

# RECOGNIZING THE BREADTH OF NON-ASSIGNABLE CONTRACTS IN BANKRUPTCY: ENFORCEMENT OF NONBANKRUPTCY LAW AS BANKRUPTCY POLICY

MICHAEL J. KELLY<sup>\*</sup>

## INTRODUCTION

A key purpose of the Bankruptcy Code of 1978 (the "Code") is to enhance the debtor's estate for the benefit of parties in interest.<sup>1</sup> The goal of maximizing the estate is accomplished by various provisions of the Code.<sup>2</sup> One of them is section 365(f)(1). The subsection states, in relevant part, "[e]xcept as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease."<sup>3</sup> In other words, subsection (f)(1) renders ineffective all contractual provisions and provisions of applicable law that stand in the way of assignment of executory contracts and unexpired leases by debtors and trustees.<sup>4</sup> Section 365(f)(1) thereby enables the estate to realize value from its contracts and leases by their sale or assignment.<sup>5</sup>

However, section 365(f)(1) does not provide complete freedom to assign. Although the subsection nullifies applicable legal and contractual anti-assignment provisions, section 365(f)(2) limits free assignability conferred by subsection (f)(1) by permitting an assignment only if the contract or lease is assumed.<sup>6</sup> Subsection (f)(2)'s condition on assignments thus implicates the limitation imposed by other provisions of the Bankruptcy Code on the right to assume a contract or lease.

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<sup>\*</sup> Deputy County Attorney, Office of the Nassau County Attorney, New York. Candidate for Master of Laws in Bankruptcy, St. John's University School of Law, June 2008; Juris Doctor, St. John's University School of Law, June 2006; Bachelor of Arts (Philosophy), Fordham University, May 2003. The views expressed in this thesis are solely those of the author and not of the Office of the Nassau County Attorney.

<sup>1</sup> See *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999) (noting two "policies" of bankruptcy: "preserving going concerns and maximizing property available to satisfy creditors"); *Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (agreeing chapter 11 "embodies the general code policy of maximizing the value of the bankruptcy estate").

<sup>2</sup> See, e.g., 11 U.S.C. § 546 (2006) (giving trustee powers of hypothetical lien creditor to avoid certain liens as described in that subsection); 11 U.S.C. § 547 (allowing trustee to avoid any preferential transfer of debtor's property within restrictions of that subsection); 11 U.S.C. § 548 (allowing trustee to avoid any fraudulent transfers of debtor's property within restrictions of that subsection).

<sup>3</sup> 11 U.S.C. § 365(f)(1).

<sup>4</sup> See *id.* In order to assign an executory contract, the contract must first be assumed under section 365(a) and adequate assurance of future performance by the assignee must be given. See 11 U.S.C. § 365(f)(2).

<sup>5</sup> See 11 U.S.C. § 365(c)(1); *In re Lil' Things, Inc.*, 220 B.R. 583, 591 (Bankr. N.D. Tex. 1998) (noting purpose of section 365 as a whole is to give debtors "the ability to assign their valuable leases and contracts, while offering some protection to third parties with which they have contracted").

<sup>6</sup> 11 U.S.C. § 365(f)(2).

Section 365(c)(1) is one of the provisions that bars or limits the right to assume or assign in some instances.<sup>7</sup> This subsection states that:

[t]he trustee may not assume or assign any 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 . . . applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and . . . such party does not consent to such assumption or assignment . . .<sup>8</sup>

This subsection acts to enforce applicable laws that excuse a reluctant non-debtor party from dealing with anyone other than the debtor or debtor in possession with respect to the contract or lease.<sup>9</sup> The section 365(c)(1) prohibition against assumption is thus a limitation on section 365(f)(1)'s otherwise free pass for assignability.

While the concepts contained in sections 365(c)(1) and (f)(1) seem simple at first glance, decisions involving these two subsections illustrate that their implementation is, put simply, problematic. A predicament lies in the use of the same term, "applicable law," in each of the two subsections. Some courts have held that the two subsections are in hopeless conflict with each other because subsection (c)(1) seemingly takes away the authority to assume and assign that subsection (f)(1) grants to trustees and debtors in possession.<sup>10</sup> Another group of courts have chosen to resolve this arguable conflict by positing four theories that describe which laws are within the scope of each subsection. These courts ultimately conclude that subsection (c)(1) covers a smaller universe of "applicable laws" than subsection (f)(1).<sup>11</sup> To date, no one theory regarding the scope of the term "applicable law" in subsection (c)(1) has become universally accepted.

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<sup>7</sup> Another provision that limits the right to assume or assign is section 365(b), which requires that, if there has been a default under the executory contract or unexpired lease to be assigned, the trustee must cure the default or provide adequate assurance that the default will be cured, provide compensation for any pecuniary loss caused by the default and provide adequate assurance of future performance. *See* 11 U.S.C. § 365(b).

<sup>8</sup> 11 U.S.C. § 365(c)(1).

<sup>9</sup> *See id.*

<sup>10</sup> *See, e.g.,* Breeden v. Catron (*In re Catron*), 158 B.R. 629, 637 (E.D. Va. 1993) (noting use of term "applicable law" in both section 365(c)(1) and (f)(1) leads to conclusion that the two subsections are in conflict); *In re Antonelli*, 148 B.R. 443, 447 (D. Md. 1992) (stating no one theory of scope of section 365(c)(1) is completely accurate and enough to dispel any notion that subsections (c)(1) and (f)(1) are in conflict).

<sup>11</sup> *See, e.g.,* Perlman v. Catapult Entm't, Inc. (*In re Catapult Entm't, Inc.*), 165 F.3d 747, 752 (9th Cir. 1998) (holding section 365(c)(1) applies to those laws that indicate identities of contracting parties are material to performance of contract); *In re Pioneer Ford Sales, Inc.*, 729 F.2d 27, 29 (1st Cir. 1984) (holding subsection (c)(1)'s scope is limited to those executory contracts and unexpired leases that are silent on subject of assignability, and (f)(1)'s scope is limited to those applicable laws that enforce contractual

This thesis attempts to resolve this three-decade-old split in the case law. A careful examination of the plain language of each subsection and the legislative history behind sections 365(c)(1) and (f)(1) shows that Congress created section 365(c)(1) to protect the non-debtor party from being forced into a contractual relationship with a party with which it did not originally agree to contract. To achieve this purpose, subsection (c)(1) directs courts to enforce nonbankruptcy laws where the non-debtor party is given the power to consent to or veto an assignment. Rather than list particular classes of contracts and leases that should not be assumable or assignable without the non-debtor's consent, Congress delegated this decision to nonbankruptcy law. Thus, the scope of "applicable laws" covered by subsection (c)(1) includes any law that requires the consent of the non-debtor party before an executory contract or unexpired lease may be assigned. In other words, section 365(c)(1) should be construed to cover those laws that prohibit assignment of executory contracts and unexpired leases without the consent of the non-debtor party. Finally, though the scope of subsection (c)(1) is broad and acts to enforce a large universe of nonbankruptcy laws, subsection (f)(1) remains viable and renders unenforceable laws that generally prohibit assignment, restrict assignment or place conditions on assignment other than the non-debtor's consent.

The importance of establishing a uniform rule relating to the scope of section 365(c) cannot be overstated: the courts' inconsistent application of the subsection allows some debtors to benefit from unassignable contracts while denying others the freedom to assign executory contracts and unexpired leases. In addition, a rule must be created to prevent courts from limiting section 365(c)(1) to override state laws that must be preserved in bankruptcy. Following the theory espoused by this thesis will end such inconsistent treatment and unjustified limitation.

## I. THE SCOPE OF SECTION 365(C)(1)

Section 365(c)(1) states that even if an executory contract or unexpired lease may otherwise be assigned under section 365(f)(1), the contract or lease may not be assumed or assigned if an "applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor" and the non-debtor party does not consent to such assignment.<sup>12</sup> This subsection has had a troubled legal history, and after thirty years of analysis, the courts have not come to a generally accepted statement of its scope.<sup>13</sup> Various theories have been put forth as to the scope of section 365(c)(1), none of which can be correct.

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provisions barring assignment); *In re Taylor Mfg. Inc.*, 6 B.R. 370, 372 (Bankr. N.D. Ga. 1980) (holding section 365(c)(1) encompasses only those contracts that require performance of non-delegable services).

<sup>12</sup> 11 U.S.C. § 365(c)(1).

<sup>13</sup> See *Rieser v. Dayton Country Club (In re Magness)*, stating that "[n]either *Pioneer Ford* nor any other decision to date provides a defensible explication of the parameters of the § 365(c) exception." 972 F.2d 689, 695 (6th Cir. 1992). In the years following *In re Magness*, the courts have argued over existing theories without gleaning anything particularly new from the statute. See *In re Catapult Entm't*, 165 F.3d at 749

*A. Personal Services Contract Theory*

The debate over the scope of section 365(c)(1) began almost immediately upon the effective date of the Code. In 1980, the Bankruptcy Court of the Southern District of Georgia in *In re Taylor Manufacturing, Inc.* was the first to weigh in on the matter.<sup>14</sup> In that case, the debtor held a lease of real property that had previously been assigned to the debtor from another entity.<sup>15</sup> The debtor wished to assign the lease during the pendency of the bankruptcy case.<sup>16</sup> The lessor objected, arguing that section 365(c)(1) blocked the assumption and assignment of the lease, because Georgia law rendered the particular lease arrangement at issue non-assignable.<sup>17</sup> Holding that a lease of real property does not fall within the subsection (c)(1) exception to subsection (f)(1),<sup>18</sup> the Court accepted the trustee's argument that subsection (c)(1) should apply only to personal services contracts.<sup>19</sup> Further, the court noted that the injury that the creditor would suffer "from accepting rent checks tendered by U.S. Gypsum rather than from [debtor Taylor Manufacturing] is not readily apparent to the Court" as the injury that might occur to a party who contracts for services that only a certain individual could perform.<sup>20</sup> The Court used as support for its position the 1973 Report of the Commission on Bankruptcy Laws of the United States ("Commission Report" or "Report"), which states that, "executory contracts requiring the debtor to perform duties *nondelegable* under applicable nonbankruptcy law should not be subject to assumption against the interest of the non-debtor party."<sup>21</sup> Here, the court reasoned that subsection (c)(1) was only meant to apply to those contracts that call for personal, non-delegable services that are meant to be performed only by the original contracting parties.<sup>22</sup>

Since the decision in *Taylor Manufacturing*, and well throughout the 1980's and into the early 1990's, courts throughout the country accepted the personal services

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(stating "proper interpretation of § 365(c)(1) has been the subject of considerable disagreement among courts and commentators"); *In re Lil' Things*, 220 B.R. 583, 587 (Bankr. N.D. Tex. 1998) ("Most of the bankruptcy courts that first addressed the language of § 365(c)(1) found that it only applied to personal services contracts.").

