shall become liable for the performance of the whole contract.[201]

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[195] LP art. 310 para. 2.
[196] *See infra* pp. 36 et seq.
[197] *See supra* n. 115.
[198] *See infra* pp. 36 et seq.
[199] *See supra* pp. 34 et seq.
[200] *See supra* n. 115.
[201] 11 U.S.C. § 365(a)(b)(1)(A). *See also* 8B C.J.S. § 914 (2006); *In re* America the Beautiful Dreamer, Inc., 46 Bankr. Ct. Dec. 174 (2006) (not reported in B.R.); *In re* Kiwi Intern. Air Lines, Inc., 344 F.3d 311, 318 (3d Cir. 2003); *In re*

France. In a French safegard procedure, when the trustee or the debtor in possession (with the assent of a French court nominee) assumes an executory contract, only the claims arising from and after the issuance of the commencement order shall bind the estate. To the contrary, claims that arose before the issuance of the commencement order are treated as (generally unsecured) pre-petition claims.[202]

Germany. In German insolvency proceedings, when the trustee or the debtor in possession (with the assent of the trustee) assumes a contract, only the claims arising from and after the issuance of the commencement order shall bind the estate. To the contrary, claims that arose before the issuance of the commencement order are treated as (generally unsecured) pre-petition claims.[203]

Switzerland. When the trustee (in bankruptcy proceedings),[204] the liquidators (after the confirmation of a plan in a reorganization with assignment of assets),[205] or the debtor in possession with the assent

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Airlift Intern., Inc., 761 F.2d 1503, 1508 (11th Cir. 1985) ("... the estate becomes liable for performance of the entire contract, as if bankruptcy had never intervened."); N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 531-532 (1984); Matter of SteelShip Corp. 576 F.2d 128, 132 (8th Cir. 1978).

[202] C. COM. arts. L. 622-13 I para. 2 sentence 2, L. 622-17 I & II, L. 627-2. *See also* Cour de cassation [Cass.] [supreme court for judicial matters] com., May 3, 1994, BULLETIN DES ARRÊTS DE LA COUR DE CASSATION, CHAMBRES CIVILES [BULL. CIV.] IV, No. 163 (this case applies former Act No. 85-98 of January 25, 1985 art. 40, which corresponds to the actual C. COM. art. L. 622-17); Vallansan, *supra* note 134, paras. 105, 113-114; Jocelyne Vallansan, *Sauvegarde, redressement et liquidation judiciaire – Déclaration et admission des créances* [*Safeguard, Receivership and Liquidation Proceedings – Filing and Admission of Claims*], JURISCLASSEUR COMMERCIAL, FASC. 2352 para. 22 (Dec. 4, 2009).

[203] Inso §§ 55 para. 1 cl. 2, 105, 279. *See also* ACHIM AHRENDT, InsO § 103, para. 29, InsO § 105, para. 8, *in* HAMBURGER KOMMENTAR ZUM INSOLVENZRECHT [HAMBURGER KOMMENTAR ON INSOLVENCY LAW] (Andreas Schmidt ed., ZAP-Verlag, 3d ed. 2009); ARNE WITTIG & CHRISTIAN TETZLAFF, InsO § 279, para. 5, *in* MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG, BAND 3, §§ 270-359, INTERNATIONALES INSOLVENZRECHT, INSOLVENZSTEUERRECHT, SACHVERZEICHNIS FÜR DIE BÄNDE [MÜNCHENER KOMMENTAR ON THE INSOLVENCY ACT, VOLUME 3, §§ 270-359, INTERNATIONAL INSOLVENCY LAW, INSOLVENCY TAX LAW, INDEX FOR THE VOLUMES] (Hans-Peter Kirchhof, Hans-Jürgen Lwowski & Rolf Stürner eds., Verlag C. H. Beck, 2d ed. 2008); Graf & Wunsch, *supra* note 60, at 2120-2121.

[204] LP arts. 211 para. 2, 262 para. 1.

[205] LP arts. 211 para. 2, 262 para. 1. *See also* ROBERT-TISSOT, *supra* note 86, paras. 801 et seq.

of the trustee (in a reorganization),[206] assume(s) a contract, only the claims arising from and after the issuance of the commencement order (in bankruptcy proceedings or after the granting of an automatic stay in a reorganization), or from and after the confirmation of the plan in a reorganization with assignment of assets,[207] bind the estate. To the contrary, claims that arose before the issuance of the commencement order are treated as (generally unsecured) pre-petition claims. Draft LP art. 211a para. 2 expressly provides that, if the estate obtained consideration from a long-term contract, (only) the related claims that arose after the issuance of the commencement order in bankruptcy proceedings bind the estate.[208] This provision

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[206] LP arts. 306 para. 2 cl. 2, 310. *See* ROBERT-TISSOT, *supra* note 86, paras. 550, 551 et seq., 662 et seq. *See also* draft LP art. 310 para. 2 sentence 2: this draft expressly provides that the consideration from a long-term contract binds the estate in a reorganization with assignment of assets or a subsequent bankruptcy to the extent that the debtor benefited from the claims provided for by the contract with the assent of the trustee.

[207] In my opinion, in a reorganization with assignment of assets, when the liquidators assume a contract, only the claims that arise from and after the confirmation of the plan bind the estate (LP arts. 211 para. 2, 262 para. 1). The effects of a reorganization on pre-petition claims and claims that arose during the automatic stay (with or without the assent of the trustee) are ruled essentially by LP arts. 306 para. 2 cl. 2, 310. *See* ROBERT-TISSOT, *supra* note 86, paras. 550, 854-855. *Contra* WALTER BÖNI, DIE MASSEVERBINDLICHKEITEN IM NACHLASSVERTRAG MIT VERMÖGENSABTRETUNG [THE ADMINISTRATIVE EXPENSES IN A REORGANIZATION WITH ASSIGNMENT OF ASSETS] 30-31 (Buchdr. U. Cavelti 1959) [hereinafter BÖNI, ADMINISTRATIVE EXPENSES]; Walter Böni, *Die Masseverbindlichkeiten im Nachlassvertrag mit Vermögensabtretung* [*The Administrative Expenses in a Reorganization With Assignment of Assets*], 26 BLÄTTER FÜR SCHULDBETREIBUNG UND KONKURS/BULLETIN DES PRÉPOSÉS AUX POURSUITES ET FAILLITES [BLSCHK] 33, 65, 97, 129, 68-69 (1962) [hereinafter Böni, BLSCHK]; Manuel Arroyo, *Zu Sinn und Tragweite von Art. 310 Abs. 2 SchKG im Nachlassverfahren – Verbindlichkeiten der Masse* [*Meaning and Scope of art. 310 para. 2 LP in a Reorganization – Administrative Expenses*], BASLER JURISTISCHE MITTEILUNGEN [BJM] 233, n.190 (2003); Lorandi, *Long-Term Contracts*, *supra* note 68, at 1216, 1221; Staehelin, *supra* note 176, at 86 (according to these scholars, when the liquidators assume a contract, the estate becomes liable for the performance of the whole contract).

