

1991

# H. LeRoy Cobabe v. Garth and Edward Stanger : Brief of Appellant

Utah Supreme Court

Follow this and additional works at: [https://digitalcommons.law.byu.edu/byu\\_sc1](https://digitalcommons.law.byu.edu/byu_sc1)



Part of the [Law Commons](#)

Original Brief Submitted to the Utah Supreme Court; digitized by the Howard W. Hunter Law Library, J. Reuben Clark Law School, Brigham Young University, Provo, Utah; machine-generated OCR, may contain errors.

Carolyn Montgomery; Parsons, Behle & Latimer; attorney for appellant.

William Thomas Thurman; McKay, Burton & Thurman; attorneys for appellees.

---

## Recommended Citation

Brief of Appellant, *H. LeRoy Cobabe v. Garth and Edward Stanger*, No. 910090.00 (Utah Supreme Court, 1991).  
[https://digitalcommons.law.byu.edu/byu\\_sc1/3446](https://digitalcommons.law.byu.edu/byu_sc1/3446)

This Brief of Appellant is brought to you for free and open access by BYU Law Digital Commons. It has been accepted for inclusion in Utah Supreme Court Briefs by an authorized administrator of BYU Law Digital Commons. Policies regarding these Utah briefs are available at [http://digitalcommons.law.byu.edu/utah\\_court\\_briefs/policies.html](http://digitalcommons.law.byu.edu/utah_court_briefs/policies.html). Please contact the Repository Manager at [hunterlawlibrary@byu.edu](mailto:hunterlawlibrary@byu.edu) with questions or feedback.

UTAH  
DOCUMENT  
KFU  
45.9  
\$9  
DOCKET NO.

BRIEF.

910090

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

---

**BRIEF OF APPELLANT**

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

---

CAROLYN MONTGOMERY (#2297)  
of and for  
PARSONS BEHLE & LATIMER  
Attorneys for Appellant  
Utah One Center  
201 South Main Street, Suite 1800  
Salt Lake City, Utah 84111  
Telephone: (801) 532-1234

WILLIAM T. THURMAN  
McKAY, BURTON & THURMAN  
Attorneys for Appellees  
10 East South Temple, Suite 1200  
Salt Lake City, Utah 84133  
Telephone: (801) 521-4135

**FILED**

**JUL 18 1991**

**CLERK SUPREME COURT,  
UTAH**

H. LeROY COBABE,	)
	)
Plaintiff and Appellant,	)
	)
vs.	)
	)
GARTH STANGER and EDWARD	)
STANGER,	)
	)
Defendants and Appellees.	)

Case No. 910090  
  
Category 16

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

**WILLIAM T. THURMAN**  
**McKAY, BURTON & THURMAN**  
**Attorneys for Appellees**  
**10 East South Temple, Suite 1200**  
**Salt Lake City, Utah 84133**  
**Telephone: (801) 521-4135**

## TABLE OF CONTENTS

<b>STATEMENT OF JURISDICTION</b>	
.....	1
<b>STATEMENT OF ISSUE PRESENTED FOR REVIEW AND STANDARD OF REVIEW</b>	
.....	1
<b>STATUTORY PROVISIONS</b>	
.....	1
<b>STATEMENT OF THE CASE</b>	
.....	2
<b>STATEMENT OF FACTS</b>	3
<b>SUMMARY OF ARGUMENT</b>	8
<b>ARGUMENT</b>	9
<b>CONCLUSION</b>	20

## TABLE OF AUTHORITIES

### CASES

<u>Copeland v. Stephens</u> , 106 Eng. Rep. 218 (K.B. 1818) . . . . .	11
<u>In re Garfinkle</u> , 577 F.2d 901 (5th Cir. 1978) . . . . .	18
<u>In Re Knight</u> , 8 B.R. 925 (1981) . . . . .	17
<u>Transamerica Cash Reserve, Inc. v. Dixie Power &amp; Water, Inc.</u> , 789 P.2d 24 (Utah 1990) . . . . .	1
<u>United States Trust Co. v. Wabash W. Ry.</u> , 150 U.S. 287 (1893) . . . . .	12
<u>Watson v. Merrill</u> , 136 F. 359 (8th Cir. 1905) . . . . .	13

### STATUTES

11 U.S.C. § 365 . . . . .	1,3,9,10,18,19
11 U.S.C. § 365(a). . . . .	2,11
11 U.S.C. § 365(c). . . . .	19
11 U.S.C. § 365(d)(1). . . . .	2,13,19
11 U.S.C. § 365(g)(1). . . . .	2,8,14,15,16,17
11 U.S.C. § 525(b). . . . .	19
11 U.S.C. § 541. . . . .	10
11 U.S.C. § 554. . . . .	10
11 U.S.C. § 701. . . . .	10

### **STATEMENT OF JURISDICTION**

The Supreme Court has jurisdiction in this matter pursuant to Section 78-2-2(3)(j) Utah Code Ann. 1953, as amended.

### **STATEMENT OF ISSUE PRESENTED FOR REVIEW AND STANDARD OF REVIEW**

The issue presented for review is whether the District Court erred, as a matter of law, in holding that a Chapter 7 bankruptcy trustee's rejection of a debtor's executory contract, pursuant to § 365 of the United States Bankruptcy Code, results in the termination of all future rights and obligations of the debtor and non-debtor under the contract.