<sup>14</sup> 6 B.R. 370 (Bankr. N.D. Ga. 1980).

<sup>15</sup> *Id.* at 371. It is interesting to note that the lessor of the property consented to the previous assignment. *See id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* The lessor relied on Georgia case law to show that an applicable law existed for the purposes of section 365(c)(1). *Id.* *Cox v. Howell* held that a usufruct, or a license of real property, could not be assigned without the consent of the licensor under the 1910 Civil Code of Georgia. 141 S.E. 82, 83 (Ga. 1928). In *Taylor Manufacturing*, the court held irrelevant whether the agreement in question was one for a usufruct or for an estate of years. 6 B.R. at 372.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 372 n.2 (quoting REPORT OF THE COMMISSION ON BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, at Part I at 199 (93d Cong. 1st Sess. 1973) (hereinafter COMMISSION REPORT or REPORT)).

<sup>22</sup> *See id.* at 372.

contract theory that *Taylor Manufacturing* espoused,<sup>23</sup> though many did not cite *Taylor Manufacturing* as authority.<sup>24</sup> Later courts have used their decisions to illustrate the very narrow nature of the personal services contract theory. For example, some courts have held that franchise agreements are not personal services contracts and are thus not subject to the restriction in subsection (c)(1).<sup>25</sup> Further, some courts have also held that while Congress intended subsection (c)(1) to apply to personal services contracts, it did not intend subsection 365(c)(1) to cover leases of real property.<sup>26</sup>

The reasoning behind the personal services contract theory is curious, and seems to represent a misreading of the statute. In sum, there are three reasons why this theory cannot be correct. First, the reading of the personal services contract courts give to subsection (c)(1) is inconsistent with the text of the statute because it unjustifiably narrows the subsection's scope.<sup>27</sup> No limitation on the restriction contained in subsection (c)(1) is evident in the text.<sup>28</sup> In addition, the statute

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<sup>23</sup> See *In re Tom Stimus Chrysler-Plymouth, Inc.*, 134 B.R. 676, 679 (Bankr. M.D. Fla. 1991) (noting court was reasonably satisfied that contract in question was not personal services contract and thus did not come within purview of section 365(c)(1)); *In re Sunrise Rests., Inc.*, 135 B.R. 149, 153 (Bankr. M.D. Fla. 1991) (holding section 365(c)(1) was meant only to cover non-delegable personal services contracts); *In re Haffner's 5 Cent to \$1.00 Stores, Inc.*, 26 B.R. 948, 950 (Bankr. N.D. Ind. 1983) (stating majority of courts hold that section 365(c)(1) applies to those contracts for non-delegable personal services); *Abney v. Fulton County, Ga. (In re Fulton Air Serv., Inc.)*, 34 B.R. 568, 572 (Bankr. N.D. Ga. 1983) (explaining subsection (c)(1) applies only to those applicable laws that excuse performance of contracts for non-delegable services).

<sup>24</sup> See *Tom Stimus Chrysler-Plymouth*, 134 B.R. at 679 (noting several courts have held that section 365(c)(1) applies only to personal services contracts); *In re Bronx-Westchester Mack Corp.*, 20 B.R. 139, 143 (Bankr. S.D.N.Y. 1982) (citing *Varisco v. Oroweat Food Co. (In re Varisco)*, 16 B.R. 634, 638 (Bankr. M.D. Fla. 1981)).

<sup>25</sup> See *Tom Stimus Chrysler-Plymouth*, 134 B.R. at 679 (noting car dealership franchise agreement is not based on "a special trust and confidence and on a special relationship" between debtor and franchiser (quoting *Varisco v. Oroweat Food Co. (In re Varisco)*, 16 B.R. 634, 638 (Bankr. M.D. Fl. 1981))); *Sunrise Rests.*, 135 B.R. at 153 (stating "[t]o run a Burger King retail establishment does not require a special knowledge in the conventional sense, that is a special judgment, taste, skill or ability"); *Bronx-Westchester Mack*, 20 B.R. at 143 ("A distributorship or franchise agreement which does not depend upon a special relationship between the parties is not within the reach of this exception.").

<sup>26</sup> See *In re Fulton Air Serv.*, 34 B.R. at 573 ("A lease for improved real property does not constitute a contract for nondelegable personal service."); *Haffner's Stores*, 26 B.R. at 950 (stating "section (c)(1)(A) is generally understood to refer to contracts for non-delegable services, and not to leases for the occupancy of real property").

<sup>27</sup> See *Magness v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 694 (6th Cir. 1992) (stating proposition in *Taylor Manufacturing* is merely paraphrase of statute and is not particularly helpful); *Pension Benefits Guar. Corp., Cont'l Airlines, Inc. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935, 943 (5th Cir. 1983) (explaining nothing in section 365 allowed for departure from language of section 365(c)(1), and Congress actually exacted principle whose reach was broader than simply personal service contracts).

<sup>28</sup> See *Murray v. Franke-Misal Techs. Group, LLC (In re Supernatural Foods, LLC)*, 268 B.R. 759, 777 (Bankr. M.D. La. 2001) (noting after decision in *In re Braniff Airways*, courts began to hold that language of section 365(c)(1) envisioned principle much broader than simply personal services contracts); *In re Pioneer Ford Sales, Inc.*, 729 F.2d 27, 29 (1st Cir. 1984) (noting "[t]he source of the 'personal services' limitation apparently is a bankruptcy court case"); *In re Braniff Airways*, 700 F.2d at 943 (stating if Congress wanted to limit section 365(c) to only apply to personal services contracts, it could have done so through more "precise" language).

explicitly states that the restriction applies not only to executory contracts, but also to unexpired leases, which do not have the characteristics of personal service contracts.<sup>29</sup> Thus, a plain text reading of the statute does not support the meaning ascribed to it by *Taylor Manufacturing* and the other courts that espouse the personal services contract theory of subsection (c)(1).

Second, the courts' reading of the Commission Report is inconsistent with the Report's text and the text of section 365(c)(1) as enacted in 1978 and amended in 1984. While *Taylor Manufacturing* is correct in stating that the Commission Report recommended that executory contracts for non-delegable personal services should not be assumable, and thus not assignable,<sup>30</sup> Congress did not ultimately enact those provisions as they were recommended. The text of section 4-602(f)(2) of the model bankruptcy act recommended in the Commission Report states:

[N]either a contract providing for a performance by the debtor of duties which are nondelegable under applicable law, whether or not delegation is prohibited or restricted by the contract, nor a contract for employment under which the debtor is an employer may be assumed without the consent of the other party or parties thereto.<sup>31</sup>

The Commission Report later explains that this provision "carries out a policy, implemented judicially under the present Act, against the use of legal compulsion under the Act to force a nondebtor party either to accept the personal services of or to perform personal services of the debtor or the trustee succeeding him."<sup>32</sup> While section 365(c)(1), as enacted, contains language similar to the recommended provision and the explanation following it, subsection (c)(1) also encompassed unexpired leases and did not refer to non-delegable services as the Commission Report's recommended provision did.<sup>33</sup> Thus, while reliance on the Commission Report is helpful in understanding the genesis of subsection (c)(1), *Taylor Manufacturing* erred in using it for a complete explanation as to the scope of subsection (c)(1).

Finally, holding that only personal services contracts fall into the scope of section 365(c)(1) shifts the focus of the statute away from applicable laws and toward the nature of the contract being analyzed, placing the cart before the horse. While it is true that "applicable law" as used in the statute does refer to applicable nonbankruptcy law, and common law that restricts the assignment of personal

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<sup>29</sup> See 11 U.S.C. § 365(c)(1) (2006) (stating subsection applies to unexpired leases in addition to executory contracts). See generally *In re Braniff Airways*, 700 F.2d at 943 (holding lease of space at Washington National Airport fell into ambit of section 365(c)(1)).

<sup>30</sup> See *In re Taylor Mfg., Inc.*, 6 B.R. 370, 372 n.2 (Bankr. N.D. Ga. 1980) (citing COMMISSION REPORT, H.R. Doc. No. 93-137, at Part I at 199 (93d Cong. 1st Sess. 1973)).

<sup>31</sup> COMMISSION REPORT, H.R. Doc. No. 93-137, at Part II at 154 (93d Cong. 1st Sess. 1973).

<sup>32</sup> *Id.* at Part II, at 158.

<sup>33</sup> The text of section 365(c)(1) clearly begins, "[t]he trustee may not assume or assign any 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 . . . ." 11 U.S.C. § 365(c)(1) (2006) (emphasis added).

service agreements constitutes applicable nonbankruptcy law,<sup>34</sup> personal services contracts do not necessarily constitute the entire universe of contracts that "applicable law" may regulate.<sup>35</sup> Rather than analyze whether the applicable law in question "excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession,"<sup>36</sup> the personal services contract theory asks whether the contract at issue is a personal services contract, and nothing else.<sup>37</sup> For these reasons, the personal services contract theory is incorrect.

### B. "Material Identity"<sup>38</sup> Theory

In the 1990's, a number of courts recognized that the personal services theory as described above could not be a correct description of the scope of section 365(c)(1).<sup>39</sup> Those courts developed a new theory as to the meaning of the subsection, one that focused on whether performance of the services contemplated in the contract could only be performed by the debtor. In these cases, several courts held that 365(c)(1) applies only in those cases where an applicable law excuses a non-debtor party from accepting performance from or rendering performance to a

<sup>34</sup> See *Breeden v. Catron* (*In re Catron*), 158 B.R. 629, 634 (E.D. Va. 1993) (stating it is generally understood by courts that term "applicable law" references applicable nonbankruptcy law); see also *In re Braniff Airways*, 700 F.2d at 943 (stating Congress most likely meant to preserve general pre-Code rule that personal services contracts are unassignable, but if Congress meant to limit provision to only that, it would have come up with clearer term than "applicable law"); WILLISTON ON CONTRACTS § 74:27 (4th ed. 1992) (stating contractual duties are non-delegable if they involve "the personal qualities or skills of the obligor, in the absence of consent by the obligee").

<sup>35</sup> See *In re Lil' Things, Inc.*, 220 B.R. 583, 558 (Bankr. N.D. Texas 1998) (holding *In re Braniff Airways* effectively put to rest notion that 365(c)(1) applies only to personal services contracts and inquiring into where reach of section 365(c)(1) stops); *Metro. Airports Comm'n v. Nw. Airlines, Inc.* (*In re Midway Airlines, Inc.*), 6 F.3d 492, 495 (7th Cir. 1993) ("Since the statutory language does not limit the applicability of § 365(c) exclusively to 'personal service contracts,' we agree with those circuits holding that it need not be so constrained.").

<sup>36</sup> 11 U.S.C. § 365(c)(1)(A) (2006).

