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

Fabrice Robert-Tissot∗

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.

∗ Doctor of Laws, LL.M. (Columbia), Attorney-at-law (Switzerland).

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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 1995² 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-

² Available at http://aei.pitt.edu/2840/ (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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\(^7\) CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE].


("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. 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”). 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);

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

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

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.
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).


\(^{24}\) 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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\(^{28}\) *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).


§ 365(e)(1) expressly invalidates *ipso facto* clauses. 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.

The French Code de Commerce also expressly invalidates *ipso facto* clauses. Indeed, C. COM. art. L. 622-131 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.\(^{34}\)

\(^{31}\) 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 COLLE\^R 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).


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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\(^35\) 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).


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) nonbankruptcy 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-


\(^{41}\) 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]n 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).
nder applicable nonbankruptcy law. 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. 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.

(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. However, the termination is not automatic: 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), should simply be to preserve the status quo until the court decides whether 11 U.S.C.

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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.”
47 1 Collier Bankruptcy Manual, supra note 27, ¶365.07.
§ 365(e)(2) is applicable. If so, the automatic stay should be vacated.

Special provisions also protect contractual rights to terminate swap agreements, certain securities contracts, commodities contracts and forward contracts, and repurchase agreements.

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 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 or the debtor in possession’s 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.

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.
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.
lines on this controversial issue, but tends to uphold *ipso facto* clauses.

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

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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.


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 consent of the trustee during the automatic stay.

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

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.

proceedings, 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.

First, ipso facto clauses shall comply with the mandatory substantive law. For instance, the termination of an employment contract concluded for a fixed period of time cannot be made dependant upon the fulfillment of a condition subsequent if the time of fulfillment of this condition is uncertain or depends unilaterally on the intent of the employer. 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).


Marchand, supra note 67, at 38. 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. See CO art. 334.

72 See CO art. 154.

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 estate76 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 effect78 in order to claim assets against the estate on which the for-


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 intermédiaires [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.


78 See CO art. 154 para. 2.
mer lost his property right with the adjudication of bankruptcy or the confirmation of a reorganization with assignment of assets.

German law and the Swiss law also provide that certain types of contracts – mostly concluded *intuitu personae* – terminate automat-
ically in case of bankruptcy or insolvency. Thus, contrary to French law, these rules are still applicable (at least) in bankruptcy and insolvency proceedings. In Germany, these provisions are also applicable in an insolvency plan. 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?).

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

The previous comparative law study showed two opposing approaches: United States and France invalidate *ipso facto* clauses, whereas Germany 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, and b) it furthers the debtor’s rehabilitation. The
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 ...” 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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91 UNCITRAL Guide at 123, para. 118.
commit, i.e., the latter will make more efforts to avoid bankruptcy or reorganization proceedings.\textsuperscript{93} Second, with the validation of \textit{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 \textit{ipso facto} clause is present (\textit{ex ante} consequences).\textsuperscript{94}

Third, according to Yeon-Koo Che & Alan Schwartz,\textsuperscript{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 \textit{ex post} because his creditors have high coalition costs,\textsuperscript{96} the invalidation of \textit{ipso facto} clauses, coupled with the risk that the court may err in finding expectation damages, could lead to an \textit{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 \textit{ipso facto} clause, the debtor cannot behave opportunistically in a bankruptcy (or a reorganization).\textsuperscript{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\textsuperscript{98} and potential contractors might exploit this situation during the negotiation of new deals and behave opportunistically.\textsuperscript{99} Therefore, the right of the debtor to assume (executory) contracts – which is recognized by the four legal systems\textsuperscript{100} – is critical to the success of a reorganiz-

\textsuperscript{93} Che & Schwartz, \textit{supra} note 29, at 447-448, 454, 461-462.
\textsuperscript{94} \textit{Id.} at 447-448, 461.
\textsuperscript{95} \textit{Id.} at 452.
\textsuperscript{96} \textit{Id.} at 450.
\textsuperscript{97} \textit{Id.} at 453, 461-462.
\textsuperscript{99} See George G. Triantis, \textit{The Effects of Insolvency and Bankruptcy on Contract Performance and Adjustment}, 43 University of Toronto Law Journal 679, 706.
\textsuperscript{100} See \textit{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

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 continuance of a (executory) contract, (at

\(^{107}\) \textit{Uniform Commercial Code} [UCC] § 2-609 (West 2010). See Che & Schwartz, \textit{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 . . . ”).

\(^{108}\) \textit{Code Civil} art. 1613.


\(^{110}\) \textit{CO} arts. 83, 266h, 316, 337a, 392 para. 3.


\(^{113}\) 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-

\(^{114}\) 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. Indeed, as indicated by Pilgram, 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.

