

LEASES AND EXECUTORY CONTRACTS IN CONSUMER BANKRUPTCY CASES

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INTRODUCTION

Many attorneys think handling leases and executory contracts in consumer bankruptcy cases is simple. You either assume it in which case the debtor performs as if there was no bankruptcy, or the debtor rejects it in which case the creditor has an unsecured claim which will be paid or not, depending on the funds available in the case. Simple.

But such a rudimentary understanding of leases and executory contracts glosses over a number of complex and often contradictory issues with regard to these claims. Is it really a lease or is it a security agreement? Can a Chapter 7 debtor just assume a lease or does she need to reaffirm the obligation as well? Can a Chapter 13 debtor assume an executory contract or lease in a Chapter 13 Plan or is something else required? What are the post-confirmation consequences of assuming a lease? Can a lessor evict a lessee in bankruptcy at the end of the lease term? Indeed, leases and executory contracts can raise a host of issues too numerous to cover in anything less than a book, but this paper will attempt to “hit the highlights” with regard to issues which arise in consumer cases - especially Chapter 7 and Chapter 13 cases - with regard to leases and executory contracts.

STATUTE AND PURPOSE

The primary Code section with regard to executory contracts and unexpired leases is 11 U.S.C. §365. (See Appendix “A”).

Purpose of Statute

¹ Portions of this paper are adapted from the Civil Resource Manual of the United States Department of Justice, Parts 59 & 60 (www.justice.gov/jm/civil-resource-manual-59-executory-contracts-bankruptcy)

The main purpose of §365 is to relieve the debtor of burdensome obligations, while at the same time providing a means whereby the debtor can force others to continue to do business with it when the debtor's bankruptcy filing might otherwise make them reluctant to do so. *In re Chateaugay Corp.*, 10 F.3d 944, 954-955 (2nd Cir. 1993). The estate's election to assume a contract or lease under Section 365 entitles the other contracting party to assert its claims on a priority basis. *Id.* at 955.

Assumption is in effect a decision to continue performance. It requires the debtor to cure most defaults and continues the parties' rights to future performance under the contract or lease. Rejection is in effect a decision to breach the contract or lease. ... In the event of rejection, the non-debtor party is generally relegated to pursuing an unsecured prepetition claim against the estate. ... Where assets of the estate are insufficient to pay unsecured creditors in full, the non-debtor party to a rejected executory contract, like other unsecured creditors of the estate, may receive only a fraction of the value of its claim. ... [A]n executory contract [i]s one "on which performance remains due to some extent on both sides[.]"

Total E&P USA, Inc. v. Marubeni Oil & Gas (USA) Inc., 393 F.Supp.3d 515, 534 (S.D.Tex. 2018), citing *In re Penn Traffic Co.*, 524 F.3d 373, 378-79 (2nd Cir. 2008).

[T]he main purpose of Section 365 is to allow a debtor to reject executory contracts in order to relieve the estate of burdensome obligations while at the same time providing "a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so." ... "In short, § 365 permits the trustee or debtor-in-possession, subject to the approval of the bankruptcy court, to go through the inventory of executory contracts of the debtor and decide which ones it would be beneficial to adhere to and which ones it would be beneficial to reject."

Id. at 534-535. As another court stated: "Thus, the purpose of Section 365(d)(4) is to protect lessors from delay and uncertainty by forcing the trustee or debtor-in-possession to act quickly to assume unexpired leases. *Id.* at 851. On the other side of the equation, to ensure that the bankrupt estate is not unwittingly burdened with liabilities, an affirmative act of assumption by the trustee is required to bring executory contracts and unexpired leases into the estate. *In re Lovitt*, 757 F.2d 1035, 1041 (9th Cir.1985), *cert. den. sub. nom. Cheadle v. Appleatchee Riders Association*, 474 U.S. 849, 106 S.Ct. 145, 88 L.Ed.2d 120 (1985)." *In re Moreggia & Sons, Inc.*, 852 F.2d 1179 (9th Cir. 1988).

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