<sup>37</sup> See *In re Tom Stimus Chrysler-Plymouth, Inc.*, 134 B.R. 676, 679 (Bankr. M.D. Fla. 1991) (noting franchise agreement at issue was not personal services contract without regard to any applicable law, and that previous courts have decided section 365(c)(1) operates only to prevent assignment of personal services contracts that are "based on a special knowledge, skill, or talent"); *In re Sunrise Rests., Inc.*, 135 B.R. 149, 152 (Bankr. M.D. Fla. 1991) ("Several Courts construed § 365(c)(1) to prohibit assignment only where the executory contract is truly personal and is based on a special knowledge, skill or talent.").

<sup>38</sup> This term is imprecise and is used for reference purposes only. The courts that espouse this theory use the term "material" to describe the "identity" of the parties to the agreement. See, for example, *In re Antonelli*, which, when discussing partnership agreements, states that the assignment of the contract turns upon "the materiality of the identity of the partners to the performance of the obligations remaining to be performed." 148 B.R. 443, 448 (D. Md. 1992).

<sup>39</sup> See *In re Midway Airlines, Inc.*, 6 F.3d at 495 (holding section 365(c) need not be constrained to personal services contracts); *Antonelli*, 148 B.R. at 448 (stating though section 365(c)(1) does bring within its scope personal services contracts, the subsection applies to any situation where "identity" of contracting parties is material); *Magness v. Dayton Country Club Co.* (*In re Magness*), 972 F.2d 689, 695 (6th Cir. 1992) (citing *Pension Benefits Guar. Corp., Cont'l Airlines, Inc. v. Braniff Airways, Inc.* (*In re Braniff Airways, Inc.*), 700 F.2d 935 (5th Cir. 1983), for proposition that personal services contract theory is incorrect).

third party where it appears from the statute that performance by the debtor is a material component of the contract.<sup>40</sup> For example, one court has decided that a golf club membership agreement with a specific member would be within the scope of section 365(c)(1) even though it is not for personal services.<sup>41</sup>

At first blush, this theory seems to fit the text and purpose of subsection (c)(1). As required by the text of section 365(c)(1), the theory mandates the analysis of an "applicable law," and does not simply assert that subsection (c)(1) applies to a certain category of contracts. In addition, this test would prevent the assignment of non-delegable duties specific to the debtor "against the interest of the nondebtor party," as emphasized in the Commission Report.<sup>42</sup> However, upon close scrutiny, this theory fails because it is essentially the same as the personal services contract theory.

The main focus of this "material identity" theory is to prevent a party other than the debtor from being forced to render performance to or accept performance from anyone other than the party with whom the non-debtor party originally contracted.<sup>43</sup> This is essentially no different from the personal services contract theory's objective of preventing a non-debtor party from being forced into a situation in which he or she might receive services from someone other than the debtor.<sup>44</sup> In addition, the "material identity" theory has the same practical effect as the personal services contract theory. Where the debtor's particular personal characteristics are important to the performance of the duties of the contract, the theory operates to prevent such debtor from assigning the contract to another party.<sup>45</sup> One court espousing this

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<sup>40</sup> The courts that espouse this theory state that subsection (c)(1) applies to those statutes that imply that the identity of the debtor, which is a vague term, is material to performance under the agreement. *See* *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747, 752 (9th Cir. 1999) (holding "[o]nly if the law prohibits assignment on the rationale that the identity of the contracting party is material to the agreement will subsection (c)(1) rescue it"); *In re ANC Rental Corp., Inc.*, 277 B.R. 226, 236 (Bankr. D. Del. 1993) (concluding section 365(c)(1) applies to those applicable laws that prohibit assignment without consent of non-debtor party where it is evident from law that identity of debtor is material or public safety is involved); *In re Magness*, 972 F.2d at 700 (Guy, J. concurring) (noting section 365(c)(1) enforces long-standing Ohio rule that excuses parties other than debtor from accepting performance from or rendering performance to party other than debtor when identity of debtor is material); *Antonelli*, 148 B.R. at 448 (stating decision of whether to apply section 365(c)(1) should be handled on case-by-case basis and that identity of debtor was material to performance under contract in case at hand).

<sup>41</sup> *See generally In re Magness*, 972 F.2d at 696.

<sup>42</sup> COMMISSION REPORT, H.R. Doc. No. 93-137, at Part I at 199 (93d Cong. 1st Sess. 1973).

<sup>43</sup> *In re Catapult Entm't*, 165 F.3d at 752 (holding section 365(c)(1) excuses party from accepting performance from or giving performance to anyone other than party with whom non-debtor party originally contracted with).

<sup>44</sup> COMMISSION REPORT, at Part I at 199.

<sup>45</sup> *See Murray v. Franke-Misal Techs. Group, LLC (In re Supernatural Foods, LLC)* stating:

While [identity theory] formulations regarding the scope of "applicable law" in § 365(c)(1)(A) might be superficially persuasive, they are, nonetheless, wrong. In each formulation, the focus of § 365(c)(1)(A) is limited strictly to what the courts term "personal contracts" (which we think are "personal services" contracts in disguise). In other words, by requiring "applicable law" as it is described by § 365(c)(1)(A) to restrict transfers of rights only if the identity of the party is material, the statute is

theory used as support for its position those cases that support the personal services contract theory.<sup>46</sup> Finally, the two theories are so alike that one commentator has named this theory the "personal services contract exception to section 365(f)(1) of the Bankruptcy Code."<sup>47</sup>

Thus, the "material identity" theory, due to its resemblance to the personal services contract theory, suffers from many of the same issues as the personal services contract theory. The theory does seem to start off, appropriately, with an applicable law.<sup>48</sup> However, the limitation the theory presents does not have any basis in the text of the statute nor the bankruptcy policies presented in the Committee Report.<sup>49</sup> Thus, the material identity theory should be likewise rejected.

### C. *The Pioneer Ford Theory*

A third theory regarding the scope of subsection (c)(1) was explained in *In re Pioneer Ford Sales, Inc.*<sup>50</sup> In *Pioneer Ford*, an automobile dealer in dire financial straits filed for protection under chapter 11 of the Code.<sup>51</sup> During the administration of the case, the debtor's principal secured creditor, Fleet National Bank, sought approval to assign a dealer franchise agreement the debtor had entered into with Ford Motor Corporation ("Ford").<sup>52</sup> Ford objected, arguing that the franchise agreement could not be assumed or assigned under section 365(c)(1).<sup>53</sup> Ford relied on a Rhode Island statute providing that motor vehicle dealership franchises could not be assigned without the consent of the motor vehicle manufacturer.<sup>54</sup> Ford

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limited in application to only those laws which restrict transfer of personal contracts, which, though they say they are not so saying, the courts limit to personal services contracts. The problem with the [identity theory] interpretations is not necessarily that these interpretations limit applicability of § 365(c)(1)(A) to personal services contracts . . . . The real problem stems from the fact that the [identity theory] courts purport to offer an interpretation that is not limited to personal service contracts, when it really is . . . .

268 B.R. 759, 780–81 (Bankr. M.D. La. 2001).

<sup>46</sup> See *In re ANC Rental Corp., Inc.*, citing *In re Fulton Air Service, Inc.*, 34 B.R. 568 (Bankr. N.D. Ga. 1983), which holds that section 365(c)(1) was meant to apply to contracts that call for non-delegable personal services. 277 B.R. 226, 236 (Bankr. D. Del. 2002).

<sup>47</sup> Michelle Morgan Harner, Carl E. Black & Eric R. Goodman, *Debtors Beware: The Expanding Universe of Non-Assumable/Non-Assignable Contracts in Bankruptcy*, 13 AM. BANKR. INST. L. REV. 187, 202–03 (2005).

<sup>48</sup> See *supra* footnotes 34–37 and accompanying text.

<sup>49</sup> See *supra* footnotes 27–33 and accompanying text.

<sup>50</sup> 729 F.2d 27 (1st Cir. 1984).

<sup>51</sup> *In re Pioneer Ford Sales, Inc.*, 26 B.R. 116, 116 (Bankr. D.R.I. 1983).

<sup>52</sup> See *Pioneer Ford*, 729 F.2d. at 28. Fleet Bank, as a secured creditor of Pioneer Ford, had foreclosed on the franchise agreement and wished to sell it to a Toyota franchise. See *In re Pioneer Ford Sales, Inc.*, 30 B.R. 458, 460 (D.R.I. 1983).

<sup>53</sup> See *Pioneer Ford*, 729 F.2d. at 28.

<sup>54</sup> See *id.* The Rhode Island statute states, in relevant part, that, "no dealer . . . shall have the right to . . . assign the franchise . . . without the consent of the manufacturer, except that such consent shall not be unreasonably withheld." R.I. GEN. LAWS § 31-5.1-4(C)(7) (2007).

claimed that this statute was an "applicable law" that, under section 365(c)(1), excused Ford from accepting performance from or rendering performance to a third party.<sup>55</sup> Accordingly, Ford Motors requested that Fleet National Bank's motion to assign the franchise agreement under section 365(f)(1) be denied.<sup>56</sup> Both the Bankruptcy Court<sup>57</sup> and the District Court<sup>58</sup> rejected this argument and allowed the assignment.<sup>59</sup>

The First Circuit reversed the Bankruptcy Court and the District Court.<sup>60</sup> While attempting to determine the scope of section 365(c)(1), the First Circuit reasoned that subsection (c)(1) of section 365 "refers to state laws that prohibit assignment whether or not the contract is silent" regarding assignability.<sup>61</sup> Conversely, the court stated that subsection (f)(1) does not contain similar language.<sup>62</sup> The court then cited the 1977 Report of the House of Representatives<sup>63</sup> ("1977 House Report" or "House Report") accompanying the text of the proposed section 365(c)(1), which states that the prohibition in subsection (c)(1) "applies only in the situation in which applicable law excuses the other party from performance independent of any restrictive language in the contract or lease itself."<sup>64</sup> From this language, the court concluded that subsection (c)(1) applies only where both an applicable law renders an executory contract or unexpired lease non-assignable and where the contract or lease is silent on the subject of assignment.<sup>65</sup> The court went on to hold that subsection (c)(1) prevented the assignment of the franchise agreement.<sup>66</sup> Applying Rhode Island law, the court concluded that Ford's refusal to consent to the assignment was not unreasonable.<sup>67</sup>

However, it does not seem as if the court's explanation of the scope of subsection (c)(1) is correct. The court incorrectly places great reliance on the 1977 House Report to conclude that (c)(1) applies only in instances where the contract or lease itself is silent on the subject of assignment. The House Report merely paraphrases the language of the statute. The House Report states that (c)(1) applies "independent of any restrictive language in the contract or lease itself."<sup>68</sup> Subsection

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<sup>55</sup> See *Pioneer Ford*, 729 F.2d at 28.

<sup>56</sup> See *id.*

<sup>57</sup> *In re Pioneer Ford Sales, Inc.*, 26 B.R. 116, 119 (Bankr. D.R.I. 1983).

<sup>58</sup> *In re Pioneer Ford Sales, Inc.*, 30 B.R. 458, 463 (D.R.I. 1983).

