

1991

# H. Le Roy Cobabe v. Garth and Edward Stanger : Reply Brief

Utah Supreme Court

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## Recommended Citation

Reply Brief, *H. Le Roy Cobabe v. Garth and Edward Stanger*, No. 910090.00 (Utah Supreme Court, 1991).  
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DOCKET NO: 910090

UTAH SUPREME COURT  
BRIEF

IN THE SUPREME COURT OF THE STATE OF UTAH

H. LeROY COBABE,

Plaintiff and Appellant,

vs.

GARTH STANGER and EDWARD  
STANGER,

Defendants and Appellees.

Case No. 910090

Category 16

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REPLY BRIEF OF APPELLANT

ON APPEAL FROM THE FIFTH JUDICIAL DISTRICT COURT  
FOR THE STATE OF UTAH  
THE HONORABLE J. PHILIP EVES

---

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**FILED**

SEP 13 1991

CLERK SUPREME COURT  
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## INTRODUCTION

The issue presented by this appeal requires a determination as to the enforceability of the Consulting Agreement (the "Agreement") entered into between Appellant, H. LeRoy Cobabe ("Cobabe") and Appellees, Garth and Edward Stanger ("Stangers"). The question of whether an agreement is enforceable can entail a very broad inquiry. However, in the instant case, the inquiry is limited to the application and interpretation of 11 U.S.C. § 365.

In response to Cobabe's Complaint seeking enforcement of the Agreement, Stangers imposed as a defense Section 365 of the United States Bankruptcy Code. No other legal arguments were raised by Stangers in their Motion for Summary Judgment or in their response to Cobabe's Motion for Summary Judgment and there is no factual question as to whether Cobabe breached the terms of the Agreement. Cobabe's Affidavit states unequivocally that he has performed according to the terms of the Agreement and Stangers have not contradicted this.<sup>1</sup> Therefore, unless § 365 somehow excuses Stangers' performance under the Agreement, the Agreement continues to be enforceable and this Court must reverse the Summary Judgment entered in favor of Stangers.

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<sup>1</sup>While Stangers' statement that Cobabe has performed no services for them since the filing of his petition is accurate, this fact does not constitute a default under the Agreement. The Agreement only requires that Cobabe be available to perform consulting and advisory services at the request of Stangers. At no time since the filing of the bankruptcy petition have the Stangers requested that Cobabe perform consulting services. Likewise, Stangers' vague references to Cobabe's obligation to indemnify Stangers regarding tax liabilities are without foundation. There is absolutely no evidence in the record to indicate that Cobabe has breached the indemnification covenants of the Agreement, nor was this issue even raised by Stangers' Answer and Counterclaim.

## I.

Stangers have expounded two arguments in support of their position that 11 U.S.C. § 365 prohibits the enforcement of the Agreement. First, Stangers argue that Cobabe failed to comply with the requirements of § 365 and is therefore barred from seeking enforcement of the Agreement. Second, they submit that the trustee's rejection of the Agreement pursuant to § 365 constitutes a termination of the Agreement.

As to the first argument, Stangers suggest that Cobabe was somehow remiss in that he did not comply with the requirements of § 365. Cobabe, as a debtor, is not required, in fact, is not allowed, to take any action under § 365. Once a Chapter 7 case is filed, only the trustee can assume or reject a contract under § 365. Stangers assert that § 365 is the exclusive statutory framework governing the rights of both the debtor and the non-debtor party to the contract. On the contrary, § 365 regulates the rights and obligations as between the trustee and the non-debtor party to the contract. Subsection (a) states that the trustee may assume or reject an executory contract; subsection (b) sets forth the conditions under which a trustee may assume a contract; and so on. Section 365 is silent as to the relationship between the debtor and the non-debtor party to the contract and with good reason. If the trustee does not assume an executory contract, it does not become property of the estate. If the contract is not property of the estate, it is outside the parameters of the bankruptcy administration and

the contractual relationship between the debtor and the non-debtor is therefore not an appropriate subject for bankruptcy legislation.

Stangers' speculations regarding Cobabe's option to file a Chapter 11 case and the possible scenarios that may have occurred if the Chapter 7 trustee had deemed it appropriate to assume the contract, are simply irrelevant. Cobabe's personal earnings from services performed post-petition would not be property of a Chapter 11 bankruptcy estate. 11 U.S.C. § 541(a)(6). Further, why would the Chapter 7 trustee want to assume a contract that would obligate him to perform consulting services for Stangers and why would the Stangers consent to such an assumption? Why would the Stangers want advice from a trustee who most likely would have no expertise in the area of car dealerships and marketing in St. George, Utah?