[208] *See* Bundesgesetz über Schuldbetreibung und Konkurs (SchKG) (Entwurf), Loi fédérale sur la poursuite pour dettes et la faillite (LP) (Projet), Legge federale sulla esecuzione e sul fallimento (LEF) (Disegno) [Federal Act on Debt Enforcement and Bankruptcy (LP) (Draft)], BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6507 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5921 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5717 (2010).

confirms a previous case, where the Federal Supreme Court ruled that, unless otherwise provided, the estate is only bound by claims arising after the issuance of the commencement order in bankruptcy proceedings.[209]

1.5. Effects of the Non-Continuation of a (Executory) Contract

The effects of the non-continuation of a (executory) contract, more precisely the treatment of pre-petition claims in such a case, is as follows in the four legal systems:

United States. In a Chapter 7 case, an executory contract or an unexpired lease of residential real property or of personal property of the debtor is deemed rejected absent an assumption by the trustee.[210] In Chapters 7, 9, 11, 12, or 13 cases,[211] the same result occurs for unexpired leases of non-residential real property of which the debtor is lessee.[212] Such a rejection results in an (unsecured) pre-petition claim.[213] Some courts decided that, in cases other than a Chapter 7 case, an executory contract or lease of other than non-residential real property (in which the debtor is lessee) which is not assumed (nor rejected) "rides through" the proceedings, i.e., the debtor will be

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209 *See* Tribunal fédéral [TF] [Federal Supreme Court] Feb. 6, 2006, 4C.252/2005, LA SEMAINE JUDICIAIRE [SJ] I 365 (2006). *See also* TF Jan. 27, 2011, 4A_630/2010, *available at* http://www.bger.ch/fr/index/juridiction/jurisdiction-inherit-template/jurisdiction-recht.htm (last visited Nov. 24, 2011); Bundesgericht [BGer] [Federal Supreme Court] Jun. 13, 1989, 115 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 65.

210 11 U.S.C. § 365(d)(1). *See also In re* Office Products of America, Inc., 136 B.R. 675, 686 (Bankr. W.D. Tex. 1992); Matter of Biopolymers, Inc., 136 B.R. 28, 29-30 (Bankr. D. Conn. 1992); *In re* ABC Books & School Supplies, 121 B.R. 329, 331 (Bankr. S.D. Ohio 1990); 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:34.

211 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:13.

212 11 U.S.C. § 365(d)(4). *See also* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:34.

213 11 U.S.C. §§ 365(g)(1), 502(g)(1). *See In re* Cardinal Export Corp., 30 B.R. 682, 684 (Bankr. E.D. N.Y. 1983); *In re* Price Chopper Supermarkets, Inc., 19 B.R. 462, 466 et seq. (Bankr. S.D. Cal. 1982); 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:34.

bound, although the counterparty cannot file a (unsecured) pre-petition claim and participate in the distribution.[214]

France. If the trustee or the debtor in possession does not make use of their right to continue the contract, the non-performance shall give rise to a claim for damages by the other party that shall be filed as a pre-petition claim[215] within one month of the automatic termination or the notification of the decision to terminate.[216] The other party may however postpone the reimbursement of sums paid in excess by the debtor in performance of the contract until the question of damages is settled.[217]

Germany. When the trustee or the debtor in possession decides not to continue a contract, the respective obligations expire, and the counterparty may file a pre-petition claim for non-performance of the contract.[218]

Switzerland. When the trustee or the debtor in possession decides not to continue a contract, the contract does not terminate automatically.[219] In this case, the counterparty may file a pre-petition claim for non-performance of the contract under LP 211 para. 1, which provides for a conversion of non-monetary claims into monetary claims.[220] Draft LP art. 211a para. 1 sentence 1 also provides that

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[214] *In re* JZ L.L.C., 371 B.R. 412, 416 et seq. (B.A.P. 9th Cir. 2007); *In re* Qintex Entertainment, Inc., 950 F.2d 1492, 1495 et seq. (9th Cir. 1991). *See also* 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:34; Andrew, *supra* note 131, at 879-881.

[215] C. COM. arts. L. 622-13 V sentence 1, L. 627-2.

[216] C. COM. art. R. 622-21 para. 2. *See also* Vallansan, *supra* note 202, para. 146.

[217] C. COM. arts. L. 622-13 V sentence 2, L. 627-2.

[218] Graf & Wunsch, *supra* note 60, at 2120.

[219] Tribunal fédéral [TF] [Federal Supreme Court] Feb. 6, 2006, 4C.252/2005, LA SEMAINE JUDICIAIRE [SJ] I 365 (2006); Bundesgericht [BGer] [Federal Supreme Court] Oct. 26, 1978, 104 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 84; Meier, *Executory Contracts*, *supra* note 67, at 92, 97, 107, 113; WEYDMANN, *supra* note 67, at 41-42; FISCHER, *supra* note 65, at 176, 178, 185.

[220] Bundesgericht [BGer] [Federal Supreme Court] Jul. 12, 1922, 48 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 158; BGer Jun. 8, 1916, 42 BGE III 279; BGer Sept. 10, 1913, 39 BGE II 398; BGer Jun. 28, 1907, 33 BGE II 371; BGer Sept. 29, 1906, 32 BGE II 528; Tribunal fédéral [TF] [Federal Supreme Court] Jun. 27, 1902, JOURNAL DES TRIBUNAUX [JdT] I 71 (1903); Bundesgericht [BGer] [Federal Supreme Court] Jun. 9, 1899, 25 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] II 438; Tribunal fédéral [TF] [Federal Supreme Court] Oct. 26, 1895, 21 ARRÊTS DU

claims based on a long-term contract, due until the next possible termination date of the contract or until the termination of the contract, may be filed as pre-petition claims from the commencement of the bankruptcy proceedings (or from the confirmation of a plan with assignment of assets).[221] [222]

2. Continuation of (Executory) Contracts From a Policy Perspective

2.1. Overview

As indicated above,[223] in order to continue running his business as a going concern, it is important that the insolvent debtor is authorized to impose the continuation of certain (executory) contracts (e.g., supply contracts, leases, employment contracts) on counterparties. Indeed, the debtor is under time and cash pressure and potential contractors might exploit this critical situation during the automatic stay by behaving opportunistically (e.g., by increasing the price of the goods sold to the insolvent debtor).

In connection with the issue of the (in)validity of *ipso facto* clauses, Che & Schwartz argue that the parties may renegotiate the contract during the insolvency proceedings.[224] Schwartz also mentions that such renegotiations are common, as is evidenced by frequent bankruptcy workouts and debt restructuring.[225] However, such (bilateral and efficient) renegotiations suppose that the parties are dealing at arm's length. When the insolvent debtor is facing such time and cash pressures and is not able to impose the continuation of the contract

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TRIBUNAL FÉDÉRAL SUISSE [ATF] II 1133 (some of these cases refer also to CO art. 97 or, more correctly, to CO art. 107 para. 2 sentence 2); PLENIO, *supra* note 67, at 23, 63.

[221] ROBERT-TISSOT, *supra* note 86, para. 872.