<sup>59</sup> *In re Pioneer Ford Sales, Inc.*, 729 F.2d at 28–29 (stating both Bankruptcy Court and District Court did not consider that section 365(c)(1) encompassed anything more than exception for personal services contracts).

<sup>60</sup> *Id.* at 31. The First Circuit's opinion was authored by then-Judge Stephen Breyer. *Id.* at 28.

<sup>61</sup> *Id.* at 29.

<sup>62</sup> *Id.*

<sup>63</sup> H.R. REP. NO. 95-595 (1977) as reprinted in 1978 U.S.C.A.N. 5787 (hereinafter 1977 HOUSE REPORT or HOUSE REPORT). See *Pioneer Ford*, 729 F.2d at 28.

<sup>64</sup> H.R. REP. NO. 95-595, at 348.

<sup>65</sup> See *Pioneer Ford*, 729 F.2d at 28.

<sup>66</sup> See *id.* at 30–31.

<sup>67</sup> See *id.* Oddly enough, the court never indicated whether the franchise agreement at issue was silent on the subject of assignment.

<sup>68</sup> H.R. REP. NO. 95-595, at 348.

(c)(1) states that its terms apply "whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties . . . ." <sup>69</sup> Neither of these passages state that the contract *must* be silent for (c)(1) to apply; they merely state that (c)(1) applies regardless of whether the contract is silent on assignability. Thus, the *Pioneer Ford* court's illustration of the scope of subsection (c)(1) is unjustifiably limited, and is not accurate.

#### D. Other Views

While the personal services contract theory, the material identity theory and the *Pioneer Ford* theory represent the major theories regarding the scope of section 365(c)(1), other decisions have attempted to formulate a meaningful analysis regarding what contracts fall under the ambit of section 365(c)(1). However, these courts, unlike the courts cited above, did not come to a theory regarding the scope of subsection (c)(1). Rather, these courts merely critique prior theories and state that courts should simply follow the plain language of the statute. For example, the Fifth Circuit Court of Appeals in *Pension Benefits Guaranty Corp., Continental Airlines, Inc. v. Braniff Airways, Inc. ( In re Braniff Airways, Inc.)* <sup>70</sup> held that the language in section 365(c)(1) is facially clear and no resort to legislative history was necessary. <sup>71</sup> In *Braniff*, Braniff Airways, Inc. sought Bankruptcy Court approval of an agreement with its creditors. <sup>72</sup> Among other things, the agreement sought to assume and assign its leases of terminal space at Washington National Airport to an entity named PSA. <sup>73</sup> Both the District Court and the Bankruptcy Court approved the agreement. <sup>74</sup> On appeal, the Fifth Circuit considered the issue of whether section 365(c)(1) and the Washington Airport Act <sup>75</sup> function to prohibit such assignment. <sup>76</sup> The court reviewed previous cases that limited the scope of subsection (c)(1) to personal services contracts. <sup>77</sup> Stating that nothing in the text of the statute justified limiting the scope of subsection (c)(1) to personal services contracts, the court held that Congress actually "codified a much broader principle," <sup>78</sup> though the court did not explain any further what that principal is.

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<sup>69</sup> 11 U.S.C. § 365(c)(1) (2006).

<sup>70</sup> 700 F.2d 935 (5th Cir. 1983).

<sup>71</sup> See *id.* at 943 (stating, even if examination of legislative history were necessary, there is no evidence within such history that would justify giving "radical" reading to section 365(c)(1) in way that personal services contract theory does).

<sup>72</sup> See *id.* at 938.

<sup>73</sup> See *id.* "PSA" is identified in the Bankruptcy Court decision as Pacific Southwest Airlines. *In re Braniff Airways, Inc.*, 25 B.R. 216, 218 (Bankr. N.D. Tex. 1982).

<sup>74</sup> See *In re Braniff*, 700 F.2d at 939.

<sup>75</sup> The Washington Airport Act did not so much prohibit assignment as it stated that the administrator of Washington National Airport had the authority to lease space on whatever terms he may deem proper for the appropriate operation of the airport. Washington Airport Act, D.C.CODE § 9-703 (2007) (formerly D.C. CODE § 7-1103).

<sup>76</sup> See *In re Braniff*, 700 F.2d at 943.

<sup>77</sup> See *id.* at 943.

<sup>78</sup> See *id.*

Next, the Court simply analyzed the Washington Airport Act and held that the assignments of certain leases of space at Washington National Airport were prohibited under section 365(c)(1) because the United States had not approved the assignment of the terminal lease from Braniff to PSA.<sup>79</sup>

In addition, the Bankruptcy Court for the Northern District of Texas in *In re Lil' Things, Inc.*,<sup>80</sup> without specifically coming to a conclusion as to the meaning of section 365(c)(1), held that the subsection must be construed in such a way as to give meaning to every provision contained in both subsections (c)(1) and (f)(1).<sup>81</sup> In this case, the debtor sought to assume and assign a lease of real property to another retailer.<sup>82</sup> The lessor objected to the assumption and assignment, arguing that Texas Property Code section 91.005, which prohibits assignments of real property leases without the consent of the lessor,<sup>83</sup> was enforceable under section 365(c)(1).<sup>84</sup> The Court decided that subsection (c)(1) "represents an exception to [subsection (f)(1)] where applicable law protects the right of the non-debtor contracting party to refuse to accept from or render performance to an assignee, and does not apply to general prohibitions on assignment."<sup>85</sup> The court then held that a section of the Texas Property Code is not an "applicable law" for the purposes of subsection (c)(1) because the Texas law was simply a prohibition on assignment made without the consent of the lessor.<sup>86</sup>

In short, *Braniff* and *Lil' Things* are valuable because they represent a break from those courts seeking to place a limitation on the scope of section 365(c)(1). Neither of these cases formulate a general rule regarding the application of subsection (c)(1). Thus, it is difficult to determine whether these cases were correctly decided. What can be drawn from reading these two cases together is that section 365(c)(1) was meant to be a limitation on the freedom to assign granted by section 365(f)(1).<sup>87</sup> However, the limitation cannot be so narrow so as to defeat the plain meaning of subsection (c)(1): to act as a meaningful check on free-assignability granted by section 365(f)(1).<sup>88</sup>

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<sup>79</sup> See *id.*

<sup>80</sup> 220 B.R. 583 (N.D. Tex. 1998).

<sup>81</sup> See *id.* at 590-91.

<sup>82</sup> *Id.* at 584-85.

<sup>83</sup> The Texas Property Code reads, "[d]uring the term of a lease, the tenant may not rent the leasehold to any other person without the prior consent of the landlord." TEX. PROP. CODE ANN. § 91.005 (Vernon 2007).

<sup>84</sup> See *Lil' Things*, 220 B.R. at 585.

<sup>85</sup> *Id.* at 591.

<sup>86</sup> See *id.*

<sup>87</sup> See *id.* at 590.

<sup>88</sup> See Pension Benefits Guaranty Corp., Continental Airlines, Inc. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 943 (5th Cir. 1983) (indicating Congress intended to formulate "broader principle" than personal services contract theory).

## II. SOLVING THE PROBLEM

### A. *The Proper Scope of Section 365(c)(1)*

As of today, the courts have not come to any kind of consensus regarding the scope of section 365(c)(1). Only the preceding theories have been put forth, none of which fully satisfy the text and intent of the statute, as discussed below. However, an examination of the text and history of the statute shows that subsection (c)(1) was meant to cover only those laws that prohibit assignment of executory contracts and unexpired leases without the consent of the non-debtor party.

### B. *Text of the Statute: "Consent" and "Excuse"*

In two places in subsection (c)(1), its text indicates that consent of the non-debtor party, and the choice of the non-debtor party to continue to be bound by the contract, is key to the scope of the statute. First, section 365(c)(1)(B) states that the prohibition on assumption and assignment of executory contracts and unexpired leases operates only if the non-debtor party does not consent to such assumption or assignment.<sup>89</sup> Secondly, subsection (c)(1)(A)'s prohibition only extends to laws that "excuse" a non-debtor party from "accepting performance from or rendering performance to" a party other than the debtor.<sup>90</sup> This implies that the limitation on assignment is intended only in the absence of the non-debtor party's consent.

Congress's choice of words is significant. The fact that Congress required the consent of the party other than the debtor to assume and assign an executory contract or unexpired lease indicates that Congress intended section 365(c)(1) to turn on lack of consent, rather than imposing an absolute prohibition on assumption and assignment.<sup>91</sup> Read in this way, the restriction in section 365(c) does not operate if the non-debtor party wishes to continue being bound by the contract or lease after it is assumed or assigned.<sup>92</sup>

In addition, subsection (c)(1)(A) indicates that section 365(c) is not a prohibition on the assignment and assumption of executory contracts and unexpired leases because the statute uses the word "excuse."<sup>93</sup> This indicates that subsection (c)(1) merely provides the non-debtor party with an escape hatch in the event that the debtor wishes to assign the contract or lease, not a general prohibition on assignment. Indeed, if Congress meant "applicable law" in subsection (c)(1) to

<sup>89</sup> 11 U.S.C. § 365(c)(1)(B) (2006).

<sup>90</sup> 11 U.S.C. § 365(c)(1)(A) (2006).

<sup>91</sup> COMMISSION REPORT, H.R. Doc. No. 93-137, at Part I at 199 (93d Cong. 1st Sess. 1973) (stating courts must be sensitive to rights of non-debtor parties).

<sup>92</sup> See *Murray v. Franke-Misal Tech. Group, LLC* (*In re Supernatural Foods, LLC*), which notes that applicable law for the purposes of section 365(c)(1) does not include applicable law that would prohibit assignment if the parties have agreed that consent to an assignment would be given under certain circumstances. 268 B.R. 759, 805 (Bankr. M.D. La. 2001). Put another way, section 365(c)(1) does not operate if the parties have otherwise opted-out of any statutory prohibition on assignment. See *id.*

<sup>93</sup> 11 U.S.C. § 365(c)(1)(A) (2006).

cover every law that prohibits assignment or assumption of an executory contract or unexpired lease in section 365(c), it would not have used the word "excuse," which indicates only a condition on assumption and assignment.<sup>94</sup> From this, it may be concluded that applicable law functions to stop an assignment and assumption of an executory contract or unexpired lease only if the law prohibits or restricts assignment in the absence of the consent thereto by the non-debtor party.

*C. Intent of the Statute: The Interests of the Non-Debtor Party*

When Congress passed the legislation that became the Bankruptcy Code of 1978, it made very little mention of the purpose or scope of section 365(c)(1). As stated earlier, the 1977 House Report merely paraphrases the text of the subsection.<sup>95</sup> The only other information that can be gleaned from the House Report is Congress's wish to prevent the trustee from requiring new advances of cash and property under loan commitments, lease commitments, and letters of credit.<sup>96</sup> However, this purpose was achieved in subsection (c)(2), which states that a trustee cannot assume or assign "a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of a debtor, or to issue a security of the debtor,"<sup>97</sup> and is thus not helpful for determining the scope of subsection (c)(1). Similarly the 1978 Senate Report on the Bankruptcy Reform Act contains only a paraphrase of the section,<sup>98</sup> and is thus unhelpful.

