Chapter V

General Case Administration

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A. Exploring and Determining the Goals for the Case

One of the primary functions of a committee is to supervise and investigate the financial and operational affairs of a debtor. A committee also serves as a significant party in interest in the negotiation and formulation of a debtor's "exit" plan out of bankruptcy. Further, the Bankruptcy Code provides that a committee has a duty to keep unsecured creditors informed. Thus, in order for a committee to properly carry out these very important roles, it must first understand the debtor, the issues faced by the debtor, and the financial and operational goals of the particular case. Once these goals are ascertained, the committee is then in a position to work with the debtor to prepare a case road map and tailor its action plans in the case to meet such goals.

First, the committee and its professionals should work with the debtor to determine whether the case is going to incorporate a sale as a going concern, reorganization, liquidation, or some combination.

Second, the committee and its professionals should work with the debtor and its advisors in analyzing the debtor's operations to understand whether further or new operational changes must take place in order for the debtor to achieve its financial and operational goals. The committee and its advisors should also assess the operational viability of the debtor through a review of historic, current and projected information, as well as monthly operating reports and other financial information. The committee and its professionals can and should independently review and confirm the business judgment of the debtor in conducting its business and operations. This undertaking involves a determination by the committee of the viability of the debtor's management and business plans.

Third, after the committee conducts its own due diligence and investigation, the committee should determine whether there are grounds for the appointment of an examiner to investigate certain activities or transactions, or whether there are grounds for the appointment of a chapter 11 trustee to displace the debtor and take over operations when, for example, the goals of the debtor and the committee are not necessarily aligned.

Finally, the committee and its professionals should work with the debtor to determine the proper "exit" from bankruptcy, and whether a plan of reorganization, plan of liquidation, structured dismissal or conversion would be appropriate. Once the committee investigates and has facts upon which it can rely, it is then in a position to engage in meaningful negotiations with the debtor about formulating a process to reach the case goals.

B. Executory Contracts and Unexpired Leases

In furtherance of chapter 11's goals of reorganization and rehabilitation, § 365 of the Bankruptcy Code provides a debtor with an indispensable tool, allowing it to reject, assume, or assume and assign executory contracts and unexpired leases.

Section 365 of the Bankruptcy Code allows the debtor, with bankruptcy court approval, to assume those executory contracts and unexpired leases that are beneficial for the estate. A debtor also has the right, with certain additional requirements, to assign an assumed executory contract or unexpired lease. These rights exist even if there were prepetition defaults. In contrast, § 365 also permits the debtor to reject — *i.e.*, breach — those executory contracts and unexpired leases that the debtor determines to be overly burdensome or unnecessary.

In order for § 365 to apply, the applicable contract must be "executory" and the lease must be unexpired. The majority of courts deem a contract to be "executory" if the obligations of both parties to the contract are so unperformed that the failure of either party to complete performance would result in a material breach, excusing performance of the other party. Thus, under a given contract, if either the debtor or the nondebtor party has substantially completed performance and the only remaining obligation is for the other party to perform, such contact would not be deemed to be executory, and § 365 would not apply to that contract. Moreover, if a lease has been properly and fully terminated prior to the commencement of the bankruptcy case, such lease would not be considered "unexpired," and indeed would be considered terminated. Finally, if the underlying agreement is a financing or security agreement under state law (even if it is characterized as a lease), such agreement is not capable of assumption or rejection.

With the exception of nonresidential real property leases, a debtor under chapter 11 will typically have until plan confirmation to decide whether to assume or reject a lease or executory contract. A nondebtor party to a lease or contract may, however, file a motion and request that the court fix a deadline by which a lease must be assumed or rejected. A bankruptcy filing itself will generally not affect the continued validity of a particular lease or contract. Thus, in the absence of a court order directing otherwise, the nondebtor party must continue to perform its obligations. *Ipso facto* clauses or defaults resulting from the mere filing of a bankruptcy case are unenforceable.

While the Bankruptcy Code is silent as to the specific remedy available to the nondebtor party to the contract or lease in the event the debtor fails to comply with its post-petition obligations, the bankruptcy court can use this nonperformance as a basis by which to fix a deadline for the debtor to either assume or reject the contract or lease.

With respect to nonresidential property leases, the Bankruptcy Code requires a debtor to timely perform all post-petition lease obligations while it determines whether to assume or reject the lease. With respect to leases of personal property, a debtor must timely perform its obligations arising 60 days after the chapter 11 filing until such lease is assumed or rejected, unless a court provides the debtor relief from doing so "based upon the equities of the case." A debtor's failure to perform its obligations under these sorts of leases has been held to give rise to an administrative priority claim for damages in favor of the lessor.

Section 365(d)(4) of the Bankruptcy Code offers nondebtor landlords under nonresidential real property leases more protection by forcing debtors to make their decision to assume or reject sooner. That section provides that debtor-lessees have 120 days from the petition date to assume or reject leases of nonresidential real property, or the lease will be automatically deemed rejected, and the debtor will be required to immediately surrender possession. Section 365(d)(4) provides that the bankruptcy court may grant a single extension of this deadline, for 90 days, on motion of the debtor or lessor "for cause."[134] The statute adds that the bankruptcy court may grant subsequent extensions only "upon [the] prior written consent of the lessor in each instance."[135] This provision has the result of forcing debtors to formulate and finalize their business plans promptly, and often much sooner than they would prefer.

A decision by a debtor to assume or reject a contract or lease is subject to the "business judgment rule" and is generally to be left to the debtor's management. Thus, so long as the debtor's decision is based on proper information and analysis, a bankruptcy court will defer to the debtor's business judgment. The debtor must also analyze the costs

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134 11 U.S.C. § 365(d)(4)(B)(i).

135 11 U.S.C. § 365(d)(4)(B)(ii).

of (a) curing its defaults under the contract or lease, or providing adequate assurance that it will promptly cure all defaults under the lease, and (b) compensating the nondebtor party for actual losses resulting from these defaults.

While the decision to assume, assign or reject a contract or lease is up the debtor, the committee should be involved in the decision-making process, as such a decision can impact the underlying case, administrative claims (which will be incurred if a contract or lease is assumed) and the general unsecured claims pool (due to rejection damages).

Moreover, significant value can be captured through the assignment of contracts or leases. For example, debtors with undermarket leases of nonresidential real estate may be able to realize significant value from an auction process for those leasehold interests. Committees must be vigilant in their investigation into potential value in a debtor's leasehold interests.