[222] *See* Bundesgesetz über Schuldbetreibung und Konkurs (SchKG) (Entwurf), Loi fédérale sur la poursuite pour dettes et la faillite (LP) (Projet), Legge federale sulla esecuzione e sul fallimento (LEF) (Disegno) [Federal Act on Debt Enforcement and Bankruptcy (LP) (Draft)], BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6507 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5921 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5717 (2010).

[223] *See supra* at 21.

[224] *See* Che & Schwartz, *supra* note 29, n.8. *See also* Schwartz, *supra* note 92, n.93.

[225] Schwartz, *supra* note 92, n.93.

on counterparties (in particular, in the situation where the contract has been breached or contains an *ipso facto* clause) the renegotiation process will be biased, because the counterparty will have a certain leverage to impose its own conditions to the insolvent debtor.

Therefore, the right of the debtor to assume (executory) contracts is critical to the success of an insolvency procedure. This is even more relevant in a reorganization procedure or a sale of the business as a going concern (as opposed to a liquidation that requires a piecemeal sale of the assets) where the debtor in possession or the estate should not be deprived of contracts that might be crucial for the proceedings.

2.2. (Non) Curing of Past Defaults Prior to Assumption

Hahn argues that the curing of past defaults prior to assumption, as required by the U.S. Bankruptcy Code,[226] is sound under a policy perspective in particular for the following reasons:[227]

First, in a debtor in possession regime (i.e., in a reorganization), there exists a moral hazard that the debtor may breach the contract, even in circumstances where he would have the ability to perform, and follow the breach by a tactical voluntary commencement of bankruptcy. So, even if the debtor breached the contract, he will not suffer from the contract's termination, for the debtor in possession has the right to assume (or reject) the (executory) contract. Thus, in order to mitigate this moral hazard, the debtor should be required to cure his past defaults prior to assumption. According to Hahn, requiring the curing of defaults should apply to all types of breach (willful breach and no-fault insolvency related breach), because it is difficult and time consuming to litigate in bankruptcy courts and make such a distinction. It is also unlikely that the over-inclusiveness of such a remedy will adversely impair the bankruptcy case.[228]

Second, in a trustee regime (i.e., in a bankruptcy or in a reorganization), even if the moral hazard of calculated breaches upon insolvency is insignificant, the curing of past defaults prior to assumption is also justified for fairness reasons. Indeed, according to Hahn, it would be unfair to force the counterparty to perform additional obli-

[226] *See* 11 U.S.C. § 365(b)(1)(a).
[227] Hahn, *supra* note 153, at 18 et seq.
[228] *Id.* at 18-19, 23.

gations without being first compensated for its losses incurred as a result of the breach. A rule providing for the non-curing of past defaults prior to assumption would force the counterparty to incur additional out of pocket expenses without first making the party whole. Hahn admits that the payment of pre-petition default claims to the counterparty effectively accords it priority over other (unsecured) creditors, but this deviation from the principle of equality of distribution is justified in light of the losses the counterparty suffers alone (when the trustee assumes the (executory) contract).[229]

Third, a rule providing for the non-curing of past defaults prior to assumption would lead the parties to demand a higher consideration in exchange (i.e., the seller would charge a risk premium to the buyer) or third party guarantees (*ex ante* efficiency).[230]

However, Hahn also calls for according discretion to the court upon the assumption of (executory) contracts to limit the counterparty's priority for pre-petition default claims: this priority should be applied only if the other party performed the contract in good faith prior to the assumption and avoided stalling its performance in the bankruptcy case.[231]

The UNCITRAL Guide also recommends that, where the debtor is in breach of a contract, the insolvency representative should be authorized to continue the contract " . . . provided the breach is cured . . . (and) the non-breaching counterparty is substantially returned to the economic position it was in before the breach . . . "[232] Even though the UNCITRAL Guide does not state clearly which policy considerations should support such a rule, it seems that this recommendation is based on fairness grounds.[233]

In my opinion, when the debtor assumes a (executory) contract, the damages claimed by the counterparty, which result from the pre-petition default of the debtor, should be treated as (unsecured) pre-petition claims not enjoying the priority given to administration expenses. The main reason is the fundamental principle of equality in

[229] *Id.* at 19-22, 31.
[230] *Id.* at 23-24.
[231] *Id.* at 24-25, 28-31.
[232] UNCITRAL Guide, Recommendation 79.
[233] *See* UNCITRAL Guide, at 126, para. 130.

bankruptcy.[234] It would also be "unfair" to the other (unsecured) creditors that the counterparty whose contract is – by chance – being continued by the trustee or the debtor in possession would benefit from a full payment of its pre-petition claims in addition to its future claims. The situation is even more unsatisfactory when the default of the debtor is without fault. At this point, I will insist that it is not the vague and subjective standard of "fairness" that is helpful (after all, in such insolvency proceedings, the majority of creditors – unsecured or even secured[235] – will complain that such proceedings are unfair): the concept of "equality" shall be the paramount guideline to examine this issue.

Similarly to the issue of the (in)validation of *ipso facto* clauses,[236] the treatment of pre-petition claims when the trustee or the debtor in possession assumes the (executory) contract might alter the debtor's pre-bankruptcy incentives to invest and commit, because its costs will be incompletely internalized in case of insolvency. However, this risk is also mitigated by the fact that insolvency proceedings entail high reputation and litigation costs. In any case, a potential moral hazard should not be compensated by way of creating the previously mentioned inequality among the unsecured creditors. Indeed, the treatment of pre-petition claims should also mirror the priorities in the non-bankruptcy world.[237] Therefore, it results from

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[234] In Swiss case law, *see*, *e.g.*, Tribunal fédéral [TF] [Federal Supreme Court] Feb. 6, 2006, 4C.252/2005, LA SEMAINE JUDICIAIRE [SJ] I 365 (2006) (pursuant to the principle of equality, pre-petition claims are not binding upon the estate when the trustee decides to continue a contract).

[235] Secured creditors may also complain that, during the automatic stay, they are stayed from enforcing their liens; the debtor often can use the collateral during bankruptcy proceedings; secured creditors may be subordinated to other creditors that extend credit after bankruptcy; and secured creditors must sometimes spend an important amount of time and money to preserve their rights. *See* ALAN SCHWARTZ & ROBERT E. SCOTT, COMMERCIAL TRANSACTIONS, PRINCIPLES AND POLICIES 809-810 (THE FOUNDATION PRESS, INC. 1982); Peter Coogan, *The New Bankruptcy Code: The Death of Security Interest?*, 14 GA. L. REV. 153 (1980). Thus, even from a secured creditor's point of view, the insolvency proceedings may be qualified as "unfair".

[236] *See supra* p. 22.

[237] *See* Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, n.3 (1987), referring to Butner v. United States, 440 U.S. 48 (1979); Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U.

this doctrine that, when the trustee or the debtor in possession decides to continue a contract, damages claimed by the counterparty, which result from the pre-petition default of the debtor, should be treated no differently than any other general unsecured claim against the debtor. As indicated in connection with the (in)validation of *ipso facto* clauses[238] and the right of the trustee or the debtor in possession to reject a (executory) contract,[239] the court should rather declare the filing of a bankruptcy as abusive in the rare cases where the non-performance of the contract was the sole objective of filing (i.e., where the debtor behaves opportunistically).