This issue was decided strictly as a matter of law. Therefore the district court's ruling is entitled to no deference and the issue must be decided independently on appeal. Transamerica Cash Reserve, Inc. v. Dixie Power & Water, Inc., 789 P.2d 24 (Utah 1990).

### **STATUTORY PROVISIONS**

The statutory provisions that are determinative to the Court's decision in this matter are the following:

11 U.S.C. § 365(a):

Except as provided in sections 765 and 766 of this title and in subsections (b)(c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

11 U.S.C. § 365(d)(1):

In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

11 U.S.C. § 365(g)(1):

Except as provided in subsection (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease- if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12 or 13 of this title, immediately before the date of the filing of the petition.

### **STATEMENT OF THE CASE**

On April 20, 1990, H. LeRoy Cobabe, Plaintiff and Appellant ("Cobabe") filed an action in the Fifth Judicial District Court against Garth and Edward Stanger, Defendants and Appellees ("Stangers"). The Complaint sought the enforcement of an Agreement for Consulting Services (the "Agreement" or "Contract") dated April 26, 1988. There being no dispute as to material facts, Cobabe filed a Motion for Summary Judgment on August 31, 1990 and Stangers subsequently filed a Cross-Motion for

Summary Judgment. Both Motions were heard by the Honorable Philip J. Eves on October 18, 1990. Judge Eves took the matter under advisement and later issued a Memorandum Decision granting Stangers' Motion for Summary Judgment and denying Cobabe's Motion for Summary Judgment. A copy of the Memorandum Decision is attached as Appendix "B" to this Brief. The Judge's decision was based solely upon his interpretation of § 365 of the United States Bankruptcy Code. An Order Granting Defendants' Motion for Summary Judgment and Dismissing the Complaint was entered and Cobabe then filed the instant appeal.

#### **STATEMENT OF FACTS**

1. On or about April 26, 1988, H. Leroy Cobabe ("Cobabe") and Garth Stanger and Edward Stanger ("Stangers") entered into an Agreement for Consulting Services (the "Agreement"). Defendants' Answer, paragraph 3 (Record at p. 10).

2. Pursuant to the Agreement, Cobabe agreed to perform consulting and advisory services on behalf of Stangers with respect to all matters relating to or affecting Stangers' acquisition of a dealer agreement with Toyota Motor Distributors, Inc. and Stangers' operation of a car dealership in St. George, Utah. A copy of the Agreement was attached to Plaintiff's Complaint and was also produced pursuant to Plaintiff's Response to Defendants' First Request for Admissions, Interrogatories and Request for Production of Documents. A copy of the Agreement is attached as Appendix "A" to this Brief.

3. Also pursuant to the terms of the Agreement, Stangers agreed to pay \$10,000.00 upon the execution of the Agreement, \$4,000.00 a month beginning May 1, 1988 and continuing on the first day of each month thereafter until September 1, 1988, at which time Stangers agreed to pay the sum of \$13,000.00. Then, beginning on October 1, 1988, and on the first day of each month thereafter, Stangers agreed to pay Cobabe the sum of \$4,000.00 until May 31, 1991, at which time the Agreement was to terminate. See Appendix "A".

4. Stangers paid the amounts as required by the terms of the contract up to and including the monthly payment for October 1, 1989. See Plaintiff's Affidavit, paragraph 2 (Record at p. 36).

5. On November 1, 1989, Cobabe filed a voluntary petition pursuant to Chapter 7 of the United States Bankruptcy Code. See Plaintiff's Reply to Counterclaim, paragraph 2 (Record at p. 30).

6. Just prior to the filing of the bankruptcy petition, a judgment creditor of Cobabe, Celia R. Snow ("Snow"), served Stangers with a Writ of Garnishment in an attempt to attach amounts owing to Cobabe under the Agreement. The Writ of Garnishment was served on October 15, 1989, after the October 1 payment had been made but before the November 1 payment was due. See Plaintiff's Affidavit, paragraph 3 (Record at p. 37).

7. When Cobabe made demand upon Stangers for the November 1, 1989 payment, Stangers refused to pay citing the Snow Writ of Garnishment. See Plaintiff's Affidavit, paragraph 4 (Record at p. 37).

8. Because of Stangers' refusal to pay, Cobabe was forced to file a Motion for Order Determining Validity of Garnishment with the Bankruptcy Court on December 14, 1989, seeking an order of the court determining that the Snow Writ of Garnishment was invalid as to post-petition earnings of Cobabe and that the post-petition earnings of Cobabe under the Agreement were not property of the bankruptcy estate but were the property of Cobabe personally and that he was entitled to receive the same. See Exhibit "B" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 61).

9. A hearing on the Motion was scheduled for December 21, 1989 and a Notice of Hearing was given to Snow and Stangers on December 14, 1989. See Exhibits "C" and "D" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 68 & 69).

10. Prior to the hearing, a Stipulation Regarding Writ of Garnishment was entered into between Cobabe and Snow whereby the parties agreed that the Writ had no force and effect as to Cobabe's post-petition earnings. An order of the court approving the stipulation was entered on December 21, 1989. See Exhibits "E" and "F" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (record at p. 71 and 73).

11. Stangers failed to appear at the hearing before the Bankruptcy Court on December 21, 1989. Based upon the proffer of evidence, the court found that amounts owed by Stangers to Cobabe on or after November 1, 1989 were not property of the bankruptcy estate but were instead post-petition earnings belonging to Cobabe in his

individual capacity. Based upon these findings, the court ordered Stangers to immediately pay over to Cobabe the funds representing post-petition earnings that were being held by Stangers. A copy of the proposed order was mailed to Stangers on December 21, 1989, and no objection to the form of the order having been filed, the court entered the order on January 5, 1990. See Exhibit "G" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 75).