While the recommended changes to the former Bankruptcy Act contained in the Commission Report refer only to executory contracts, the basic recommendations it makes and the principles it espouses are helpful in determining the proper scope of subsection (c)(1).<sup>99</sup> The Commission makes several specific references to the assumption of executory contracts. First, the Report states that any bankruptcy law must provide that a trustee not be given the authority to assume a contract that requires that the debtor perform "duties that are nondelegable under applicable law .

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<sup>94</sup> In *Bonneville Power Administration v. Mirant Corp. (In re Mirant Corp.)*, a case regarding section 365(e)(2) (which contains language almost exactly the same as section 365(c)(1)), the Fifth Circuit held that if Congress meant to include only those applicable laws in the statute that prohibited assignment, then they would have used a word other than "excuse." 440 F.3d 238, 249–50 (5th Cir. 2006). The court goes on to explain that if, on the facts and circumstances of the case, no excuse language exists in any applicable law, then application of section 365(c)(1) is not available. *Id.* at 250.

<sup>95</sup> See *supra* footnotes 69–70 and accompanying text.

<sup>96</sup> See H.R. REP. NO. 95-595, at 348 (1977) as reprinted in 1978 U.S.C.C.A.N. 5787, 5963, 6304.

<sup>97</sup> 11 U.S.C. § 365(c)(2) (2006).

<sup>98</sup> S. REP. 95-989, at 59 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5845 (stating subsection (c)(1) "applies only in the situation in which applicable law excuses the other party from performance independent of any restrictive language in the contract or lease itself").

<sup>99</sup> The Commission Report only contains recommendations to Congress on the subject of bankruptcy laws to replace the Bankruptcy Act, and as such is not dispositive on the meaning of any portion of the Bankruptcy Code. However, its recommendations are helpful in understanding the purposes of bankruptcy law and the genesis of section 365(c), as actual legislative statements regarding section 365(c) are few and far between.

. . ."<sup>100</sup> In addition, the Commission Report states, "executory contracts requiring the debtor to perform duties nondelegable under applicable nonbankruptcy law should not be subject to assumption *against the interest of the nondebtor party*."<sup>101</sup> Finally, the Commission's model bankruptcy act indicates that an executory contract that requires the debtor to perform duties that are personal and non-delegable "cannot be assumed over the objection of a party other than the debtor."<sup>102</sup> These provisions indicate that the non-debtor party's wishes are significant in regard to whether an executory contract or unexpired lease may be assigned.

It is also important that any interpretation of the Bankruptcy Code comply with basic principles and standards applicable to bankruptcy laws generally. The Commission Report makes reference to allocative standards to which any bankruptcy law must adhere.<sup>103</sup> Principally, the Report states that any law must balance the goal of fair and equitable treatment of creditors with a fresh start for the debtor, further indicating that a bankruptcy law should place the burden of a debt on the party who is most able to bear it.<sup>104</sup> The Report goes on to say that this reflects an "external social policy respecting responsibility indicated by the debt" and "an internal policy that looks to the ability of the creditor to pass on the risk of loss."<sup>105</sup>

The suggestion that subsection (c)(1) should apply only to those applicable laws that require the consent of the non-debtor party before any assumption or assignment may take place is congruent with each of these recommendations by the Commission Report. First, the interpretation only functions to disallow assumption or assignment when such would be against the non-debtor's interest, which is manifested in the requirement that the non-debtor party consent to the assumption and assignment. Second, the interpretation properly shifts the risk of loss to the debtor, as it is possible that the performance of the duties of such an executory contract or unexpired lease may not be completely fulfilled if the contract or lease were assigned to another party. In such a situation, the non-debtor party would be harmed, and the debtor and the estate would have unreasonably benefited despite such harm. Allowing the non-debtor party to consent, or withhold such consent, allows for such a shift of the risk of loss. Finally, where an applicable law conditions the assignment of a contract or lease on the consent of the non-debtor party, it recognizes that the debtor has represented to the non-debtor party that it is solely responsible for performance under the contract. If the debtor were to breach such a contract, the debtor would necessarily be responsible for the damages of such a breach, and the rejection of such a contract or lease in bankruptcy would properly

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<sup>100</sup> COMMISSION REPORT, H.R. Doc. No. 93-137, at Part I at 17 (93d Cong. 1st Sess. 1973). This recommendation also states that employment contracts should be subject to the same restriction. *See id.*

<sup>101</sup> *Id.* at Part I, at 199 (emphasis added).

<sup>102</sup> *Id.* at Part II, at 158.

<sup>103</sup> *See id.* at Part I, at 78. Here, the Report states generally that all classes of claims in an open credit economy must be viewed as a single class, and that for such class, "the bankruptcy process must take into account the allocation of the economic burden of the debt." *Id.*

<sup>104</sup> *See id.*

<sup>105</sup> *Id.*

become a claim against the debtor's estate.<sup>106</sup> Consequentially, this thesis's definition of the scope of section 365(c)(1) is congruent to the intent of the statute as indicated by the Commission Report.

#### *D. Deference to State Laws*

In enacting section 365(c)(1) of the Code, Congress recognized the fact that some contracts exist where the non-debtor party's interest in who performs under the contract outweighs the general policy of free-assignability contained in section 365(f)(1). In further recognition of this fact, Congress certainly had the opportunity to create a comprehensive list of those contracts and leases that may not be assigned without the consent of the non-debtor party.<sup>107</sup> However, as a matter of bankruptcy policy, Congress left to the states the determination of which types of contracts or leases should be included in the scope of subsection (c)(1).

One principle of bankruptcy law is that "property interests are created and defined by state law," and that state laws regarding property interests are to be respected where federal policy does not indicate to the contrary.<sup>108</sup> As Congress is empowered to create uniform bankruptcy laws,<sup>109</sup> it follows that the proper administration of bankruptcy laws requires the uniform treatment of property interests.<sup>110</sup> As such, property interests should not be treated differently between state law and federal law "simply because an interested party is involved in a bankruptcy proceeding."<sup>111</sup> This policy of uniform treatment of property interests is indicated in section 541(c)(1) of the Code.<sup>112</sup> This section states that property becomes property of the estate notwithstanding any applicable law, conditioned on the financial state of the debtor or the commencement of a bankruptcy case, that effects a modification of a debtor's interest in such property.<sup>113</sup> In short, without a

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<sup>106</sup> This policy is further indicated in section 365(g), which provides that if an executory contract or unexpired lease is rejected during the pendency of the case, and such contract or lease has not been otherwise assumed prior to the rejection, the rejection constitutes a breach that is deemed to occur immediately before the commencement of the case. See 11 U.S.C. § 365(g) (2006).

<sup>107</sup> Section 365(c) does list two categories of contracts which may not be assumed or assigned in any event (contracts for the making of a loan or extending financing and leases of non-residential real property that have been terminated under applicable law prior to the filing of the case). 11 U.S.C. § 365(c)(2) & (3) (2006). However, the assumption or assignment of these contracts does not turn on the consent of the non-debtor party, or lack thereof.

<sup>108</sup> *Butner v. United States*, 440 U.S. 48, 55 (1979). See *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 20 (2000) ("Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code.").

<sup>109</sup> See U.S. CONST., Art. I, § 8, cl. 4; see also *Butner*, 440 U.S. at 54 (noting Congress has power to form "uniform Laws on the subject of Bankruptcies throughout the United States").

<sup>110</sup> See *Butner*, 440 U.S. at 55 ("Unless some federal interest requires a different result, there is no reason why [property] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

<sup>111</sup> *Id.*

<sup>112</sup> See 11 U.S.C. § 541(c)(1) (2006).

<sup>113</sup> See *id.*

contravening federal bankruptcy policy, property interests must be treated alike whether such interest is being dealt with in bankruptcy or not.

The Code is replete with examples of bankruptcy policy bowing to otherwise applicable state law dealing with property interests, thus creating uniformity. For example, section 510(a) states that a subordination agreement is enforceable in a bankruptcy case to the same extent it would be enforceable under state law.<sup>114</sup> Section 544 defers to state and local priority policies in determining the avoidance powers of a trustee as a hypothetical lien creditor.<sup>115</sup> Section 545 defers to state and local perfection rules in determining whether the trustee may avoid a statutory lien.<sup>116</sup> Finally, section 546(b) states that a trustee's avoidance powers are subject to any "generally applicable" law that allows perfection of a property interest to relate back to a point in time before such perfection actually takes place.<sup>117</sup>

In light of the above policy and the language of the Code, reading section 365(c)(1) to include those applicable laws that condition the assignment of executory contracts or unexpired leases on the consent of the non-debtor party, no matter how broad such law is, is consistent with established bankruptcy policy. No federal policy exists that would deprive a non-debtor party of its rights under applicable state laws to determine whom it wishes to contract with.<sup>118</sup> If bankruptcy courts were to limit the scope of subsection (c)(1) so as to affect these rights, property interests would be treated differently between state and federal laws without any reason based in federal law to do so. Thus, if an executory contract or unexpired lease is subject to a condition in applicable law that prohibits assignment without the consent of the non-debtor party, then that contract or lease passes to the bankruptcy estate subject to such condition.

*E. In re ANC Rental Corporation, Inc. and In re Federated Dep't Stores, Inc.*

The conclusion advanced by this thesis is directly challenged by two cases: *In re ANC Rental Corp., Inc.*<sup>119</sup> and *In re Federated Department Stores, Inc.*<sup>120</sup> In *ANC Rental*, the debtors attempted to assume and assign concession agreements for the

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<sup>114</sup> See 11 U.S.C. § 510(a) (2006) ("A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law.").

<sup>115</sup> See 11 U.S.C. § 544(a) (2006) (stating that trustee has rights and powers of hypothetical lien creditor against property of debtor and any interests in property of debtor).

<sup>116</sup> See 11 U.S.C. § 545 (2006) (stating that trustee may avoid statutory lien on real property which is not perfected as against hypothetical bona fide purchaser of such property at time of commencement of case).

<sup>117</sup> 11 U.S.C. § 546(b) (2006). The sections listed in the above text are not the only examples of Code sections that defer to generally applicable laws in the absence of contravening bankruptcy policy. For example, section 522(b) defers to the states in deciding whether to allow their domiciliaries to utilize exemptions listed in § 522(d) or those available under applicable state law. 11 U.S.C. § 522(b) & (d) (2006). Also, section 541 states that all "legal or equitable interests of the debtor in property as of the commencement of the case" pass to the bankruptcy estate. 11 U.S.C. § 541(a) (2006).