Stangers also claim that it is inequitable to allow Cobabe to obtain a discharge of his debts and obligations but still allow him to compel Stangers' performance under the terms of the Agreement. Stangers' equitable concerns are misplaced because Cobabe was discharged of pre-petition debts and obligations only. 11 U.S.C. §727(b). Any post-petition obligations, including his obligations under the Agreement, continue to be enforceable. The case cited by Stangers, In re Executive Technology Data Systems, 79 B.R. 276 (Bankr. E.D. Mich. 1987), holds that a rejecting trustee cannot compel performance by the other party to the contract. Cobabe has no quarrel with this position. To allow such lopsided enforcement certainly would "offend basic

principles of equity and mutuality of obligation". Id. at 282. By rejecting an executory contract, the trustee absolves the estate from any performance obligations under the contract. The trustee can hardly expect the other party to the contract to comply with its contractual obligations where the trustee had indicated that he will not do the same.

The fact situation in the present case is markedly different. While there is no question that the trustee has rejected the Agreement, the trustee is not the party seeking to enforce the Agreement. Cobabe, who has always performed under the terms of the Agreement and who has never repudiated the Agreement, is asking that Stangers live up to their end of the bargain. There is nothing inequitable in this request and there is nothing that Cobabe need do under the terms of § 365 in order to obtain the benefit of his bargain.

## II.

As a second argument, Stangers submit that the rejection of an executory contract by the trustee pursuant to § 365 results in a termination of the contract. While there is some case law to support such an interpretation, the plain statutory language of § 365 is contrary to such a conclusion. Section 365(g)(1) provides: "[t]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease ... immediately before the date of the filing of the petition." The statute does not state that rejection constitutes a termination of the contract. There is absolutely no language in § 365(g) that equates rejection with termination.



As a matter of law, there is a very real distinction between breach and termination. This distinction is discussed in the case of In re Storage Technology Corporation, 53 B.R. 471 (Bankr. D.Colo. 1985), where the court held that the rejection of an unexpired lease did not have the effect of terminating the lease. Citing Matter of Garfinkle, 577 F.2d 901 (5th Cir. 1978), the Colorado Bankruptcy Court stated that termination of a lease is a totally separate legal issue from rejection. Id. at 474.

The Court went on to explain that breach of a lease is not synonymous with termination of a lease and that a review of § 365 indicates that the two words were intended to have different meanings. Where Congress intended to provide for termination as a result of rejection, it did so very ably. Subsections (h) and (i) provide specific protections for the non-debtor party to an agreement where the debtor is the lessor of real property or the seller of a timeshare interest and the debtor rejects the lease or the executory contract to sell. These subsections provide that upon the trustee's rejection, the non-debtor party to the lease or contract may "treat such lease or timeshare plan as terminated by such rejection". Clearly, the drafters of § 365 knew the difference between breach and termination. While the rejection of a lease or contract is deemed to be a breach of the agreement, the rejection does not constitute a termination of the agreement. The concept of rejection as termination applies only to the limited situations stated in subsections (h) and (i). Had the drafters intended rejection to

trigger a termination of all contracts and leases under § 365, they certainly could have written such a provision.

It is not the purpose of § 365(g) to effect a termination of rejected contracts. Rather, § 365(g) provides a mechanism for allowing and classifying the non-debtor party's claim for damages. Until rejection, the contract continues in effect and the non-debtor party to the contract is not a creditor with a provable claim. In re Cochise College Park, Inc. 703 F.2d 1339 (9th Cir. 1983) at 1352. If the trustee assumes the contract, he must cure all defaults and the non-debtor party would have no claim for damages. If the trustee rejects, subsection (g) makes it clear that any claim asserted for damages will be treated as a general unsecured claim, as though it arose immediately before the filing of the petition even though the rejection by the trustee occurred post-petition.

Stangers cite two cases, In re Giles Associates, Ltd., 92 B.R. 695 (Bankr. W.D. Tex. 1988) and In re Gillis, 92 B.R. 461 (Bankr. D. Haw. 1988), for the proposition that rejection of a lease results in the termination of the lease. First, it should be noted that the leases in these cases covered nonresidential real property and that the courts were analyzing the specific provisions of § 365(d)(4). Subsection (d)(4) gives the trustee a 60 day deadline within which to assume or reject a lease of nonresidential real property. If the trustee does not act within that time period, the lease is deemed rejected and the trustee is required to immediately surrender the property to the lessor. This subsection,

dubbed the "shopping center" amendment, was enacted as part of the 1984 Bankruptcy Amendments and Federal Judgeship Act, was the result of extensive lobbying efforts by lessors of such facilities and applies only to nonresidential real property leases.

In concluding that the trustee's rejection works a termination of the lease, both Giles and Gillis rely heavily on the specific language of subsection (d)(4) requiring the trustee to surrender the property. The courts reasoned that such a surrender was tantamount to a termination. See Giles, 92 B.R. 695 at 698. While subsection (d)(4) gives lessors of nonresidential real property a unique remedy, it does not, by its terms, operate as a termination of the lease.

The logic of the Giles and Gillis opinions is faulty in linking surrender to termination, particularly when contrasted with the language of subsections (h) and (i) which specifically provide for termination of an agreement upon the trustee's rejection. In any event, § 365(d)(4) is not applicable to the subject Agreement which is a personal service contract, not a nonresidential lease of real property.