12. A copy of the conformed order was sent to Stangers by the clerk of the court on January 5, 1990. However, Stangers ignored the order and refused to pay over to Cobabe those amounts ordered by the court. After repeated demands made personally by Cobabe, the Stangers continued to refuse to make payment and Cobabe was forced to file a Motion for Order to Show Cause with supporting affidavit. See plaintiff's Affidavit, paragraphs 7 and 8 (Record at p. 37 and 38). Based upon these pleadings, Judge Boulden issued an Order to Show Cause ordering Stangers to appear on February 1, 1990 and show cause why they should not be held in contempt for failure to obey the court's order of January 5, 1990. See Exhibits "H", "I" and "J" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 79, 82 and 84).

13. At the hearing on February 1, 1990, the court heard testimony from both Cobabe and Stangers. After considering the pleadings, the evidence and the arguments of counsel, the court entered an order finding that the conduct of Stangers constituted willful failure to abide by the court's previous order and ordered that Stangers

immediately pay to Cobabe, within 24 hours of the order, all amounts due and owing which represented post-petition earnings. Said order was entered February 2, 1990. See Exhibit "K" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 86).

14. Subsequently, Stangers filed a Motion to Stay Enforcement of Ruling on Contempt. This Motion was denied, although the court modified its prior order by ordering that Stangers pay the funds to Cobabe's counsel, who was to hold the funds for a period of five days to allow the bankruptcy trustee an opportunity to assert an interest in the funds if he determined that it was appropriate to do so. See Exhibit "L" to Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 90).

15. Pursuant to the February 2, 1990 order, Stangers paid to Cobabe's counsel the sum of \$20,300.00, representing monthly payments for November, December, January and February, plus attorneys' fees of \$300.00 as required by the Order. The trustee never asserted any interest in the funds and the funds were disbursed to Cobabe. See Plaintiff's Reply to Counterclaim, paragraph 5 and Plaintiff's Affidavit, paragraph 9 (Record at p. 31 and 38).

16. Stangers subsequently filed a Motion For Relief from Order and a supporting Memorandum, seeking to set aside the Bankruptcy Court's previous orders. While contesting the Stangers' Motion, Cobabe agreed that the state court would be an appropriate forum in which to resolve the dispute between the parties and on that basis alone agreed that the January 5, 1990 order could be vacated. See Exhibit "M" to

Memorandum of Points and Authorities in Support of Plaintiff's Motion for Summary Judgment (Record at p. 96).

17. Cobabe then filed this case in the Fifth Judicial District Court and Stangers raised as an Affirmative Defense the fact that Cobabe's bankruptcy trustee rejected the contract. See Answer and Counterclaim (Record at p. 11).

18. During the term of the Agreement, Cobabe at all times performed according to the Agreement and was not in breach of the Agreement, either before or after his bankruptcy filing. See Plaintiff's Affidavit, paragraph 10 (Record at p. 38).

#### **SUMMARY OF ARGUMENT**

The validity of the Agreement between Cobabe and Stangers is not affected by Cobabe's bankruptcy filing nor by the Chapter 7 Trustee's rejection of the Agreement. The trustee's rejection simply means that the Contract will not become part of the bankruptcy estate because the trustee has determined that it will not benefit the estate.

Section 365(g)(1) provides that a rejection of an executory contract constitutes a breach of the contract as of the filing of the bankruptcy petition. The rejection does not terminate the contract but only creates the fiction that the contract was breached as of the filing date in order to allow the non-debtor party to the contract to assert a claim against the bankruptcy estate.

The Bankruptcy Code does not allow a trustee to repudiate contracts. If an executory contract was valid and enforceable the day before a bankruptcy filing, it

continues to be enforceable, notwithstanding the trustee's rejection of the contract, so long as the debtor performs according to the terms of the contract.

## **ARGUMENT**

### **I. THE AGREEMENT FOR CONSULTING SERVICES BETWEEN COBABE AND STANGERS CONTINUES TO BE VALID AND ENFORCEABLE NOTWITHSTANDING THE REJECTION OF THE AGREEMENT BY COBABE'S CHAPTER 7 TRUSTEE.**

As described in the facts set forth above, Cobabe has been trying for almost two years to enforce the Consulting Agreement. For months Stangers ignored the bankruptcy process and Court Orders until found in contempt and ordered to perform their obligations under the Agreement. At no time during the bankruptcy proceeding did Stangers assert § 365 of the Bankruptcy Code (11 U.S.C. § 101 et. seq.) as a defense to Cobabe's efforts to enforce the Agreement. (All subsequent statutory references are to the United States Bankruptcy Code unless otherwise noted.) When Cobabe commenced the instant action in Fifth District Court, Stangers resisted Cobabe's efforts to collect by asserting a bankruptcy defense. Stangers asserted that because Cobabe's Chapter 7 trustee rejected the Consulting Agreement, the entire Agreement was terminated. Section 365 codifies the rights and obligations as between a trustee in bankruptcy and the non-debtor party to an executory contract or unexpired lease and allows the trustee to either assume or reject an executory contract of the debtor.