The *ex ante* inefficiency of a regime where only the claims arising from and after the issuance of the commencement order bind the estate when the trustee or the debtor in possession continues a (executory) contract is also limited. Indeed, as indicated previously,[240] the counterparty is still protected for its future claims in such circumstances. Therefore, compared to the other (unsecured) creditors whose contracts have not been assumed by the trustee or the debtor in possession, the counterparty will not incur additional out of pocket expenses. There is one exception: the counterparty would incur such additional costs if the contract should have been performed as a whole. In other words, the counterparty would suffer an additional burden in case of partial performance of the contract when the contractual performances due to the parties are not severable. For this reason, German law states explicitly that this regime applies only when the contract is severable.[241] The potential contractor also face a supplementary *ex ante* risk in a regime where the whole contract shall be performed when the trustee or the debtor in possession continues a (executory) contract: if the trustee or the debtor in possession assumes a (executory) contract of another creditor that appears later to be unprofitable, the pre-petition claims of the counterparty will be

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CHI. L. REV. 97, 101-102 (1984); Triantis, *supra* note 99, at 696. *See also* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 153-156 (The Harvard University Press 1986), referring to Reading Co. v. Brown, 391 U.S. 471, 485 et seq. (1968) (Warren, J., with whom Douglas, J., joins, dissenting).

[238] *See supra* p. 22.

[239] *See infra* p. 57.

[240] *See supra* p. 23.

[241] *See* Inso § 105.

lower in such a regime, because the whole assumed contract (still) binds the estate.

As indicated by Brunetti-Pons,[242] the regime where only the claims arising from and after the issuance of the commencement order bind the estate when the trustee or the debtor in possession continues a (executory) contract may also be seen as a continuation of the (sound)[243] principle according to which *ipso facto* clauses are invalid.

C. Rejection of (Executory) Contracts

1. Comparative Law Study of the Rejection of (Executory) Contracts

The right of the trustee or the debtor in possession to reject (executory) contracts is explicitly recognized only in the United States and in France. To the contrary, in Germany and in Switzerland, the trustee or the debtor in possession does not have a (general) right to reject a contrat. However, Swiss law will probably be revised on this point. More precisely, the four legal systems are as follows:[244]

United States. A bankruptcy trustee or a debtor in possession[245] may reject any executory contract[246] or unexpired lease.[247] The power to reject is subject to court approval[248] with the exception of certain leases and contracts that are deemed rejected.[249] The rejection of an executory contract or unexpired lease constitutes a breach of such a contract or lease by the debtor (not by the bankruptcy estate),[250] which is deemed to have occurred immediately before the filing of the petition.[251] Thus, the rejection results in a (unsecured) pre-

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[242] Brunetti-Pons, *supra* note 34, para. 13.
[243] *See supra* pp. 19 et seq.
[244] *See also* discussion about the rights and duties pending continuation or rejection of (executory) contracts *supra* pp. 28 et seq.
[245] 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, §§ 46:10, 46:23.
[246] *See also* discussion about the definition of the terms "executory contract" *supra* p. 26.
[247] *See* 11 U.S.C. § 365(a).
[248] *Id.*
[249] *See* 11 U.S.C. § 365(d)(1) and (4).
[250] Fried, *supra* note 98, 519.
[251] *See* 11 U.S.C. §§ 365(g)(1), 502(g)(1). *See also In re* American HomePatient, Inc., 414 F.3d 614, 620 (6th Cir. 2005) (" . . . the Bankruptcy Code specifically fixes the date of breach for rejection damages purposes as the date immediately

petition claim for resulting damages, i.e., this claim is not treated as an administrative expense.[252] While constituting a "breach of the contract", the rejection does not terminate the contract or lease, except in 11 U.S.C. § 365(h), (i) and (n) cases.[253]

France. The Order No 2008-1345 of December 18, 2008 brought a major modification to the French COMMERCIAL CODE: (when the (executory) contract has not been automatically terminated)[254] at the request of the trustee or the debtor in possession[255] (the assent of the

before the date of the filing of a bankruptcy petition."); *In re* FBI Distribution Corp., 330 F.3d 36, 42 (1st Cir. 2003); *In re* Miller, 282 F.3d 874, 878 (6th Cir. 2002); *In re Continental Airlines,* 981 F.2d 1450, 1459 (5th Cir. 1993).

252 *See In re* FBI Distribution Corp., 330 F.3d 36, 42 (1st Cir. 2003); 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, § 46:24.

253 *See In re* Onecast Media, Inc., 439 F.3d 558, 563 (9th Cir. 2006); A & L Laboratories, Inc. v. Bou-Matic LLC, 429 F.3d 775, 779 (8th Cir. 2005); *In re* Teleglobe Communications Corp., 304 B.R. 79, 83 (D. Del. 2004); *In re* Miller, 282 F.3d 874, 878 (6th Cir. 2002); *In re* Lavigne, 114 F.3d 379, 386-387 (2d Cir. 1997); *In re* Tri-Glied, Ltd., 179 B.R. 1014, 1017-18 (Bankr. E.D.N.Y. 1995); *In re* Printronics, Inc., 189 B.R. 995, 1000 (Bankr. N.D. Fla. 1995); Matter of Austin Development Co., 19 F.3d 1077, 1080-1084 (5th Cir. 1994); First Sec. Bank of Utah, N.A. v. Gillman, 158 B.R. 498, 504 (D. Utah 1993); *In re* Continental Airlines, 981 F.2d 1450, 1459-61 (5th Cir. 1993); *In re* SRJ Enterprises, Inc., 150 B.R. 933, 937 (Bankr. N.D. Ill. 1993); *In re* Modern Textile, Inc., 900 F.2d 1184, 1191-92 (8th Cir. 1990); Andrew, *supra* note 131, at 856 et seq.

254 C. COM. art. L. 622-13 IV applies when the executory contract has not been automatically terminated. Under the COMMERCIAL CODE, the contract shall automatically terminate in three situations: 1) A formal notice has been sent to the trustee that has remained unanswered within a month (C. COM. art. L. 622-13 III cl. 1). 2) When the trustee assumes an executory contrat and the performance concerns the payment of a sum of money, it must be paid promptly, except where the trustee is given a moratorium by the other party. In the absence of payment under these conditions or if the other party does not agree to continue the contractual relationship, the contract will automatically be terminated (C. COM. art. L. 622-13 III cl. 2 sentence 1). 3) Where the contract is to be performed over time and paid in installments, the trustee shall terminate the contract if he believes that the estate does not have the necessary funds to satisfy the obligations of the next term (C. COM. art. L. 622-13 II para. 2 sentence 3). *See* Le Corre-Broly, *supra* note 162, paras. 5-6.