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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,\(^{129}\)

\(^{121}\) 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).
\(^{127}\) 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).
\(^{129}\) 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 Lilieberg 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 Borroto, 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. 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, the debtor in possession (with the assent of the court nominee), or the liquidator (in liquidation proceedings), 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.
Germany. Subject to certain express limitations, the trustee (in insolvency proceedings) or the debtor in possession (in an insolvency plan, with the assent of the trustee) may assume any contract. 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.

Switzerland. Subject to certain express limitations, 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. 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 or at the time of the confirmation of a plan with assignment of assets.

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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. 2**b** (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.

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 and whether the contract will be performed prior to continuation (or rejection). 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, or obtain an extension of time from the court, or the contract or lease will be deemed rejected. In Chapters 9, 11, 12, or 13 cases, the trustee or debtor in possession 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 shall decide. 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.

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.
148 Id.
or 13 cases, the trustee or the debtor in possession 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). For cases filed on or after October 17, 2005 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.

France. Once the counterparty has sent a formal notice to the trustee (or to the debtor in possession or the liquidator), 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. The one-month period to assume (or reject) begins running on the date of the receipt of the

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)).
156 Vallansan, supra note 134, para. 73.
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.
163 Vallansan, supra note 134, para. 130.
164 Id.
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. If the trustee does not give his statement, he shall no longer insist on the continuation of the contract. “Immediately” means without undue delay under BGB § 121 para. 1. 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. This (criticized) theory was modified in a decision rendered in April 25, 2002: 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”, i.e., as a “pending stage”). If the trustee decides not to continue the contract, then the respective obligations expire.

**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. 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.
170 See Graf & Wunsch, supra note 60, at 2120.
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,\textsuperscript{175} or even promptly.\textsuperscript{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).\textsuperscript{177} The duration of this time limit should not be fixed in accordance with the general rules on the default of an obligee,\textsuperscript{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.\textsuperscript{179}

\textsuperscript{175} FISCHER, supra note 65, at 210-211.

\textsuperscript{176} HANS FRITZSCHE & HANS ULRICH WALDER-BOHNER, SCHULDBETREIBUNG UND KONKURS NACH SCHWEIZERISchem RECHT – KONKURSRECHT, ARREST, MIEFE UND PACHT, PAULIANISCHE ANFECHTUNG, NACHLASSVERTRAG UND NOTSTUNDUNG, BESONDere ORDNUNGEN (BAND II) [DEBT ENFORCEMENT AND BANKRUPTCY UNDER SWISS LAW – BANKRUPTCY, FREEZING ORDERS, LEASES AND USURFRUCTUARY 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).

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

\textsuperscript{178} See CO art. 107 para 1.

\textsuperscript{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”, i.e., as a “pending stage”). Contrary to German law, when the trustee decides not to continue the contract, the respective obligations do not expire.

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 and in Switzerland, 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

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181  See supra p. 32.


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-
tion with assignment of assets or subsequent bankruptcy proceedings. Therefore, when the trustee (in an U.S. Bankruptcy, in a French safeguard 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 safeguard procedure), decide(s) to perform the contract, (at least) the future claims of the counterparty are treated as administrative expenses, i.e., the “estate” 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).

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

In the four legal systems, the claims of the counterparty are treated as administrative expenses in the event of the continuation of a (executory) contract, i.e., the “estate” 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.

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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 infra pp. 34 et seq.
200 See supra n. 115.
France. In a French safeguard 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.\textsuperscript{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.\textsuperscript{203}

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

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\textsuperscript{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, INSOLVENZ-SCHADENSTEUERRECHT, 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.

\textsuperscript{204}  LP arts. 211 para. 2, 262 para. 1.

\textsuperscript{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), 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, 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. This provision

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 [BLSK] 33, 65, 97, 129, 68-69 (1962) [hereinafter Böni, BLSK]; 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 [BB] [FEDERAL GAZETTE] 6507 (2010), Feuille fédérale suisse [FF] [FEDERAL GAZETTE] 5921 (2010), Oglìo 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.\textsuperscript{209}

\section*{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.\textsuperscript{210} In Chapters 7, 9, 11, 12, or 13 cases,\textsuperscript{211} the same result occurs for unexpired leases of non-residential real property of which the debtor is lessee.\textsuperscript{212} Such a rejection results in an (unsecured) pre-petition claim.\textsuperscript{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

\begin{footnotesize}
\begin{enumerate}
\item[211] 2 NORTON BANKR. L. & PRAC. 3D, supra note 45, § 46:13.
\item[212] 11 U.S.C. § 365(d)(4). See also 2 NORTON BANKR. L. & PRAC. 3D, supra note 45, § 46:34.
\end{enumerate}
\end{footnotesize}
bound, although the counterparty cannot file a (unsecured) pre-petition claim and participate in the distribution.\textsuperscript{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\textsuperscript{215} within one month of the automatic termination or the notification of the decision to terminate.\textsuperscript{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.\textsuperscript{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.\textsuperscript{218}