However, the section does not alter the rights and obligations as between the debtor and the non-debtor party to the contract.<sup>1</sup>

**A. A CHAPTER 7 TRUSTEE'S REJECTION OF THE DEBTOR'S  
EXECUTORY CONTRACT DOES NOT TERMINATE THE CONTRACT.**

To better understand the purpose and workings of § 365, it is helpful to have an overview of bankruptcy law. The basic premise of bankruptcy law involves the collection of the debtor's property by a disinterested third person who will administer it for the benefit of all creditors. The current Bankruptcy Code accomplishes this transfer by the creation of an estate upon the filing of a petition by or against the debtor. § 541. A trustee is then appointed to administer the assets of the estate by collecting and liquidating all property in which the debtor has an interest, unless the property is of inconsequential value or burdensome to the estate. §§ 554 and 701.

Creditors who have a right to payment from the debtor as of the date of the bankruptcy filing are entitled to a distributive share of the estate. The estate may have its own creditors as well; obligations or expenses incurred in the administration of the estate. These creditors are entitled to an administrative claim which carries with it a priority of payment ahead of the debtor's general creditors. Because the debtor's

---

<sup>1</sup>The parties agree that the subject Consulting Agreement is an executory contract within the meaning of the Bankruptcy Code. A generally accepted definition of an executory contract is one where the obligations of both parties are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.

personal liability is discharged in the bankruptcy process, any creditor's recovery is limited to a share of the distribution from the estate.

Within this scheme of bankruptcy administration, executory contracts have historically received unique treatment. Executory contracts pose a special problem to a bankruptcy trustee because they embody both an asset--the non-debtor's performance to be rendered, and a liability--the debtor's obligations under the contract. The Bankruptcy Code provides that the trustee may assume or reject any executory contract of the debtor. § 365(a). This ability to pick and choose is necessary in order to protect the estate from becoming burdened with additional liability. If the executory contract automatically passed into the estate in the same manner as all other property of the debtor, the estate would acquire an asset--the right to performance from the non-debtor party, but it would also become liable for the corresponding performance originally due from the debtor. Accordingly, the trustee is given the option to assume or not assume an executory contract depending upon which course of action will result in benefit to the estate.

The source of current executory contract doctrine is largely an English case, Copeland v. Stephens, 106 Eng. Rep. 218 (K.B. 1818). Copeland, a lessor of real property sued to recover rent from Stephens, an assignee of Copeland's original lessee. Stephens had gone into bankruptcy before the rent became due and argued that the leasehold interest had passed to his bankruptcy trustee.

The court concluded that the general bankruptcy assignment [for the benefit of creditors] "does not vest a term of years in the [bankruptcy] assignees, unless they do

some act to manifest their assent to the assignment as it regards the term, and their acceptance of the [leasehold] estate." Id. at 222.

The court held that the bankruptcy estate should be protected from the continuing liabilities of the debtor that would accompany a leasehold interest into the estate, unless the trustee specifically assented to the lease, as he might if the terms were favorable and outweighed the liabilities. The trustee therefore had the right to "assume or refuse" the lease. The debtor's interest in the lease never passed to the trustee because the trustee did not take any kind of affirmative action.

This principle was adopted by courts of the United States, including the United States Supreme Court in United States Trust Co. v. Wabash W. Ry., 150 U.S. 287 (1893):

The general rule applicable to this class of cases is undisputed that an assignee or receiver is not bound to adopt the contracts, accept the leases, or otherwise step into the shoes of his assignor, if in his opinion it would be unprofitable or undesirable to do so; and he is entitled to a reasonable time to elect whether to adopt or repudiate such contracts.

The Eighth Circuit Court of Appeals described the application of the law as follows:

The "effect [of an adjudication in bankruptcy] is to transfer to the trustee all the property of the bankrupt except his executory contracts, and to vest in the trustee the option to assume or to renounce these," but it "neither releases not absolves the

debtor from any of his contracts or obligations." Watson v. Merrill, 136 F. 359 (8th Cir. 1905). The Court further observed:

"Nor are those who contract with [the debtor] absolved from their obligations. If he or his trustee pays the stipulated rents for his place of residence or for his place of business, the lessors may not deny to the payor the use of the premises according to the terms of the lease." Id. at 363.

In reviewing these principles, it becomes obvious that the defendants have misunderstood and are attempting to misapply the law regarding executory contracts. The confusion seems to stem from the use of the word "reject" in the statute. As previously discussed, the Bankruptcy Code gives to the trustee the option to assume or reject an executory contract. And, in a Chapter 7 case, if the trustee does not assume the contract within 60 days of the entry of the order for relief, the contract is deemed rejected. § 365(d)(1). But a rejection by the trustee, either by direct action or by operation of law, does not terminate the contract.

To "reject" a contract is simply an election by the trustee, either expressly or by inaction, to leave matters as they are. The trustee, by rejecting, declines the contract as an asset of the estate and prevents the estate from becoming obligated pursuant to the terms of the contract. The debtor's obligations are unaffected.

**B. A CHAPTER 7 TRUSTEE'S REJECTION OF THE DEBTOR'S EXECUTORY CONTRACT CONSTITUTES A BREACH OF THE CONTRACT ONLY FOR THE PURPOSE OF ALLOWING THE NON-DEBTOR PARTY TO THE CONTRACT TO ASSERT A CLAIM AGAINST THE ESTATE.**

The defendants have relied upon the language of §365(g)(1) which provides that the rejection of an executory contract constitutes a breach of such contract as of the date of the petition. The linking of the word "rejection" and "breach" in this context has engendered much confusion, but can be understood by again analyzing the purpose and history of the bankruptcy laws.