255 *See* Le Corre-Broly, *supra* note 162, para. 9; Philippe Roussel-Galle, *Les «nouveaux» régimes des contrats en cours et du bail* [*The "New" Regimes on Executory Contracts and Leases*], REVUE DES PROCÉDURES COLLECTIVES 55, para. 13 (2009).

court nominee seems not to be required in this case),[256] the supervisory judge shall reject the contract when it is necessary to safeguard the debtor and does not excessively harm the interests of the other party.[257] The rejection of an executory contract may give rise to damages to the other party that may be filed as pre-petition claims[258] within one month of the automatic termination or the notification of the decision to terminate.[259] The other party may however postpone the reimbursement of sums paid in excess by the debtor in performance of the contract until the question of damages is settled.[260]

Germany. German law does not provide for a general right of the trustee or the debtor in possession to reject contracts, except in the cases of leases[261] or employment contracts.[262] However, when the trustee or the debtor in possession decides not to continue the contract, the respective obligations expire.[263]

Switzerland. Swiss law does not confer upon the trustee or the debtor in possession a right to reject contracts.[264] However, Swiss law is

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[256] *See* C. COM. art. R. 627-1 para. 5 sentence 2 (pursuant to this provision, the debtor in possession shall enclose the assent of the court nominee to the petition in the event he obtained such an assent; therefore, the assent of the court nominee seems not to be mandatory); Le Corre-Broly, *supra* note 162, para. 9. *Contra* Roussel-Galle, *supra* note 255, para. 13.

[257] C. COM. arts. L. 622-13 IV, L. 627-2.

[258] C. COM. arts. L. 622-13 V sentence 1, L. 627-2.

[259] C. COM. art. R. 622-21 para. 2.

[260] C. COM. arts. L. 622-13 V sentence 2, L. 627-2.

[261] *See* Inso §§ 109, 279.

[262] *See* Inso §§ 113, 279

[263] *See supra* p. 31.

[264] Tribunal fédéral [TF] [Federal Supreme Court] Oct. 5, 2006, 4C.239/2006, *available at* http://www.bger.ch/fr/index/juridiction/jurisdiction-inherit-template/jurisdiction-recht.htm (last visited Nov. 24, 2011); Bundesgericht [BGer] [Federal Supreme Court] Jun. 30, 2006, 5C.97/2006, 71 BLÄTTER FÜR SCHULDBETREIBUNG UND KONKURS/BULLETIN DES PRÉPOSÉS AUX POURSUITES ET FAILLITES [BLSCHK] 54 (2007); TF Feb. 6, 2006, 4C.252/2005, LA SEMAINE JUDICIAIRE [SJ] I 365 (2006); BGer Feb. 14, 1979, 105 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 11; BGer Oct. 26, 1978, 104 BGE III 84. *See also* Ramon Mabillard, *Kündigung der Dauerschuldverhältnisse im ordentlichen Nachlassverfahren, Prozessuale Kompensation des materiell-rechtlichen Eingriffs gemäss Art. 297a VE-SchKG* [*Termination of Long-Term Contracts in Ordinary Reorganization Proceedings, Procedural Indemnification of the Intervention in Substantive Law Pursuant to Art. 297 Draft LP*], 74 BLÄTTER FÜR SCHULDBETREIBUNG UND KONKURS/BULLETIN DES PRÉPOSÉS AUX POURSUITES ET FAILLITES [BLSCHK] 189, 190-191 (2010).

likely to be revised on this point: draft LP art. 297a provides that, with the consent of the trustee (the power to reject is not subject to court approval),[265] the debtor in possession has the right, during the automatic stay, to terminate a long-term contract at any date; the debtor shall indemnify the other party. The damages are (unsecured) pre-petition claims. However, when the contract is terminated for a later date, the claims that arose from and after the issuance of the commencement order until the termination of the contract bind the estate.[266] The provisions on the termination of employment contracts have been reserved, i.e., this type of contract is explicitly excluded from the regime of draft LP art. 297a.[267] Only the debtor in possession has the right to reject a long-term contract during the automatic stay (in a reorganization procedure), i.e., such a right is not conferred to the trustee in bankruptcy proceedings or after the confirmation of the plan in a reorganization with assignment of assets.[268]

2. Rejection of (Executory) Contracts From a Policy Perspective

In order to promote the principle of equal treatment,[269] the UNCITRAL Guide recommends that any damages arising from the

[265] *See* Botschaft zur Änderung des Bundesgesetzes über Schuldbetreibung und Konkurs (Sanierungsrecht), Message relatif à une modification de la loi fédérale sur la poursuite pour dettes et la faillite (droit de l'assainissement), Messaggio sulla modifica della legge federale sulla esecuzione e sul fallimento (procedura di risanamento) [Message regarding the Amendment of the Federal Act on Debt Enforcement and Bankruptcy (Financial Reorganization Law)] Sept. 8, 2010, BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6455, 6489 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5871, 5903 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5667, 5698-5699 (2010).

[266] Mabillard, *supra* note 264, at 200-201.

[267] *See* Botschaft zur Änderung des Bundesgesetzes über Schuldbetreibung und Konkurs (Sanierungsrecht), Message relatif à une modification de la loi fédérale sur la poursuite pour dettes et la faillite (droit de l'assainissement), Messaggio sulla modifica della legge federale sulla esecuzione e sul fallimento (procedura di risanamento) [Message regarding the Amendment of the Federal Act on Debt Enforcement and Bankruptcy (Financial Reorganization Law)] Sept. 8, 2010, BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6455, 6465, 6489 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5871, 5881, 5903 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5667, 5677, 5699 (2010).

[268] *Id.*, BBL 6488 (2010), FF 5902-5903 (2010), FF 5698 (2010).

[269] UNCITRAL Guide at 128, para. 134

rejection of a pre-commencement contract should be determined in accordance with the applicable law and treated as an ordinary unsecured (pre-petition) claim. Insolvency law may also limit claims relating to the rejection of a long-term contract.[270]

Triantis argues that 11 U.S.C. § 365 (which corresponds to the recommendations of the UNCITRAL Guide regarding the rejection of a (executory) contract) exacerbates the above-mentioned[271] incentives for the debtor to take excessive risks. In other words, bankruptcy law promotes excessive breach by the debtor for the following reasons:[272]

First, no contractual obligations are specifically enforced in bankruptcy since equitable remedies are converted into monetary bankruptcy pre-petition claims.

Second, the Bankruptcy Code gives the debtor a moral right to breach since the 11 U.S.C. § 365 rule enhances the prospects of successful rehabilitation and is consistent with the principle of equality of distribution in bankruptcy proceedings.[273]

Third, the duration of the debtor's option to perform or breach and pay damages to the counterparty is prolonged in insolvency proceedings, because, in case of a material breach by the debtor, the counterparty is not allowed to terminate the contract, sue for damages, and enforce its judgment during the automatic stay.[274]

Fourth, the asymmetric treatment of the priority of obligations in an assumed contract[275] and damages from rejected contracts[276] reinforces the bias in the decision of the insolvent debtor in favor of rejecting (executory) contracts. While the costs of performance to the debtor are fully considered in the trustee's or debtor in possession's decision to assume a (executory) contract, the costs of breach to the

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[270] UNCITRAL Guide, Recommendation 82.

[271] *See supra* p. 21.

[272] Triantis, *supra* note 99, at 692-694, 698. *See also* Fried, *supra* note 98, at 522 et seq.