**Switzerland.** When the trustee or the debtor in possession decides not to continue a contract, the contract does not terminate automatically.\textsuperscript{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.\textsuperscript{220} Draft LP art. 211a para. 1 sentence 1 also provides that


\textsuperscript{215} C. COM. arts. L. 622-13 V sentence 1, L. 627-2.

\textsuperscript{216} C. COM. art. R. 622-21 para. 2. See also Vallansan, *supra* note 202, para. 146.

\textsuperscript{217} C. COM. arts. L. 622-13 V sentence 2, L. 627-2.

\textsuperscript{218} Graf & Wunsch, *supra* note 60, at 2120.


claims based on a long-term contract, due until the next possible
termination date of the contract or until the termination of the con-
tract, 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 con-
tractors 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 bank-
ruptcy 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

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 En-
forcement and Bankruptcy (LP) (Draft)], BUNDESBLATT [BBL] [FEDERAL
GAZETTE] 6507 (2010), FEUILLE FÉDÉRALE SUISSE [FF] [FEDERAL GAZETTE]
5921 (2010), OGGLIO 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, is sound under a policy perspective in particular for the following reasons:

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.

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-

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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 (\textit{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

\(^{229}\) \textit{Id.} at 19-22, 31.

\(^{230}\) \textit{Id.} at 23-24.

\(^{231}\) \textit{Id.} at 24-25, 28-31.

\(^{232}\) UNCITRAL Guide, Recommendation 79.

\(^{233}\) See UNCITRAL Guide, at 126, para. 130.
bankruptcy.\textsuperscript{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\textsuperscript{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 \textit{ipso facto} clauses,\textsuperscript{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.\textsuperscript{237} Therefore, it results from

\textsuperscript{234} In Swiss case law, see, e.g., Tribunal fédéral [TF] [Federal Supreme Court] Feb. 6, 2006, 4C.252/2005, \textit{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).

\textsuperscript{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 \textit{Alan Schwartz & Robert E. Scott, Commercial Transactions, Principles and Policies} 809-810 (The Foundation Press, Inc. 1982); Peter Coogan, \textit{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”.

\textsuperscript{236} See supra p. 22.

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 \textit{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 \textit{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


\(^{238}\) 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, 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) 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 contract. However, Swiss law will probably be revised on this point. More precisely, the four legal systems are as follows:

United States. A bankruptcy trustee or a debtor in possession may reject any executory contract or unexpired lease. The power to reject is subject to court approval with the exception of certain leases and contracts that are deemed rejected. 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), which is deemed to have occurred immediately before the filing of the petition. Thus, the rejection results in a (unsecured) pre-

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242 Brunetti-Pons, supra note 34, para. 13.
243 See supra note 19 et seq.
244 See also discussion about the rights and duties pending continuation or rejection of (executory) contracts supra note 28 et seq.
246 See also discussion about the definition of the terms “executory contract” supra p. 26.
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. 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.

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) at the request of the trustee or the debtor in possession (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).

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

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-Gled, 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.

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.

court nominee seems not to be required in this case), 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. The rejection of an executory contract may give rise to damages to the other party that may be filed as pre-petition claims within one month of the automatic termination or the notification of the decision to terminate. 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.

**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 or employment contracts. However, when the trustee or the debtor in possession decides not to continue the contract, the respective obligations expire.

**Switzerland.** Swiss law does not confer upon the trustee or the debtor in possession a right to reject contracts. 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.


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

259 See C. COM. art. R. 622-21 para. 2.


261 See Inso §§ 109, 279.

262 See Inso §§ 113, 279.

263 See supra p. 31.

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), 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. 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. 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.