As mentioned above, historically, only those creditors with claims against the debtor, as of the date of the petition, could assert a claim against the bankruptcy estate. And the purpose of the "assume or refuse" doctrine of executory contracts was to protect the estate from having to assume obligations on a contract or lease where there were no corresponding benefits to the estate.

However, this doctrine which protected the estate did not always adequately protect the non-debtor party to the contract. If the debtor was not in default at the time of the bankruptcy petition, the non-debtor party to the contract had no claim for damages against the debtor and therefore no claim against the estate. If the trustee subsequently decided not to assume the contract, there would be no administrative claim against the estate because the estate had no obligation under the contract. And if the debtor then breached the contract post-petition, the non-debtor party had no recourse against the debtor because the debtor received a discharge of his personal liability.<sup>2</sup>

---

<sup>2</sup>If the debtor had already breached the contract at the time of the filing, the non-debtor party would then be entitled to assert a claim against the estate. Even though the trustee subsequently rejects the contract, it is still deemed a breach of the contract as of the date of filing for purposes of asserting a

A creditor in this position was left with no remedy. To ameliorate this situation, the courts created the fiction that upon the filing of the petition, it would be assumed that the debtor would not perform under the terms of the contract. Thus, if in fact, the debtor failed to perform post-petition, the other party to the contract was entitled to a claim against the estate as a general unsecured creditor, as of the date of the filing of the petition, notwithstanding the fact that the actual breach may have occurred sometime later. If the trustee assumed the contract during the pendency of the bankruptcy, the estate itself became obligated to perform under the contract. In that case, the non-debtor party would not have a claim for non-performance but would be entitled to a contractual performance from the trustee. However, unless and until the trustee assumed the contract, the debtor still retained his rights under the contract and his ability to perform as well as demand performance.

The current Bankruptcy Code has incorporated this concept in § 365(g)(1) by providing that upon the trustee's determination that rejection of an executory contract is in the best interest of the estate, such rejection will relate back to the date of the bankruptcy filing and will be deemed a breach as of that time for purposes of allowing the non-debtor party to the contract to assert a claim against the estate. It must be emphasized that a rejection pursuant to §365 does not mean that the contract itself is

---

claim. § 365(g)(1) clarifies the timing of the breach in order that the rejection not be construed as a post-petition breach which would result in a priority claim. Instead, the damage resulting from the breach is treated as a general unsecured claim. In the instant case, there is no dispute that Cobabe at all times complied with the terms of the Agreement and that Cobabe was not in breach of the Agreement at the time of his bankruptcy filing.

rejected or repudiated. It means that the trustee will not assume the debtor's obligation to perform and that the non-debtor party to the contract can treat the contract as breached for purposes of asserting a claim against the estate.

Take, for example, a debtor who is obligated to produce and sell widgets under an executory contract. At the time of the bankruptcy filing, the debtor is current with its contractual obligations. After the filing of the bankruptcy petition, the trustee of the debtor's estate determines that the contract holds no benefit for the estate and therefore he rejects it. Subsequently, the debtor is unable to perform. In such a case, the other party to the contract is entitled to a claim for damages which can be asserted against the bankruptcy estate. The right to damages does not arise because the trustee rejected the contract, but because the debtor failed to perform under the terms of the contract. If the debtor had instead continued to perform under the contract, there would be no damages and the creditor would not have a claim against the estate, notwithstanding the trustee's "rejection". The language of § 365(g)(1) simply creates the fiction that whenever the breach occurs, it will be deemed to be effective as of the date of filing.

**C. § 365 OF THE BANKRUPTCY CODE DOES NOT GIVE A CHAPTER 7 TRUSTEE THE POWER TO REPUDIATE THE DEBTOR'S EXECUTORY CONTRACTS.**

Case law is replete with examples of debtors who are seeking to escape the obligations of their contracts, both executory and executed. And the Bankruptcy Code allows debtors to accomplish this by granting them a discharge. But where the debtor

wishes to perform, as in the instant case, the Bankruptcy Code does not provide an excuse for the non-debtor party to breach the contract.

In the case of In Re Knight, 8 B.R. 925 (1981), the Bankruptcy Court for the District of Maryland was faced with a similar situation where the Chapter 7 trustee did not assume the debtor's residential lease. The court considered the specific language of §365(g)(1) stating that the trustee's rejection of a lease was deemed to be a breach of the lease as of the date of the filing of the petition. The Court considered several interpretations of this language and determined that the trustee's rejection did not constitute a termination of the lease that would justify the landlord's nonperformance.

"[Such a reading] would adopt a policy that allows a landlord to evict tenants regardless of default solely on the basis that the tenant has sought relief under the Code. Such an inequitable result could not have been intended." Id. at 929. The court held that the landlord could not treat the lease as breached by the debtor based solely on the trustee's rejection.

The breach described in subsection (g)(1) is deemed a breach for the sole purpose of allowing the non-debtor party to the contract the legal opportunity to assert a claim against the estate. Such a rejection is not a cancellation of the contract and the non-debtor party must continue to honor the contract unless the debtor actually commits a breach of the lease or contract.

Similarly, where the debtor has pledged his rights under a lease, the trustee's rejection of the lease does not destroy the underlying leasehold estate. The rejection

merely puts the lease and its performance outside of the bankruptcy administration. In re Garfinkle, 577 F.2d 901 (5th Cir. 1978).

Bankruptcy law does not give a trustee the power to repudiate contracts. The trustee only has the ability to determine whether the estate should become liable under the terms of the contract in order to accede to its benefits. And bankruptcy law certainly does not give a non-debtor party to a contract the right to treat a contract as breached simply because the debtor has filed a petition.