[273] *See also* Fried, *supra* note 98, at 522, 528.

[274] *See* in the United States: 11 U.S.C. 362(a)(1) and (2).

[275] In the United States, when the trustee or the debtor in possession assumes an executory contract, the estate becomes liable for the performance of the whole contract. *See* 11 U.S.C. § 365(a)(b)(1)(A).

[276] In the United States, when the trustee or the debtor in possession rejects an executory contract, the claims of the counterparty are treated as (unsecured) pre-petition claims. *See* 11 U.S.C. §§ 365(g)(1), 502(g)(1).

counterparty are incompletely internalized.[277] As indicated by Fried, the lower is the expected payout rate for an unsecured pre-petition claim, the greater is the distortion in favor of rejection.[278]

Instead of relying on the court to supervise the decision to reject, Triantis proposes that bankruptcy law elevates the priority assigned to damages for the rejection of executory contracts in bankruptcy.[279] Triantis admits that such a proposition would contradict the principle of equality in bankruptcy and impair the prospects of successful rehabilitation.[280] Furthermore, it would also violate the above-mentioned[281] principle that the treatment of (executory) contracts should mirror the priorities in the non-bankruptcy world.[282] According to Triantis, discrepancies between the bankruptcy and the non-bankruptcy world would also create a "forum shopping", i.e., " . . . the use or avoidance of the bankruptcy process motivated by distributional concerns . . . ".[283] For instance, if bankruptcy law elevates the priority assigned to damages for the rejection of (executory) contracts, the debtor would have an incentive to breach an onerous contract immediately before the commencement of bankruptcy proceedings instead of rejecting it during the automatic stay.[284] However, according to Triantis, bankruptcy law violates this principle with respect to several claims arising during the bankruptcy proceedings.[285] For instance, in the United States, tort claims arising from accidents during the automatic stay bind the estate,[286] with the result that the insolvent firm fully internalizes the costs of its negligent behavior.[287] Thus, the benefits from creating optimal breach incentives potentially outweigh the costs resulting from forum shopping

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[277] *See also* Fried, *supra* note 98, at 531-532.
[278] *See Id.*, at 532-533.
[279] Triantis, *supra* note 99, at 696 et seq. On this proposition, *see also* Fried, *supra* note 98, at 545-547.
[280] Triantis, *supra* note 99, at 696.
[281] The counterparty is an unsecured creditor. Therefore, she should not be entitled to higher priority in a bankruptcy or a reorganization (*see supra* p. 44).
[282] Triantis, *supra* note 99, at 696.
[283] *Id.*
[284] *Id.* at 698.
[285] *Id.* at 696.
[286] *See In re* Women First Healthcare, Inc., 332 B.R. 115, 123 et seq. (Bankr. D. Del. 2005); *In re* Charlesbank Laundry, Inc., 755 F.2d 200, 201 et seq. (1st Cir. 1985); Reading Co. v. Brown, 391 U.S. 471, 483-485 (1968).
[287] Triantis, *supra* note 99, at 696-697, 699.

opportunities.[288] The creation of optimal breach incentives is even more valuable where the (executory) contract involves relation-specific investments, because the non-debtor incurs additional costs when the debtor behaves opportunistically.[289] According to Triantis, the bankruptcy law treatement of the debtor and the non-debtor is also unbalanced: it encourages termination and facilitates adjustement of the contract by the debtor, while it deters such a termination and adjustement of the contract by the non-debtor. The elevation of the priority assigned to damages for the rejection of (executory) contracts in bankruptcy would eliminate such an asymmetric treatement between the debtor and the non-debtor.[290] Triantis also mentions the risk that the insolvent debtor acts opportunistically by using the threat to reject in order to extract a renegotiation of onerous terms from the non-debtor.[291]

I agree with the analysis of the UNCITRAL Guide that the fundamental principle of equality of distribution in bankruptcy applies to the (unsecured) pre-petition claims resulting from the rejection of a (executory) contract.[292] Thus, the elevation of the priority assigned to damages for the rejection of (executory) contracts in bankruptcy, as proposed by Triantis, would violate this principle.[293] In my opinion, the tort example given by Triantis as a case where the bankruptcy law would deliberately violate this principle is not appropriate. Indeed, tort claims arising from post-petition accidents should enjoy administrative expense priority because the wrongdoing and the resulting damages occurred during the automatic stay, whereas the damages for the rejection of a (executory) contract or, at least, the cause of such remedies (the conclusion of a contract) existed before the commencement of the bankruptcy proceedings.[294] The treatment of (executory) contracts should also mirror the priorities in the non-bankruptcy world: as indicated above,[295] the non-debtor is an unse-

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[288] *Id.* at 696, 699.
[289] *See Id.* at 690, 697-698.
[290] *Id.* at 705 et seq.
[291] *Id.* at 706-708, 710.
[292] *See also* in the United States: JACKSON, *supra* note 237, at 108-109; Westbrook, *supra* note 131, at 252-253, 335-336.
[293] Fried, *supra* note 98, at 546.
[294] *See* under Swiss law: ROBERT-TISSOT, *supra* note 86, paras. 621, 624-625, 654-656, 743-744, 797.
[295] *See supra* p. 44.

cured creditor, whose pre-petition claims should not be entitled to higher priority in a bankruptcy or a reorganization in case of rejection or continuation of the (executory) contract by the trustee or the debtor in possession.

However, the recommendations of the UNCITRAL Guide are inconsistent, for it also recommends "converting" (unsecured) pre-petition claims into administrative expenses when the trustee or the debtor in possession decides to continue a (executory) contract,[296] which would clearly violate the principle of equality of distribution.[297] The same is true for 11 U.S.C. § 365. In my opinion, such a "two measures and two yardsticks" approach violates this principle. To the contrary, the potential inefficiency of the right to reject a (executory) contract given to the trustee or the debtor in possession could be reduced by decreasing the cost of performance of a (executory) contract,[298] i.e., by providing that only the claims that arose during the automatic stay bind the estate, whereas the damages resulting from

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[296] UNCITRAL Guide, Recommendation 79.

[297] *See supra* p. 44.

[298] *See also* Fried, *supra* note 98, at 550 et seq. In order to reduce the trustee's incentives to reject contracts that are "value-creating", Fried indicates three rules that would embody a "price-adjustement" approach, but which may also give rise to more frequent litigation and higher litigation costs than the actual "ratable damages" rule (which is the actual rule that provides that the rejection results in a (unsecured) pre-petition claim for resulting damages; *see* 11 U.S.C. §§ 365(g)(1), 502(g)(1)): 1) The "ratable damages"/adjusted price rule: it makes an offsetting adjustment of the contract price in favor of the estate which is exactly equal to the amount of the reduction in the cost of non-performance under the "ratable damages" rule (cost of rejection). 2) The "no damage"/adjusted price rule: it gives the estate the choice between paying no damages for rejection to the counterparty or performing at a price reduced to the cost of performance of the counterparty. Under such a "no damage" rule, the estate would be even better off if it rejects the contract than under the "ratable damages" rule. Thus, an appropriate adjustment would be to reduce the contract price by the counterparty's expected profits. 3) The modified price/"expectation damages" rule: it ajusts the contract price in favor of the estate by a fixed percentage that would be known by the parties at the time of the conclusion of the contract (*ex ante*) and then gives the estate the choice between performing at the modified price or paying expectation damages, which correspond to the difference between the modified price and the cost of performance of the counterparty. The expectation damages would be treated as administrative expenses. This regime would give the parties the proper performance incentives. Fried's article provides numerical examples.

the pre-petition default of the debtor remain (unsecured) pre-petition claims.