<sup>118</sup> Excepted, however, is section 365(f)(1), which remains operative in situations outside section 365(c)(1). See 11 U.S.C. § 365(c)(1); *infra* footnotes 159–165 and accompanying text.

<sup>119</sup> 277 B.R. 226 (Bankr. D. Del. 2002).

<sup>120</sup> 126 B.R. 516 (Bankr. S.D. Ohio 1990).

operation of rental car establishments at several airports.<sup>121</sup> Two rental agencies, Avis and Hertz, objected to the assumption and assignment, arguing that section 365(c)(1) prevented such assumption and assignment.<sup>122</sup> In deciding that section 365(c)(1) was not applicable to the concession agreements, the court rejected the argument that section 365(c)(1) applies only to executory contracts and unexpired leases where applicable law requires the consent of the non-debtor party before assignment.<sup>123</sup> Citing *Federated Department Stores*, the court stated that to allow for such an interpretation would permit municipal governments to "eviscerate" section 365(f)(1)'s policy of free-assignability by enacting general laws that prohibit assignment of executory contracts and unexpired leases without the consent of the non-debtor party.<sup>124</sup> The court concluded that section 365(c)(1) applies only when an applicable law states that "the contracting party is excused from accepting performance from a third party under circumstances where it is clear from the statute that the identity of the contracting party is crucial to the contract or public safety is at issue."<sup>125</sup>

In *Federated Department Stores*, the debtor moved to assume and assign a twenty-five year lease of space at a shopping center.<sup>126</sup> In its argument that section 365(c)(1) prohibits the assignment, lessor LaSalle Street Fund, Inc. cited a section

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<sup>121</sup> 277 B.R. at 229.

<sup>122</sup> *Id.* at 230.

<sup>123</sup> *Id.* at 236.

<sup>124</sup> *Id.* It is important to note that in the thirty years since the enactment of the Bankruptcy Code, no such mass movement to prohibit assignment of contracts without the consent of the non-debtor party has occurred. In fact, many of the applicable laws discussed in the cases reviewed for this thesis existed prior to the enactment of the Bankruptcy Code. For example, the federal Anti-Assignment Act has a history going as far back as 1940. See 41 U.S.C. § 15 (2006). The Rhode Island statute in *In re Pioneer Ford Sales, Inc.* that prohibited assignment of an automobile dealer franchise without the consent of the manufacturer was originally enacted in 1974. See 729 F.2d 27, 31 (1st Cir. 1984). Finally, the Washington Airport Act, cited by *Pension Benefits Guar. Corp., Cont'l Airlines, Inc. v. Braniff Airways, Inc.* (*In re Braniff Airways, Inc.*), which was an applicable law that prevented the assignment of terminal space at Washington National Airport, was enacted in 1940. See 700 F.2d 935, 943 (5th Cir. 1983). Thus, there does not seem to be any reason that, as a result of § 365(c)(1) and thirty years after the fact, municipalities will enact blanket statutes prohibiting the assignment of executory contracts and unexpired leases without the consent of the non-debtor party. Even if states did enact general statutes that prohibited assignment of contracts without the consent of the non-debtor party, such statutes would be enforceable under the Bankruptcy Code. See *supra* footnotes 109–118 and accompanying text.

<sup>125</sup> *ANC Rental*, 277 B.R. at 236. The case does not explain whether the "identity of the contracting party" refers generally to the party's characteristics or to a specific person or party. See *id.* In addition, the court states that its test for whether (c)(1) applies is the position taken by a majority of courts. See *id.* at 235. However, a review of case law does not reveal any other cases prior to *ANC Rental* in which public safety is a consideration in whether to assign an executory contract or unexpired lease under section 365(c)(1). After *ANC Rental*, only one case cites public safety as a consideration in whether to assign an executory contract or unexpired lease under section 365(c)(1). See *Allentown Ambassadors, Inc. v. Ne. Am. Baseball, LLC* (*In re Allentown Ambassadors, Inc.*), 361 B.R. 422 (Bankr. E.D. Pa. 2007). There, the court, citing *ANC Rental*, stated that subsection (c)(1) concerns applicable laws that prohibit assignment without the consent of the non-debtor party and where it is evident in the policy of the statute the identity of the debtor is material to the agreement or where public safety is at issue. See *id.* at 454–55. Here, as in *ANC Rental*, no explanation is given for considering the materiality of the identity of the debtor or public safety.

<sup>126</sup> 126 B.R. 516, 517 (Bankr. S.D. Ohio 1990).

of the Texas Property Code that prohibits lease assignments without the consent of the lessor.<sup>127</sup> Federated argued that section 365(f)(1) allows the assignment notwithstanding the Texas Property Code.<sup>128</sup> The court decided that Congress did not intend subsection (c)(1) to merely apply in those situations where an applicable law requires consent before assignment may take place.<sup>129</sup> To allow for such a result, the court stated, would thwart congressional intent favoring lease assignments.<sup>130</sup> Rather, the court noted that previous cases that have ruled that subsection (c)(1) functioned to prohibit the sort of assignment at issue dealt with applicable laws involving overriding public policy considerations.<sup>131</sup> The Texas Property Code, the court stated, was not such a law.<sup>132</sup>

The position advanced by *ANC Rental* and *Federated Dep't Stores* is inconsistent both with the text of section 365(c)(1) and the intent of the statute. First, no mention is made in subsection (c)(1) of the identity of a party being crucial to the contract or the protection of public safety.<sup>133</sup> Also, the proposition contained in *ANC Rental* does not take into account the non-debtor party's decision of whether to consent to assumption or assignment, an integral part of the operation of section 365(c)(1).<sup>134</sup> As far as congressional intent is concerned, the Commission Report preceding the passage of the Code in 1978 does make mention of the necessity of being "sensitive" to the rights of the non-debtor party.<sup>135</sup> In addition, the Commission Report does state that the Commission's recommendations were intended to prevent the non-debtor party from being forced into a situation where that party would be required to accept performance from or render performance to someone other than the party with whom it originally contracted.<sup>136</sup> However, no legislative or Commission materials either state or imply that the criticality of the debtor's identity (whether "identity" refers to the general characteristics of the debtor or the debtor itself) is a necessary condition for section 365(c)(1) to apply. In addition, no legislative or Commission materials inject the importance of public safety as a consideration into the question of whether an executory contract or

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<sup>127</sup> *See id.*

<sup>128</sup> *See id.* at 517–18.

<sup>129</sup> *See id.* at 519.

<sup>130</sup> *Id.*

<sup>131</sup> *See id.* at 518.

<sup>132</sup> *See id.* at 518–19.

<sup>133</sup> *See* 11 U.S.C. § 365(c)(1) (2006). In order for this statute to prohibit assumption or assignment of an executory contract or unexpired leases, the non-debtor party must show only that an applicable law excuse the non-debtor party from accepting performance from or rendering performance to a third party and that the non-debtor party does not consent to the assignment.

<sup>134</sup> *See id.*

<sup>135</sup> *See* COMMISSION REPORT, H.R. Doc. No. 93-137, at Part I, at 199 (93d Cong. 1st Sess. 1973); *see also* S. REP. 95-989, at 59 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5845 (discussing section 365(e) and noting non-debtor party should get full benefit of her bargain when courts consider assumption and assignment of executory contracts and unexpired leases).

<sup>136</sup> COMMISSION REPORT, at Part I, at 199.

unexpired lease may be assumed or assigned.<sup>137</sup> Thus, the bases upon which *ANC Rental* and *Federated Department Stores* rest their conclusions are not supported by the history upon which they are premised, and should be rejected.<sup>138</sup>

### III. POTENTIAL CONFLICT WITH SECTION 365(F)(1)

Many of the courts that have considered the issue of the scope of subsection (c)(1) have concluded that the subsection, given various factual scenarios, conflicts with section 365(f)(1).<sup>139</sup> The main reason for this perception is the use of the term "applicable law" in two seemingly different manners in both subsections (c)(1) and (f)(1). One court has described the situation as follows:

Conflict between subsection (c) and (f) of § 365 is inescapable because of the contradictory language found at the beginning of § 365(f)(1), specifically the exception carved out for § 365(c) and the reference to "applicable law" that immediately follows it. As explained previously, § 365(c)(1)(A) operates to restrict the assumption or assignment of executory contracts, if applicable law excuses the nondebtor parties to a contract from accepting substitute performance, i.e., if under applicable law the contract is found to be nonassignable. The subsection (c) exception, however, contradicts the portion of § 365(f)(1) that immediately follows it, which reads "notwithstanding a provision . . . in applicable law, that prohibits, restricts, or conditions the assignment of such contract." In other words, while § 365(c) explicitly directs the court to

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<sup>137</sup> Of the cases cited by *ANC Rental*, this consideration was only possibly raised in one case, *In re West Electronics, Inc.* See 852 F.2d 79 (3d Cir. 1988). In that case, debtor West wished to assume an executory contract for the manufacture and supply of power units for AIM-9 missile launchers to the United States Air Force. *Id.* at 80. The court held that the Anti-Assignment Act contained in 41 U.S.C. § 15 was an applicable law as described in section 365(c)(1) and operated to prevent the assumption and assignment for the power unit agreement. *Id.* at 83. In the opinion, public safety was not mentioned and the exigencies of national defense were mentioned only as a consideration of the Bankruptcy Court judge in a description of the case's procedural history. See *id.* at 81. Thus, it is curious how the court in *ANC Rental* came to the conclusion that public safety was a relevant consideration in the decision of whether to assume or assign an executory contract or unexpired lease.

<sup>138</sup> However, it should be noted that the courts in *ANC Rental* and *Federated Department Stores* do come close to the reading of section 365(c)(1) advanced by this thesis. Both opinions stress the requirement that the non-debtor party consent to a proposed assignment of a contract or lease before it may be assigned. However, the opinions go too far in limiting the applicability of the subsection (c)(1) to situations where the identity of the debtor is material to performance under the contract or where public safety considerations are evident.

<sup>139</sup> See *Breeden v. Catron (In re Catron)*, 158 B.R. 629, 636–37 (E.D. Va. 1993); *In re Antonelli*, 148 B.R. 443, 447 (D. Md. 1992); see also Michelle Morgan Harner, Carl E. Black & Eric B. Goodman, *Debtors Beware: The Expanding Universe of Non-Assumable/Non-Assignable Contracts in Bankruptcy*, 13 AM. BANKR. INST. L. REV. 187, 197–98 (2005) (explaining term "applicable law" as used in subsection (c)(1) can be construed to have different meaning than term "applicable law" in subsection (f)(1), creating conflict between two sections).

consider whether "applicable law" prohibits assignment, the language "notwithstanding a provision . . . in applicable law, that prohibits . . . assignment" of § 365(f) just as explicitly directs the court to ignore applicable law.<sup>140</sup>

Courts have dealt with this perceived conflict in various ways. One court decided that, though it could not be determined with any "intellectual honesty" the exact parameters of section 365(c)(1) or the situations in which it would apply, the question would need to be answered on a case-by-case basis.<sup>141</sup> The Eastern District of Virginia in *In re Catron* decided that the only way to resolve the conflict is to ignore the "applicable law" language in section 365(f)(1).<sup>142</sup>

This thesis argues, on the other hand, that a careful reading of the statute reveals that subsections (c)(1) and (f)(1) contemplate two forms of "applicable law" of "markedly different scope,"<sup>143</sup> and thus the two subsections do not conflict. However, one must first examine the scope of subsection (f)(1) before explaining why the two subsections do not conflict.