The concepts set forth above include a general summary of the analysis contained in an article entitled "Executory Contracts in Bankruptcy: Understanding 'Rejection'", 59 U. Colo. L. Rev. 845 (1988), a thoughtful commentary on § 365, its history and application. Many of the ideas espoused in this Brief have been liberally borrowed from the article and counsel acknowledges said contribution as an important source for the work herein.

Allowing the District Court's construction of the statutory language to prevail would result in a grave injustice and would stand on its ear the bankruptcy policy of a fresh start for the debtor. If the non-debtor party to a contract or lease can treat the agreement as terminated regardless of the debtor's actual conduct, all debtors will be in jeopardy of losing their jobs and possibly their homes.

The Knight case illustrates the potential problem involved where a debtor has a residential lease of an apartment. In such a situation, there is no reason for a trustee to assume the lease because there could be no benefit to the estate. But can the landlord treat the lease as terminated upon the trustee's rejection when the tenant is in

compliance with the terms of the lease? Can the landlord evict the tenant based upon nothing more than a bankruptcy filing? The answer must be "No".

Unless the District Court decision is overturned, the same skewed result occurs in the employment arena. Obviously, a Chapter 7 trustee would not assume a debtor's employment contract. In most cases, he would be prohibited from doing because § 365(c) prohibits the assumption of personal service contracts. So if the trustee took no action, § 365(d)(1) would deem the contract rejected. To follow the lower court's reasoning to its logical conclusion, an employer could then refuse to pay an employee who had continued to work after filing bankruptcy asserting that the employment contract had been automatically severed by the filing of the bankruptcy case and the trustee's rejection. Such a result could never have been intended by the drafters of the Bankruptcy Code. In fact, such a result contravenes the proscription of § 525(b) which prohibits discrimination by a private employer because of an employee's bankruptcy filing.

In the instant case, the Consulting Agreement was an employment contract between Cobabe and Stangers. Even though Cobabe was denominated as an independent contractor and not legally an employee, the contract provided Cobabe with his only source of employment. To allow Stangers to repudiate their obligations under the Agreement when there has been absolutely no breach on the part of Cobabe flies in the face of reason and equity. Section 365 does not require such a result and this Court should not torture the statutory interpretation to reach such a result.

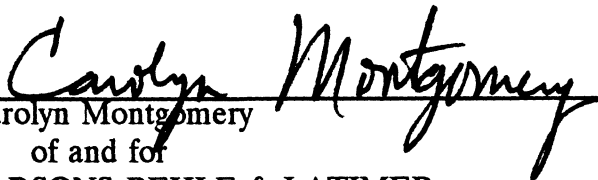
### CONCLUSION

The Agreement for Consulting Services entered into by Cobabe and Stangers is an enforceable contract. Cobabe has never breached the terms of the contract and has at all times been ready, willing and able to perform his duties under the contract. The Chapter 7 Trustee's refusal to assume the contract as property of the bankruptcy estate has no impact upon the parties' rights and obligations under the contract.

The rejection by the trustee constitutes a breach of the agreement only for the purpose of allowing Stangers to make a claim against the estate, if at any time Stangers may have a claim to assert.

Section 365 does not give a trustee the power to terminate a contract. However, the District Court's decision enables a trustee to repudiate a debtor's executory contract regardless of the debtor's conduct. In this case, such a decision allows Stangers to breach the contract with impunity and leaves Cobabe without a remedy for such breach. Such a result is contrary to law and equity. For these reasons, this Court should reverse the decision of the District Court and enforce the terms of the contract between the parties.

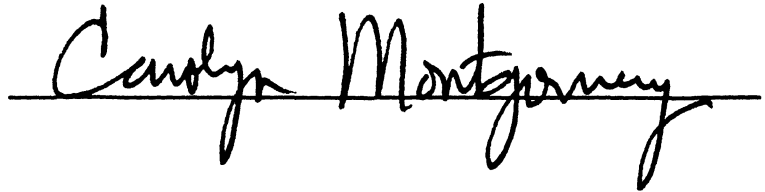
DATED this 15<sup>th</sup> day of July, 1991.

  
\_\_\_\_\_  
Carolyn Montgomery  
of and for  
PARSONS BEHLE & LATIMER  
Attorneys for Appellant

**CERTIFICATE OF MAILING**

I hereby certify that I caused to be mailed, postage prepaid, four (4) true and correct copies of the foregoing Brief of Appellant to the following on this 15<sup>th</sup> day of July, 1991.

William T. Thurman, Esq.  
McKay, Burton & Thurman  
10 East South Temple, Suite 1200  
Salt Lake City, Utah 84133

A handwritten signature in cursive script, reading "Carolyn Montgomery", is written over a horizontal line.

Tab A

## AGREEMENT FOR CONSULTING SERVICES

This Agreement is made this \_\_\_\_\_ day of April, 1988 between Garth Stanger and Edward Stanger ("Stanger") and H. LeRoy Cobabe ("Consultant").