In my opinion, the risk that the insolvent debtor acts opportunistically and imposes a renegotiation of onerous terms on the non-debtor is largely mitigated by bankruptcy law itself. Indeed, in all four legal systems, a (executory) contract or lease shall be assumed or rejected in its entirety. Thus, the trustee or the debtor in possession shall not assume beneficial provisions while rejecting burdensome provisions.[299] In other words, bankruptcy law does not open the door to a renegotiation of a (executory) contract. Such a renegotiation may only occur before the commencement of insolvency proceedings.

As indicated by Triantis,[300] in the U.S. Bankruptcy Code,[301] the requirement that the court approve the rejection of an executory contract might provide a safeguard against excessive rejection by the debtor. However, Triantis defines such a safeguard as "modest",[302] for few courts have adopted the (equitable) balancing approach, which consists of not permitting the trustee to reject an executory contract if the damage caused to the counterparty from rejection

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[299] United States: *see*, *e.g.*, *In re* University Medical Center, 973 F.2d 1065, 1075-1076 (3d Cir. 1992); *In re* Royster Co., 137 B.R. 530, 532 (Bankr. M.D. Fla. 1992); U.S., Dept. of Air Force v. Carolina Parachute Corp., 907 F.2d 1469, 1472 (4th Cir. 1990); *In re* S.E. Nichols Inc., 120 B.R. 745, 747-748 (Bankr. S.D. N.Y. 1990); Matters of Crippin, 877 F.2d 594, 597-598 (7th Cir. 1989); Lee v. Schweiker, 739 F.2d 870, 876 (3d Cir. 1984); 2 NORTON BANKR. L. & PRAC. 3D, *supra* note 45, §§ 46:11, 46:27.
France: *see* C. COM. arts. L. 622-13 II sentence 1, L. 627-2. *See also* Vallansan, *supra* note 134, para. 84, referring to Cour de cassation [Cass.] [supreme court for judicial matters] com., Oct. 19, 1970, BULLETIN DES ARRÊTS DE LA COUR DE CASSATION, CHAMBRES CIVILES [BULL. CIV.] IV, No. 271.
Germany: Bundesgerichtshof [BGH] [Federal Court of Justice] Aug. 10, 2006, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (earlier: "UND INSOLVENZPRAXIS") [ZIP] 1736, 2006.
Switzerland: *see* Cour de justice du Canton de Genève [Justice Court of the Canton of Geneva] Nov. 20, 1925, LA SEMAINE JUDICIAIRE [SJ] 139 (1926); Lorandi, *Employer's Bankruptcy*, *supra* note 67, at 152; PLENIO, *supra* note 67, at 25-26 & n.40, at 47; SCHWOB, LP art. 211, para 11, *supra* note 67; KREN, *supra* note 180, at 95; GILLIÉRON, LP art. 211, para 36, *supra* note 67. *Contra* FISCHER, *supra* note 65, at 168 et seq., 263-264.
See also UNCITRAL Guide at 128-129, para. 136.

[300] Triantis, *supra* note 99, at 694.

[301] *See* 11 U.S.C. § 365(a).

[302] Triantis, *supra* note 99, at 694.

would be disproportionately greater than the benefit to the estate.[303] Courts apply instead the (more deferential) predominant business judgement standard, which corresponds to the judicial review of corporate decisions outside bankruptcy:[304] approval will be refused only if it is evidenced that the trustee or the debtor in possession abused their discretion or that the decision was so manifestly unreasonable that it could not be based on sound judgment.[305] Thus, the rejection (or the assumption) of an executory contract will be approved upon a mere showing that the action will benefit the estate, i.e., the general unsecured creditors (best interests of the estate).[306] The requirement of court approval may also be time-consuming and costly. For this reason, in Switzerland, draft LP art. 297a does not require a judicial intervention: the rejection of a contract by the debtor in possession is (only) subject to the trustee approval.[307] Such a

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[303] *See*, *e.g.*, in the United States: *In re* Health Science Products, Inc., 191 B.R. 895, 909 (Bankr. N.D. Ala. 1995); *In re* Sundial Asphalt Co., Inc., 147 B.R. 72, 82 (E.D. N.Y. 1992); *In re* Blackstone Potato Chip Co., Inc., 109 B.R. 557, 560-561 (Bankr. D. R.I. 1990); *In re* Patterson, 119 B.R. 59, 60-61 (E.D. Pa. 1990); *In re* Midwest Polychem, Ltd., 61 B.R. 559, 562 et seq. (Bankr. N.D. Ill. 1986); *In re* Petur U.S.A. Instrument Co., Inc., 35 B.R. 561, 563 (Bankr. Wash. 1983); *In re* Chi-Feng Huang, 23 B.R. 798, 800-802 (9th Cir. 1982). *See also* Fried, *supra* note 98, at 523, 540-543 (according to Fried, the "balancing test" doctrine would only prevent the trustee from rejecting when rejection is especially value-wasting).

[304] *See* in the United States: Johnson v. Fairco Corp., 61 B.R. 317, 320 (N.D. Ill. 1986); Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1046 et seq. (4th Cir. 1985).

[305] *See*, *e.g.*, in the United States: Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1046 et seq. (4th Cir. 1985); *In re* Fashion Two Twenty, Inc., 16 B.R. 784, 787 (Bankr. Ohio 1982); *In re* Marina Enterprises, Inc., 14 B.R. 327, 333 (Bankr. Fla. 1981); *In re* J. H. Land & Cattle Co., Inc., 8 B.R. 237, 238-239 (Bankr. Okla. 1981); *In re* Summit Land Co., 13 B.R. 310, 314 et seq. (Bankr. Utah 1981). *See also* Triantis, *supra* note 99, at 694.

[306] *See* in the United States: *In re* Chestnut Ridge Plaza Associates, L.P., 156 B.R. 477, 485 (Bankr. W.D. Pa. 1993); *In re* Pierce Terminal Warehouse, Inc., 133 B.R. 639, 645-646 (Bankr. N.D. Iowa 1991); *In re* TS Industries, Inc., 117 B.R. 682, 689 (Bankr. D. Utah 1990); *In re* Continental Country Club, Inc., 114 B.R. 763, 767 (Bankr. M.D. Fla. 1990); *In re* A.J. Lane & Co., Inc., 107 B.R. 435, 439 et seq. (Bankr. D. Mass. 1989); *In re* Lafayette Radio Electronics Corp., 8 B.R. 528, 533 (Bankr. E.D. N.Y. 1981); Matter of Minges, 602 F.2d 38, 43 (2d Cir. 1979).