#### *A. The Scope of Section 365(f)(1)*

##### 1. Section 365(f)(1) as a General Rule

Section 365(f)(1) of the Code provides for a great deal of freedom for trustees and debtors in possession to assign executory contracts and unexpired leases.<sup>144</sup> Its provisions are simple: even if a contractual provision or an applicable law<sup>145</sup> says that a contract or lease cannot be assigned, the contract or lease may nonetheless be assigned if it is assumed under the provisions of section 365 and adequate assurance of future performance by the assignee is given.<sup>146</sup>

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<sup>140</sup> *In re Catron*, 158 B.R. at 636–37.

<sup>141</sup> *Antonelli*, 148 B.R. at 447. *Antonelli* concerned the assignment of a general partnership interest without the consent of the other general partners, a subject on which Maryland Partnership Law was not silent. *See id.* at 444–46.

<sup>142</sup> *See* 158 B.R. at 637. Here, the court explains that its only options are to ignore the "applicable law" language in section 365(f)(1) or ignore section 365(c)(1) in its entirety. *See id.* The court chose to simply ignore the "applicable law" language in subsection (f)(1) because to give effect to the "applicable law" language in subsection (f)(1) would render subsection (c)(1) "nugatory," and because ignoring the "applicable law" language produces a more sensible result. *See id.*

<sup>143</sup> *See* *Rieser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 695 (6th Cir. 1992).

<sup>144</sup> *See* 11 U.S.C. § 365(f)(1) (2006); *Metro. Airports Comm'n v. Nw. Airlines, Inc. (In re Midway Airlines, Inc.)*, 6 F.3d 492, 494 (7th Cir. 1993) (stating power of trustee to assume and assign contracts is "rather extensive" and reflects policy that trustees should be able to set aside contracts that burden estate, but continue on with contracts that add value to estate); *In re Quantegy, Inc.*, 326 B.R. 467, 470 (Bankr. M.D. Ala. 2005) (stating section 354 creates "broad policy favoring assumption and assignment of unexpired leases and executory contracts," with limited exceptions).

<sup>145</sup> It is generally understood that the term "applicable law" means "applicable non-bankruptcy law." *In re Catron*, 158 B.R. at 634.

<sup>146</sup> *See* 11 U.S.C. § 365(f)(1) (2006).

Section 365(f)(1) is clearly a general rule. First, the subsection begins by stating that its provisions are subject to those provisions contained in subsections (b) and (c) of section 365.<sup>147</sup> As such, the drafters of the Code have formed exceptions to section 365(f)(1), logically leading one to conclude that subsection (f)(1) necessarily applies to a wider universe of executory contracts and unexpired leases than subsections (b) and (c).

Second, the courts have been nearly unanimous in holding that subsection (f)(1) is a general rule. This fact was first recognized by the Northern District of Georgia in *In re Taylor Manufacturing*, the first case to discuss the scopes of subsections (c)(1) and (f)(1).<sup>148</sup> There, the court termed the generality of subsection (f)(1) as "obvious."<sup>149</sup> This, coupled with the structure of (f)(1), shows that (f)(1) is a general rule regarding assignment, and other provisions of section 365 that form exceptions to (f)(1) are necessarily more limited in scope.

## 2. Another Interpretation of the Scope of Section 365(f)(1)

Very few cases have held that subsection (f)(1) is anything other than a general rule governing the assignability of executory contracts and unexpired leases.<sup>150</sup> The seminal case espousing this theory is the First Circuit's decision in *In re Pioneer Ford Sales, Inc.*<sup>151</sup> Viewing the reference to contractual language as key, Judge Breyer stated in *dicta* that (f)(1) includes "state laws that enforce contract provisions prohibiting assignment" when a contract is not silent concerning assignment while subsection (c)(1) covers state laws that prohibit assignment when the contract is silent regarding assignment.<sup>152</sup>

The First Circuit's remark regarding the scope of section 365(f)(1), while only *dicta*, has created a great deal of controversy regarding the meaning of subsection (f)(1) and its relationship to subsection (c)(1).<sup>153</sup> At least one court has expressed its complete agreement with *Pioneer Ford's dicta* statement, asserting that it "strikes

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<sup>147</sup> *Id.* See *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747, 752 (9th Cir. 1999) (stating subsection (f) creates a "broad rule" favoring assumption and assignments of executory contracts and subsection (c) creates "carefully crafted exception to the broad rule"); *Murray v. Franke-Misal Tech. Group, LLC (In re Supernatural Foods, LLC)*, 268 B.R. 759, 774 (Bankr. M.D. La. 2001) (noting power of trustee to assign executory contracts and unexpired leases is not absolute, and is "made clear" by first sentence of section 365(f)(1), which states its provisions are subject to subsections (b) and (c) of section 365).

<sup>148</sup> 6 B.R. 370, 372-73 (Bankr. N.D. Ga. 1980)

<sup>149</sup> *Id.* at 372. The court stated that the generality of section 365(f)(1) was evident in its structure. See *id.*

<sup>150</sup> *In re Pioneer Ford Sales, Inc.*, 729 F.2d 27, 29 (1st Cir. 1984) (stating section 365(f)(1) only includes those laws that enforce contractual provisions that prohibit assignment); *In re Nitec Paper Corp.*, 43 B.R. 492, 498 (S.D.N.Y. 1984) (holding subsection (f)(1) only covers applicable laws that give "legal force to contractual provisions barring assignment").

<sup>151</sup> 729 F.2d 27 (1st Cir. 1984). For a description of the facts of *Pioneer Ford*, see footnotes 51-59 and accompanying text.

<sup>152</sup> *Id.* at 29 (noting this subsection is different from subsection (c)(1) because subsection (f)(1) "specifically excepts (c)(1)(A)'s state laws that forbid assignment even when the contract is silent") (emphasis in original).

<sup>153</sup> See *supra* footnotes 50-70 and accompanying text.

the proper balance" between subsections (c)(1) and (f)(1) in a world in which no theory on the scope of (c)(1) will be completely accurate.<sup>154</sup> Other courts have indirectly espoused this theory.<sup>155</sup> However, still other courts attempting to determine the scope of subsection (c)(1) have determined that *Pioneer Ford's* comment about (f)(1) cannot be correct.<sup>156</sup>

The First Circuit's subsection (f)(1) remark in *Pioneer Ford* is erroneous for two reasons. First, the text of subsection (f)(1) does not contain any language that would limit the scope of subsection (f)(1) to only those applicable laws that enforce contractual provisions restricting assignment.<sup>157</sup> The text of the statute states that it applies "notwithstanding a provision in an executory contract or unexpired lease of the debtor, *or* in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease . . . ." <sup>158</sup> The statute applies both in situations where a contractual provision that prohibits assignment exists *or* where an applicable law that prohibits assignment exists. Those two concepts, contractual provisions and applicable laws, are not codependent; the statute applies when one or both exist.

Second, if the First Circuit were correct in its assertion that (f)(1) encompasses only those laws that enforce contractual provisions, subsection (f)(1) would cease to be a general rule. Assuming for the sake of argument that subsection (f)(1) applies only to applicable laws that enforce contractual provisions barring assignment, subsection (f)(1) stands as a provision concerning one set of laws while subsections (b) and (c) would concern other laws. Not only would (f)(1) and (c)(1) cover different matters, but the opening language of section 365(f)(1), i.e., "Except as provided in subsections (b) and (c) of this section,"<sup>159</sup> would be rendered a nullity. As such, *Pioneer Ford's* notion regarding subsection (f)(1) is incorrect.

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<sup>154</sup> See *Ford Motor Co. v. Claremont Acquisition Corp., Inc.* (*In re Claremont Acquisition Corp.*), 186 B.R. 977, 984 (C.D. Cal. 1995) (noting other cases are irrelevant either because they are inconsistent with *Pioneer Ford* or are distinguishable); see also *Murray v. Franke-Misal Tech. Group, LLC* (*In re Supernatural Foods, LLC*), 268 B.R. 759, 789 (Bankr. M.D. La. 2001) (holding *Pioneer Ford* provides only cogent explanation regarding interplay between subsections (c)(1) and (f)(1)).

<sup>155</sup> *Metro. Airports Comm'n v. Nw. Airlines, Inc.* (*In re Midway Airlines, Inc.*), 6 F.3d 492, 495 (7th Cir. 1993) (noting court finds analysis in *Pioneer Ford* to be "persuasive"); *Nitec Paper*, 43 B.R. at 497–98 (stating subsection negates contractual provisions barring assignment, and any "applicable law" that enforces contractual provisions barring assignment).

<sup>156</sup> See *Rieser v. Dayton Country Club Co.* (*In re Magness*), 972 F.2d 689, 695 (6th Cir. 1992) (holding there is nothing in text of subsection (f)(1) that allows for limitation placed in it by *Pioneer Ford*); *In re Antonelli*, 148 B.R. 443, 447 (D. Md. 1992) (citing *Pioneer Ford* and holding no theory thus far will lead to "principled conclusion" regarding interplay between subsections (c)(1) and (f)(1)); *In re Federated Dep't Stores, Inc.*, 126 B.R. 516, 519 (Bankr. S.D. Ohio 1990) (noting court finds *Pioneer Ford* to be unpersuasive).

<sup>157</sup> See *In re Magness*, 972 F.2d at 695 (holding no such limitation exists in (f)(1) and provisions of (f)(1) can be reasonably interpreted to have other meanings).

<sup>158</sup> 11 U.S.C. § 365(f)(1) (2006) (emphasis added).

<sup>159</sup> *Id.*

*B. Lack of Conflict*

Subsection (f)(1) has been established as a general rule favoring the free-assignability of executory contracts and unexpired leases. In addition, it has been established that exceptions to this rule must necessarily be more limited in scope. Thus it is now possible to illustrate that the text of subsection (c)(1) does not conflict with the text of subsection (f)(1). Subsection (f)(1) refers to statutes that "prohibit, restrict, or condition" assignment<sup>160</sup> while subsection (c)(1) refers to those laws that "excuse" a non-debtor party from rendering performance to or accepting performance from a party other than the debtor, if the non-debtor party has not consented.<sup>161</sup> Applicable laws requiring the consent of the non-debtor party function only as a type of condition on assignment, that condition being the consent of the non-debtor party. Stated another way, reading subsection (c)(1) to include only those applicable laws that require the consent of the non-assigning party before any assignment may take place, and therefore merely placing a condition on assignment eliminates the potential for a conflict between subsections (c)(1) and (f)(1).