### RECITALS

WHEREAS, Stanger is currently in the business of buying and selling automobiles and is desirous of operating a dealership located in St. George, Utah and is also desirous of entering into a Dealer Agreement with Toyota Motor Distributors, Inc. ("Toyota") and

WHEREAS, Consultant has extensive experience in the area of buying and selling automobiles, as well as operating and managing a dealership, and

WHEREAS, Stanger desires to have Consultant provide services including assistance in entering into a Dealer Agreement with Toyota and assistance and advice in operating, maintaining and managing the St. George dealership, and

WHEREAS, Consultant agrees to perform these services under the terms and conditions set forth below;

THEREFORE, in consideration of the mutual promises set forth herein, the parties hereto agree as follows:

1. Consultant will perform consulting and advisory services on behalf of Stanger with respect to all matters relating to or affecting Stanger's acquisition of a Dealer Agreement with Toyota and Stanger's operation of a car dealership in St. George.

2. Consultant's services will be rendered largely in St. George, Utah, but Consultant will, on request, perform services at such other places as required or as designated by Stanger.

3. In the performance of the services, the hours Consultant is to work on any given day will be entirely within Consultant's control and Stanger will rely upon Consultant to put in such number of hours as is reasonably necessary to fulfill the spirit and purpose of this agreement.

4. Stanger agrees to pay Consultant the sum of \$10,000.00 upon the execution of this Agreement for services performed to date. Stanger shall then pay to Consultant a monthly salary of \$4,000.00 beginning on May 1, 1988 and continuing on the first day of each month thereafter until September 1, 1988, when Stanger shall pay to Consultant \$13,000.00. Thereafter, Stanger shall pay to Consultant \$4,000.00 on the first day of each and every month until May 31, 1991, at which time this Agreement shall terminate.

5. This Agreement provides for the performance of services by Consultant as an independent contractor. Nothing in this Agreement shall be in any way construed to be inconsistent with this relationship or status.

6. Consultant agrees to hold Stanger harmless from any and all liability for withholding state or federal income tax, state or federal industrial accident contributions and any employer's tax liability now or subsequently imposed on Stanger.

7. Nothing contained herein shall limit Consultant's right to enter into other employment agreements provided that the work to be performed under such other agreements shall not conflict with Consultant's duties under this Agreement.

8. Stanger's obligation to make monthly payments as set forth in this Agreement shall terminate upon Toyota's refusal to enter into a Dealer Agreement with Stanger.

9. The entire agreement between the parties with respect to the subject matter herein is contained in this Agreement. The provisions of this Agreement are solely for the benefit of the parties hereto and not for the benefit of any other person, persons or entities.

10. No waiver, alteration or modification of any of the provisions of this Agreement shall be binding unless in writing and signed by the parties hereto.

11. All notices and communications regarding this Agreement shall be sent to the parties as follows:

Garth Stanger  
Edward Stanger  
3655 Lupin Way  
St. George, Utah 84770

H. LeRoy Cobabe  
1021 South Valley View Drive, #116  
St. George, Utah 84770

12. This Agreement shall be governed by the laws of the State of Utah.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 1988.

\_\_\_\_\_  
Garth Stanger

\_\_\_\_\_  
Edward Stanger

\_\_\_\_\_  
H. LeRoy Cobabe

I hereby certify that the annexed and foregoing is a true and complete copy of a document on file in the United States Bankruptcy Court for the District of Utah

Dated: 7-21-90

Attest:

Shirley Marshall

Deputy Clerk

6521m

Tab B

IN THE DISTRICT COURT OF THE FIFTH JUDICIAL DISTRICT  
IN AND FOR WASHINGTON COUNTY, STATE OF UTAH

---

H. LeROY COBARE,	)	
	Plaintiff,	) MEMORANDUM DECISION
vs.	)	
GARTH STANGER and	)	Civil No. 900503248
EDWARD STANGER,	)	
	Defendants.	)

---

This matter came before the Court on October 18, 1990, the Honorable J. Philip Eves presiding, on cross Motions for Summary Judgment. The Plaintiffs were represented by Carolyn Montgomery, their attorney of record and the Defendants by Joel T. Marker, their attorney of record. The Court heard extensive oral argument and then took the matter under submission. The Court has now reviewed the file in its entirety including the article entitled Executory Contracts in Bankruptcy: Understanding "Rejection", by Michael T. Andrew which was submitted by Plaintiff and the copies of statutes and cases cited in opposition to the Plaintiff's Motion for Summary Judgment submitted by counsel for the defense. The Court being fully advised in the premises now enters the following Decision and Order.

This case places this Court in a rather unusual position of being required to decide a hotly disputed issue of Federal Bankruptcy Law which is really the only legal issue presented by either side in their Motions for Summary Judgment. A brief explanation of the facts would appear appropriate. These are the facts to which the parties have agreed there is no dispute.

#### UNDISPUTED FACTS

On or about April 26th, 1988, the parties entered into an agreement for consulting services, (the agreement), wherein the Plaintiff agreed to act as consultant for the Defendants who were purchasing a Toyota dealership from the Plaintiff. The agreement contained provisions for compensation to the Plaintiff from the Defendants. Both sides kept up their obligations under the agreement through the month of October, 1989. On November 1, 1989, the Plaintiff filed bankruptcy in response to a Writ of Garnishment which was served on the Defendants by a prevailing party in another lawsuit with the Plaintiff therein seeking to garnish the payments due from these Defendants to this Plaintiff. Thereafter, these Defendants refused to make any more payments under the agreement with this Plaintiff and the matter wound up before the Federal Bankruptcy Court on a Motion to determine the validity of the garnishment.

After hearing, the Bankruptcy Court ordered that the garnishment had no validity as it was attempting to garnish post-petition earnings. The Bankruptcy Court ordered the Defendants to pay to this Plaintiff some \$20,000.00 in overdue payments under the agreement or to be found in contempt of court with stated penalties. A payment of \$20,300.00 was made to Plaintiff by Defendants under that order.