[307] *See* in Switzerland: Botschaft zur Änderung des Bundesgesetzes über Schuldbetreibung und Konkurs (Sanierungsrecht), Message relatif à une modification de la loi fédérale sur la poursuite pour dettes et la faillite (droit de

protection of the counterparty may sound weak. Therefore, in a recent publication, Mabillard recommends that the power of the debtor in possession to reject should be instead subject to the condition of an approval by an assembly of creditors.[308] However, in my opinion, such a protection would be ineffective. Indeed, there is a potential conflict of interest: an assembly of creditors will tend to further its own interest, i.e., the best interests of the estate. In any case, if the rejection would benefit the other general (unsecured) creditors, it is doubtful that such an assembly would not grant its approval. The French COMMERCIAL CODE has chosen a middle approach: at the request of the trustee or the debtor in possession, the supervisory judge (instead of the *plenum* of the court) shall reject the contract when it is necessary to safeguard the debtor and does not excessively harm the interests of the other party.[309]

As indicated in connection with the (in)validation of *ipso facto* clauses[310] and the treatment of pre-petition claims when the trustee or the debtor in possession continues a (executory) contract,[311] the potential inefficiency of the right to reject (executory) contracts might be mitigated by allowing the court to declare the filing of a bankruptcy abusive where the rejection was the sole objective of filing.[312]

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l'assainissement), Messaggio sulla modifica della legge federale sulla esecuzione e sul fallimento (procedura di risanamento) [Message regarding the Amendment of the Federal Act on Debt Enforcement and Bankruptcy (Financial Reorganization Law)] Sept. 8, 2010, BUNDESBLATT [BBL] [FEDERAL GAZETTE] 6455, 6489 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE] 5871, 5903 (2010), OGLIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5667, 5698-5699 (2010).

308 *See also* Mabillard, *supra* note 264, at 203-205.

309 C. COM. arts. L. 622-13 IV, L. 627-2.

310 *See supra* p. 22.

311 *See supra* p. 45.

312 *See*, *e.g.*, in the United States: *In re* Integrated Telecom Express, Inc., 384 F.3d 108, 127 et seq. (3d Cir. 2004); *In re* Southern California Sound Systems, Inc., 69 B.R. 893, 900 (Bankr. S.D.Cal. 1987); *In re* Cardi Ventures, Inc., 59 B.R. 18, 22-23 (Bankr. S.D.N.Y. 1985). *But see In re* PPI Enterprises (U.S.), Inc., 324 F.3d 197, 211 (3d Cir. 2003); *In re* W. & L. Associates., Inc., 71 B.R. 962, 967-68 (Bankr. E.D.Pa. 1987); *In re* Bofill, 25 B.R. 550, 552 (Bankr. S.D.N.Y. 1982) (it is not necessarily "bad faith" for debtors to file for bankruptcy to benefit from certain provisions of the U.S. Bankruptcy Code).
See also in Switzerland: Bundesgericht [BGer] [Federal Supreme Court] Jan. 15, 2009, 5A_676/2008, LA SEMAINE JUDICIAIRE [SJ] I 267 (2009); BGer Aug. 28, 1997, 123 ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS

III. Conclusion

The following figure summarizes the different options chosen by each legal system:

	(In)validity of *ipso facto* clauses	**Effects of the continuation of a (executory) contract when the debtor is in breach**	**Effects of a (eventual) rejection of a (executory) contract when the debtor is in breach**
United States	Invalidity	In case of a continuation of an executory contract, estate liable for the performance of the whole contract	In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings
France	Invalidity	In case of a continuation of an executory contract, estate liable only for the performance of the claims arising after the insolvency proceedings	In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings
Germany	(Validity)[313]	In case of a continuation of a contract, estate liable only for the performance of the claims arising after the insolvency proceedings	No general right of the trustee or the debtor in possession to reject a contract, except in the cases of leases[314] or employment contracts[315]

[BGE] III 402; Appellationshof des Kantons Bern [Court of Appeal of the Canton of Bern] Jun. 14, 1978, 44 BLÄTTER FÜR SCHULDBETREIBUNG UND KONKURS/BULLETIN DES PRÉPOSÉS AUX POURSUITES ET FAILLITES [BLSCHK] 79 (1980).

313 This issue is highly controversial in Germany. *See supra* p. 13.

314 *See* Inso §§ 109, 279.

315 *See* Inso §§ 113, 279

Switzerland	Validity	In case of a continuation of a contract, estate liable only for the performance of the claims arising after the insolvency proceedings	Under current law,[316] no general right of the trustee or the debtor in possession to reject a contract
UNCITRAL	Invalidity	In case of a continuation of a (executory) contract, estate liable for the performance of the whole contract	In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings
Best Model[317]	Invalidity	In case of a continuation of a (executory) contract, estate liable only for the performance of the claims arising after the insolvency proceedings	In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings

This figure shows that the four legal systems still entail major differences. United States and France legal systems are very similar, except on the effects of the continuation of an executory contract when the debtor is in breach. Germany and Switzerland (under current law) are also very similar, except on the effects of the non-continuation of a contract. Indeed, in Germany, when the trustee or the debtor in possession decides not to continue a contract, the contract terminates automatically, whereas, in Switzerland, such a decision has no impact on the existence of the contract.[318]

From a policy perspective, my "Best Model" would be:

(i) Invalidity of *ipso facto* clauses in insolvency proceedings.

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[316] *But see* draft LP art. 297a.

[317] The "Best Model" row conveys my opinion as to which options are most sound from a policy perspective.

[318] *See supra* p. 40.

(ii) In case of a continuation of a (executory) contract by the trustee or the debtor in possession, the estate becomes liable only for the performance of the claims arising after the insolvency proceedings.

(iii) In case of a rejection of a (executory) contract by the trustee or the debtor in possession, the estate becomes liable only for the performance of the claims arising after the insolvency proceedings. In other words, any damages arising from the rejection of a pre-commencement contract should be treated as (unsecured) pre-petition claims. The requirement of an approval of the supervisory judge to reject a (executory) contract might provide a safeguard against excessive rejection by the debtor if the (equitable) balancing approach is adopted, i.e., the supervisory judge would not permit the trustee or the debtor in possession to reject a (executory) contract when the damage caused to the counterparty from rejection would be disproportionately greater than the benefit to the estate. The potential inefficiency of the right to reject (executory) contracts might also be mitigated by allowing the court to declare the filing of a bankruptcy abusive where the rejection was the sole objective of filing.

Thus, the recommendations of the UNCITRAL Guide, which correspond to 11 U.S.C. § 365, are sound from a policy perspective, except those relating to the effects of the continuation of a (executory) contract when the debtor is in breach (in case of a continuation of a (executory) contract by the trustee or the debtor in possession, the UNCITRAL Guide recommends that the estate becomes liable for the performance of the whole contract).

In my opinion, the French law is the most effective legal system from a policy perspective. Indeed, it is the only legal system that applies my "Best Model" in its entirety. This is also due to a recent effort of the French legislature to improve its insolvency law in order to assist the rehabilitation of the debtor and to ensure that the treatement of (executory) contracts does not violate the fundamental bankruptcy principle of equality of treatment.