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

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

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\[265\] 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), OGILIO 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), OGILIO FEDERALE SVIZZERO [FF] [FEDERAL GAZETTE] 5667, 5677, 5699 (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 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 contract275 and damages from rejected contracts276 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

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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{279} Triantis admits that such a proposition would contradict the principle of equality in bankruptcy and impair the prospects of successful rehabilitation.\textsuperscript{280} Furthermore, it would also violate the above-mentioned\textsuperscript{281} principle that the treatment of (executory) contracts should mirror the priorities in the non-bankruptcy world.\textsuperscript{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 . . . ”\textsuperscript{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.\textsuperscript{284} However, according to Triantis, bankruptcy law violates this principle with respect to several claims arising during the bankruptcy proceedings.\textsuperscript{285} For instance, in the United States, tort claims arising from accidents during the automatic stay bind the estate,\textsuperscript{286} with the result that the insolvent firm fully internalizes the costs of its negligent behavior.\textsuperscript{287} Thus, the benefits from creating optimal breach incentives potentially outweigh the costs resulting from forum shopping

\[\text{See also Fried, supra note 98, at 531-532.}\]
\[\text{See Id., at 532-533.}\]
\[\text{Triantis, supra note 99, at 696 et seq. On this proposition, see also Fried, supra note 98, at 545-547.}\]
\[\text{Triantis, supra note 99, at 696.}\]
\[\text{The counterparty is an unsecured creditor. Therefore, she should not be entitled to higher priority in a bankruptcy or a reorganization (see supra p. 44).}\]
\[\text{Triantis, supra note 99, at 696.}\]
\[\text{Id.}\]
\[\text{Id. at 698.}\]
\[\text{Id. at 696.}\]
\[\text{Triantis, supra note 99, at 696-697, 699.}\]
opportunities.\textsuperscript{288} The creation of optimal breach incentives is even more valuable where the (executory) contract involves relationship-specific investments, because the non-debtor incurs additional costs when the debtor behaves opportunistically.\textsuperscript{289} According to Triantis, the bankruptcy law treatment of the debtor and the non-debtor is also unbalanced: it encourages termination and facilitates adjustment of the contract by the debtor, while it deters such a termination and adjustment 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 treatment between the debtor and the non-debtor.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{294} The treatment of (executory) contracts should also mirror the priorities in the non-bankruptcy world: as indicated above,\textsuperscript{295} the non-debtor is an unse-

\textsuperscript{288} Id. at 696, 699.
\textsuperscript{289} See Id. at 690, 697-698.
\textsuperscript{290} Id. at 705 et seq.
\textsuperscript{291} Id. at 706-708, 710.
\textsuperscript{292} See also in the United States: JACKSON, supra note 237, at 108-109; Westbrook, supra note 131, at 252-253, 335-336.
\textsuperscript{293} Fried, supra note 98, at 546.
\textsuperscript{294} See under Swiss law: ROBERT-TISSOT, supra note 86, paras. 621, 624-625, 654-656, 743-744, 797.
\textsuperscript{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, which would clearly violate the principle of equality of distribution. 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, 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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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 adjusts 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

\(^{299}\) 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.
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; GILLIERON, 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.\textsuperscript{303} Courts apply instead the (more deferential) predominant business judgement standard, which corresponds to the judicial review of corporate decisions outside bankruptcy.\textsuperscript{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.\textsuperscript{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).\textsuperscript{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.\textsuperscript{307} Such a


\textsuperscript{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

308 See also Mabillard, supra note 264, at 203-205.
310 See supra p. 22.
311 See supra p. 45.

III. Conclusion

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

<table>
<thead>
<tr>
<th></th>
<th>(In)validity of <em>ipso facto</em> clauses</th>
<th>Effects of the continuation of a (executory) contract when the debtor is in breach</th>
<th>Effects of a (eventual) rejection of a (executory) contract when the debtor is in breach</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>Invalidity</td>
<td>In case of a continuation of an executory contract, estate liable for the performance of the whole contract</td>
<td>In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
</tr>
<tr>
<td>France</td>
<td>Invalidity</td>
<td>In case of a continuation of an executory contract, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
<td>In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
</tr>
<tr>
<td>Germany</td>
<td>(Validity)(^{313})</td>
<td>In case of a continuation of a contract, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
<td>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})</td>
</tr>
</tbody>
</table>

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\(^{313}\) This issue is highly controversial in Germany. See *supra* p. 13.

\(^{314}\) See Inso §§ 109, 279.

\(^{315}\) See Inso §§ 113, 279
<table>
<thead>
<tr>
<th></th>
<th>Validity</th>
<th>Under current law,(^{316}) no general right of the trustee or the debtor in possession to reject a contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>In case of a continuation of a contract, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
<td></td>
</tr>
<tr>
<td>UNICITRAL</td>
<td>In case of a continuation of a (executory) contract, estate liable for the performance of the whole contract</td>
<td>In case of a rejection, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
</tr>
<tr>
<td>Best Model(^{317})</td>
<td>In case of a continuation of a (executory) contract, estate liable only for the performance of the claims arising after the insolvency proceedings</td>
<td></td>
</tr>
</tbody>
</table>

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 treatment of (executory) contracts does not violate the fundamental bankruptcy principle of equality of treatment.