Thereafter, on stipulation of both sides, the Order of the Bankruptcy Court was vacated and the enforcement of the consulting agreement between this Plaintiff and these Defendants became the subject of a Complaint before this Court on April 23, 1990. The Plaintiff's Complaint states simply that there is an agreement between himself and the Defendants, that he is entitled to payment under that agreement, that the Defendants have failed and refused to pay as required under the agreement. The Plaintiff seeks Judgment for the amounts due under the agreement. To that Complaint the Defendants have filed an Answer and asserted a Counterclaim. The issue raised by the Answer and Counterclaim is the issue which this Court must resolve in this decision, mainly whether or not the agreement between the parties has any further force or effect between these parties.

The parties agree for purposes of this decision that the agreement is in fact an executory contract within the meaning of the bankruptcy laws, that it was not assumed within 60 days of the petition date by the trustee in bankruptcy, that by operation of law the nonassumption meant that the contract had been rejected by the trustee in bankruptcy, and that the Bankruptcy Court did not rule on the issue of the effect of that rejection upon the rights and obligations of these parties to the contract, under 11 U.S.C., Section 365 of the Federal Bankruptcy Act.

#### LEGAL ISSUE

The issue upon which the resolution of these Motions for Summary Judgment turns is the effect of the rejection of the executory contract by the trustee in bankruptcy. Plaintiff contends that such a rejection is merely a decision by the bankruptcy trustee not to include the executory contract as an asset (with a corresponding liability) in the estate of the bankrupt. Plaintiff contends further that the effect of the rejection by the trustee is simply to leave the parties in the position they were in prior to the rejection and thus seeks to enforce the agreement. Plaintiff contends he remains ready, willing and able to perform consulting services and has never

breached the agreement. Defendants contend that the rejection by the trustee in bankruptcy has the effect, as a matter of law, of terminating their obligations to perform under the contract. Defendants cite 11 U.S.C. Section 365 for the proposition that the rejection by the trustee constitutes a breach of the contract and ends their obligations and rights thereunder except their right to file a claim for damages with the trustee. They assert therefore in their Answer and Counterclaim that the contract is of no further force and effect and Plaintiff has no right to pursue payments under the agreement.

#### ANALYSIS

In support of Plaintiff's position counsel has referred the Court to several cases and to the article by Michael T. Andrew referred to above. None of the cases appear dispositive of the issue as it is apparent by the cases cited by the parties as well as the cases cited by Mr. Andrew in his article that there is a longstanding dispute among the Federal Judges as to the exact effect of a rejection of an executory contract by a trustee in bankruptcy. Mr. Andrew, and the Plaintiff, contend the Federal Courts has erred in their interpretation of 11 U.S.C., 365. There are cases cited by both sides which appear to support their

respective positions to some extent. None of the cases cited appear to be factually similar to this case. (See In Re Knight, 8 B.R. 925 [1981] and In Re Cochise College Park, Inc., 703 F.2d 1339 [1983]).

The Court is substantially persuaded by the article by Mr. Andrew cited hereinabove that the doctrine of rejection of an executory contract by a trustee did not originally include the concept that the debtor and the non-debtor party to the contract would have their rights and liabilities thereunder automatically terminated by the rejection. The Court is further substantially persuaded that it was not the original intent to the Courts involved in the development of the concept of rejection that the statutory breach language contained in the present bankruptcy code would somehow operate to terminate those rights and liabilities. In fact, the arguments and policy considerations stated by Mr. Andrew appear to make perfect sense to this Court. However, this Court is obligated to apply Federal Bankruptcy Law as it has been interpreted by the Federal Courts to the best of its ability rather than to apply a novel interpretation of that law in this case. This does not appear to be a case of first impression and therefore this Court must follow Federal decisions.

In two cases the Federal Courts have apparently held that rejection of an executory contract by a trustee in bankruptcy has the effect of terminating the liabilities under the contract

excusing any further performance by the non-debtor party. (See In Re Cochise College Park , Inc., 703 F.2nd 1339, 1353 [9th Circuit 1983] and In Re Pacific Express, Inc., 780 F.2nd 1482, 1486, footnote 3 [9th Circuit 1986]). In addition, several Federal decisions have held that similar language relating to leasehold interests means that the lease is terminated if the lease is rejected by the bankruptcy trustee. These latter authorities are less persuasive on the issue before this Court in view of the additional language contained in that statute which seems to provide that if the rejection occurs the debtor must immediately return possession of the property to the landlord. (See 11 U.S.C. Section 365 (d)(4).)

It is apparent to this Court in analyzing the authorities that although Mr. Andrew may have a superior intellectual position as demonstrated by his article, the Federal Courts have not followed his logic in applying the statute and have indeed followed the rule that rejection by the trustee results in a termination of all future rights and liabilities both of the debtor and of the non-debtor in an executory contract. This Court feels constrained to follow that authority.

MAILING CERTIFICATE

I hereby certify that on this 2nd day of  
November, 19 90, a true and correct copy of the  
above and foregoing was mailed, first-class postage prepaid, or  
hand-delivered, to:

Carolyn Montgomery, Esq.  
P. O. Box 45340  
Salt Lake City, UT 84145

Joel T. Marker, Esq.  
1200 Kennecott Building  
10 East South Temple Street  
Salt Lake City, UT 84133

Carolyn Smithman