Due to the fact that the consent of the non-debtor party is only one type of condition to assignment, subsection (f)(1) remains operative in those situations where an applicable nonbankruptcy law generally prohibits, restricts, or conditions an assignment in ways other than as contemplated in subsection (c)(1). For example, subsection (f)(1) remains operative in the following situations:

- (f)(1) would bar application of a Wisconsin statute that prohibits the assignment or transfer of a contract between the state and a lottery retailer to another person or location.<sup>162</sup> This contract would be assignable so long as the trustee assumes the contract and adequate assurance of future performance by the assignee is given.<sup>163</sup>
- (f)(1) would bar application of a law that, while generally allowing assignment of an executory contract, would preclude an assignment to an assignee engaged in a particular business. This contract would be assignable, notwithstanding such restriction or preclusion, so long as the contract could be assumed and adequate assurance of future performance by the assignee is given.<sup>164</sup>

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<sup>160</sup> *Id.*

<sup>161</sup> 11 U.S.C. § 365(c)(1) (2006).

<sup>162</sup> See WIS. STAT. § 565.10(9) (2007).

<sup>163</sup> See 11 U.S.C. § 365(f)(2) (stating in order to assign contract under subsection (f)(1), contract needs to be assumed subject to provisions of section 365(a) and adequate assurance of future performance is given by assignee).

<sup>164</sup> However, it is worth noting that the debtor or trustee may be required by section 365(b)(3) to comply with certain contractual restrictions in shopping center leases such as radius, location, use, and exclusivity restrictions.

- (f)(1) would bar application of a Maine law that allows the assignment of a contract to purchase goods from a work center for the physically challenged, but only in circumstances of financial hardship.<sup>165</sup> This contract could be assigned so long as it can be assumed under section 365 and adequate assurance of future performance requirement is satisfied.

To the contrary, laws that condition assignment on the consent of the non-debtor party are within the scope of subsection (c)(1). For example, Texas Property Code section 91.005, which prohibits the assignment of a lease by a tenant without the consent of the landlord, would fall within the scope of subsection (c)(1).<sup>166</sup> In addition, Nevada Revised Statute section 332.095, which prohibits the assignment of a concession agreement without the consent of the local airport authority that awarded it, would fall within the scope of subsection (c)(1).<sup>167</sup> Thus, for the reasons stated above, no conflict between subsections (c)(1) and (f)(1) of section 365 exists.<sup>168</sup>

#### IV. APPLICABILITY TO SECTION 365(E)(2)

Section 365(c)(1) is not the only place in the Code that uses language similar to that contained in the text of subsection (c)(1). Section 365(e)(1) states that an executory contract or unexpired lease cannot be terminated solely due to a contract or lease provision that provides for *termination* of such contract or lease upon the filing of a bankruptcy petition, or based on the financial condition of the debtor.<sup>169</sup> Section 365(e)(2), which acts as an exception to section 365(e)(1), states that section 365(e)(1) does not apply where:

[A]pplicable 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 "such party does not consent to such assumption or assignment . . . ."<sup>170</sup>

<sup>165</sup> See ME. REV. STAT. ANN. tit. 5 § 1826-C(7) (2007) ("The director shall ensure that contracts awarded to work centers may not be assigned . . . except as may be necessary to complete the contracts, because of extraordinary events beyond the control of the work centers.").

<sup>166</sup> See *In re Federated Dep't Stores, Inc.*, 126 B.R. 516, 517 (Bankr. S.D. Ohio 1990) (providing "11 U.S.C. § 365(c)(1)(A), honors Texas contract law").

<sup>167</sup> See *In re ANC Rental Corp., Inc.*, 277 B.R. 226, 235–36 (Bankr. D. Del. 1993).

<sup>168</sup> See *Murray v. Franke-Misal Tech. Group, LLC (In re Supernatural Foods, LLC)*, 268 B.R. 759, 775 (Bankr. M.D. La. 2001) ("[T]here is no conflict between § 365(c) and § 365(f)(1)."); *In re Lil' Things, Inc.*, 220 B.R. 583, 590 (Bankr. N.D. Tex. 1998) (stating all parts of section 365 must be given effect and there is no conflict between subsections (c)(1) and (f)(1)).

<sup>169</sup> 11 U.S.C. § 365(e)(1) (2006).

<sup>170</sup> 11 U.S.C. § 365(e)(2) (2006).

This language is virtually identical to the language contained in section 365(c)(1).<sup>171</sup> Thus, any interpretation regarding the scope of subsection (c)(1) should also apply to subsection (e)(2).<sup>172</sup>

Mention should be made, however to the difference in the language in subsection (e)(2) and subsection (c)(1). Subsection (c)(1)(A) states that an "applicable law" under that section is one that excuses a party other than the debtor from rendering performance to or accepting performance from "an entity other than the debtor or the debtor in possession," while subsection (e)(2)(A), regarding rendition of performance, uses the term "the trustee or to an assignee of such contract or lease."<sup>173</sup> As this language concerns the person to whom performance must be rendered or from whom performance must be accepted, it is relevant to the determination of whether subsections (c)(1) or (e)(2) establish a "hypothetical" or "actual" test for determining whether an executory contract or unexpired lease may be assumed by the debtor or assigned to another party, a topic that is outside the scope of this thesis.<sup>174</sup> However, for the purposes of this thesis, the differing language between subsections (c)(1) and (e)(2) should not affect the types of applicable laws or executory contracts to which subsection (c)(1) or (e)(2) apply.

<sup>171</sup> The text of subsection (e)(2) differs from subsection (c)(1) in that it contains the language "the trustee or to an assignee of such contract or lease" in place of "an entity other than the debtor or the debtor in possession" as used in subsection (c)(1). Compare 11 U.S.C. § 365(e)(2), with 11 U.S.C. § 365(c)(1).

<sup>172</sup> As such, with few exceptions, those cases attempting to discern the scope of subsection (e)(2) have sought guidance in those opinions that concern subsection (c)(1). See *Perlman v. Catapult Entm't, Inc.* (*In re Catapult Entm't, Inc.*), 165 F.3d 747, 753 n.6 (9th Cir. 1999) (noting section 365(e)(2)(A) "expressly revives the 'ipso facto' clauses in precisely the same contracts that fall within the scope of § 365(c)(1)"); *Breden v. Catron* (*In re Catron*), 158 B.R. 629, 639 (E.D. Va. 1993) (holding since subsection (e)(2) tracks "almost verbatim" language of subsection (c)(1), that arguments made by appellant regarding subsection (c)(1) apply with "equal force" to subsection (e)(2)); *In re Footstar, Inc.*, 337 B.R. 785, 788 (Bankr. S.D.N.Y. 2005) (concurring with *Summit Investment and Development Corp. v. LeRoux* and stating "[a] proper construction of Section 365(e)(2)(A) requires a consideration of companion section 365(c) as well" (quoting *Summit Inv. and Dev. Corp. v. LeRoux*, 69 F.3d 608, 612 (1st Cir. 1995))); *In re Morgan Sagamon P'ship*, 269 B.R. 652, 654 (Bankr. N.D. Ill. 2001) (agreeing with *In re Catapult Entm't* that subsection (e)(2) applies to same executory contracts as subsection (c)(1)). But see *Bonneville Power Admin v. Mirant Corp.* (*In re Mirant Corp.*), 440 F.3d 238, 247 n.16 (5th Cir. 2006) (noting even though language between subsections (c)(1) and (e)(2) are similar, they are not exactly alike, and thus case law for one should not be given more than "informative weight in interpreting the other").

<sup>173</sup> Compare 11 U.S.C. § 365(c)(1)(A) (2006), with 11 U.S.C. § 365 (e)(2)(A) (2006).

<sup>174</sup> The courts have disagreed since the passage of the Code by Congress in 1978 about whether subsections (c)(1) and (e)(2) establish a "hypothetical" test (i.e. that an executory contract or unexpired lease cannot be assumed by the debtor if it cannot be assigned to another party under subsection (c)(1)) or an "actual" test (i.e. that an executory contract or unexpired lease cannot be assumed only if the debtor actually plans on assigning the contract, which assignment would be prohibited by subsection (c)(1)). This debate is also relevant to subsection (e)(2) because of that subsections almost identical language as subsection (c)(1). One court—the Fifth Circuit Court of Appeals in *In re Mirant*—stated that the language of (c)(1) was exactly identical to the language of (e)(2) before the passage of the 1984 amendments to the Code, at which time the language of subsection (c)(1) was changed to its current form. See 440 F.3d at 249 n.17. Thus, in determining whether subsection (e)(2) creates an actual or hypothetical test, pre-1984 amendments cases on subsection (c)(1) are very helpful, while post-1984 amendments cases are not necessarily helpful. This is the reason why the court in *In re Mirant* stated that cases construing subsection (c)(1) are not necessarily relevant to questions regarding subsection (e)(2). See *id.* at 247 n.16.

As such, subsection (e)(2) should be read to cover only those applicable laws that require the consent of the non-debtor party before any assignment may take place.<sup>175</sup>

#### CONCLUSION

After 30 years of debate, the courts are no closer to a final conclusion of what the scope of section 365(c)(1) is than when they started. Many of the conclusions to which the courts have already come are based on valid considerations of the section's text and history, and their possible negative effects. However, no court has come to a final conclusion that is completely consistent with the text and history of section 365 and of the Code, let alone a conclusion as to whether subsection (c)(1) conflicts with subsection (f)(1). However, a close examination of section 365(c)(1) shows that Congress intended to include in that subsection only those laws that require the consent of the non-debtor party before an assignment of the subject contracts or leases may take place. In addition, this interpretation allows both subsections (c)(1) and (f)(1) to coexist. Thus there is no reason for the courts to believe that the two subsections are in conflict with each other.

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<sup>175</sup> Since the language of subsection (c)(1) and (e)(2) are virtually identical, it is difficult to imagine a situation in which one of the subsections would apply and the other would not. The distinction, however, may be practical. In order to exercise the power to terminate a contract under subsection (e)(2), one must first petition the court to lift the automatic stay under section 362(d). See *In re Mirant*, 440 F.3d at 251–52 (holding terminating contract under section 365(e)(2) violates automatic stay). Thus, if it is not imperative that a contract be immediately terminated, a hypothetical creditor could simply wait to see if the debtor rejects the contract or lease, and save the time and money that would be involved in arguing a motion to lift the automatic stay. Conversely, if the debtor chooses to assume or assign the contract or lease, and there is an applicable law that prohibits assignment without the consent of our hypothetical creditor, the creditor would have the choice of having the automatic stay lifted and terminating the contract or lease, or arguing that subsection (c)(1) operates to prohibit the assumption or assignment. Thus, while the two subsections seem to concern exactly the same executory contracts and unexpired leases, the existence of the two sections may provide a strategic avenue for certain creditors.