An executory contract to provide personal services continues to be effective as between the Chapter 7 debtor and the non-debtor party to the contract, notwithstanding the automatic rejection of the contract by the trustee. In re Tonry, 724 F.2d 467 (5th Cir. 1984). In Tonry, the 5th Circuit Court ruled that the contingent fee agreements between an attorney (the Chapter 7 debtor) and his clients were not affected by the trustee's rejection. Until the trustee assumes an executory contract, it does not become

part of the bankruptcy estate. Id. at 469. Because the Tonry trustee could not assume the personal service contract, it was deemed rejected. However, this did not result in a termination of the agreement as between the debtor and his clients. This case squarely fits the facts presented by the transaction between Cobabe and Stangers and the Chapter 7 trustee's subsequent rejection. By applying the Tonry reasoning to the instant case, the Court must conclude that the Agreement between Cobabe and Stanger continues to be an enforceable agreement.

Stangers represent to the Court that the case of In re Calder, 94 B.R. 200 (Bankr. D. Utah 1988) is a reliable indicator of the federal judiciary's view of executory contracts. The Bankruptcy Court's one line comment in Calder concerning executory contracts was clearly outside the parameters of the issue presented to the Court. The only issue before Judge Allen was a determination as to the scope of 11 U.S.C. § 541; i.e., were certain checks property of the bankruptcy estate. Obviously, the question of rejection of executory contracts was not presented to nor considered in any detail by the Court. There was no reason to do so inasmuch as it was not the focus of the court's inquiry. The court's sweeping statement that a debtor filing a chapter 7 liquidation case automatically severs a personal service contract is simply incorrect. A personal service contract may be assumed, under certain circumstances, by the trustee. However, the rejection of such a contract may occur at any time during the case, up to the statutory deadline of 60 days. If the contract were severed at the time of the filing, it would be

impossible for a trustee to subsequently assume it. This Court should consider the Calder case for what it is: an analysis of § 541 which has no applicability to the present question regarding executory contracts.

Stangers would have this Court believe that the federal judiciary is unanimous in ruling that rejection of an executory contract constitutes a termination of the contract. Such is not the case. Cobabe's briefs have cited and discussed several cases that specifically reject this argument. None of the cases cited by Stangers considered the history of executory contracts or the structure of the Bankruptcy Code as a whole in reaching the conclusion that rejection equals termination. The better reasoned decisions analyze the statutory language of § 365 and acknowledge the distinction between rejection and termination. None of the cases cited by Stangers involved a fact situation where the trustee had rejected a contract but the debtor had continued to perform under the contract and was seeking a corresponding performance from the non-debtor party. Section 365 was never intended to be used as an excuse for nonperformance by the non-debtor party to the contract nor does it confer upon the trustee the right to repudiate a contract. In re Knight, 8 B.R. 925 (Bankr. D. Md. 1981).

### CONCLUSION

This Court need not overrule federal case law in order to reverse the judgment of the District Court. The facts of the cases relied upon by Stangers are so

disparate from those presented by this appeal that the holdings simply do not apply to the instant case. To the extent that the cases purport to apply the "termination" argument to a situation beyond what was presented to the court, the language is dicta and not controlling nor binding on this or any other Court. The Fifth Circuit, as well as several bankruptcy courts, have found that an executory contract continues to be enforceable as between the debtor and the non-debtor party to the contract notwithstanding the trustee's rejection of the contract.

A logical reading of § 365 demands a ruling in favor of Cobabe. It would be highly inequitable to allow Stangers to ignore their contractual obligations with impunity. But the Court need not rely on equity in order to enforce the Agreement. The proper statutory interpretation of § 365 mandates a result that comports with equity. Based upon such an interpretation, this Court should reverse the Summary Judgment in favor of Stangers and order the entry of Summary Judgment in favor of Cobabe.

DATED this 12<sup>th</sup> day of September, 1991.

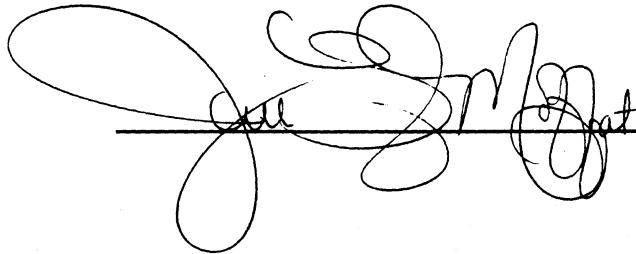
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### CERTIFICATE OF MAILING

I hereby certify that I caused to be mailed, postage prepaid, a true and correct copy of the foregoing Reply Brief of Appellant to the following on this 12<sup>th</sup> day of September, 1991:

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A handwritten signature, likely of Joel T. Marker, is written over a horizontal line. The signature is stylized and cursive.