UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re

DEFERIET PAPER COMPANY, INC. Case No. 01-11834

Debtor

DEFERIET PAPER COMPANY, INC.

Plaintiff

-against- Adversary No. 02-90027

NIAGARA MOHAWK POWER CORPORATION AND NIAGARA MOHAWK ENERGY MARKETING, INC.

Defendant

APPEARANCES:

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Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

Currently before the court is a motion for summary judgment filed by Deferiet Paper Company, Inc. (the "Debtor") in connection with its adversary proceeding commenced on or about January 18, 2002 against Niagara Mohawk Power Company ("NMPC") pursuant to 11 U.S.C. § 542 and § 105. The Debtor seeks turnover of $230,567.17 which it claims it overpaid

NMPC for electricity supplied post-petition. NMPC filed a cross motion for summary judgment against the Debtor for dismissal and for judgment against the Debtor in connection with its counterclaim asserted in the adversary proceeding. Specifically, NMPC seeks authorization to recoup the Debtor's $50,000.00 post-petition utility deposit and to apply all post-petition payments received from the Debtor to post-petition electricity charges. In addition, NMPC seeks payment in full of its administrative claim, dated January 7, 2002, for post-petition electricity supplied to the Debtor during the period March 26, 2001 - March 31, 2001 in the amount of $288,588.46 pursuant to 11 U.S.C. §507 (a)(1) (the "Administrative Claim"). Also before the court is the motion filed by the Debtor on or about July 3, 2002 for an order permitting it to reject its pre-petition electric supply agreement with NMPC pursuant to 11 U.S.C. § 365.

By agreement of the parties, this matter was submitted to the court for consideration upon the pleadings and memoranda.

This proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (C), (E), and (O). The court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334.

FACTS

Having reviewed the parties' pleadings, memoranda, submitted documents, and joint stipulation of facts, and having taken judicial notice of certain other facts already in the records of this court, the court makes the following findings of fact.

1. On or about June 11, 1999, the Debtor and NMPC became parties to a certain electric supply agreement (the "ESA") pursuant to which NMPC supplied electricity to the Debtor in connection with its operation of a paper manufacturing facility located in Deferiet, New York (the "Mill").

2. While under a second extension of the ESA, the Debtor and NMPC signed a March 3,

2000 Memorandum of Understanding (The "MOU"), which amended certain terms of the ESA. (NMPC's Ex. 3.)

3. The ESA was a "take or pay" agreement whereby certain of the charges to the Debtor were unrelated to actual electricity usage. The affidavit of Gerald Haenlin submitted on the cross-motion sets forth NMPC's position on the benefits the Debtor received in return.

4. On or about March 20, 2001, NMPC issued a termination notice to the Debtor advising it that the electricity supply to the Mill was subject to termination on March 26, 2001, if payment or mutually acceptable arrangements for payment were not made. (NMPC's Ex. 5.) The final termination notice does not specifically address the ESA.

5. This case was commenced by the filing of an emergency voluntary petition under Chapter 11 of the Bankruptcy Code on Sunday, March 25, 2001 (the "Petition Date").

6. As of the Petition Date, the Debtor owed NMPC $2,817,627.00 for pre-petition electricity usage.

7. The ESA expired by its terms on March 31, 2001, six days after the Petition Date. This expiration date resulted from a further extension of the MOU between the parties that was agreed to on March 20, 2001. (NMPC's Ex. 4.)

8. On March 29, 2001, the Debtor moved for an interim order pursuant to Bankruptcy Code § 366. On or about May 14, 2001, the Court issued a final utility order requiring the Debtor to pay NMPC certain amounts as adequate assurance for the Debtor's post-petition electricity usage (the "Final Utility Order"). Pursuant to the terms of the Final Utility Order, the Debtor was to pay NMPC the sum of $50,000.00 as a security deposit, plus the weekly sum of $20,000 in advance for anticipated weekly post-petition electricity usage by the Debtor, plus an additional sum of $140,000 for the seven weeks which had elapsed from the Petition Date until

the time the Final Utility Order was entered. The Final Utility Order also provides that NMPC will be entitled to an administrative expense priority for any unpaid post-petition debts. Neither the interim order or Final Order specifically address the ESA.

9. All pre-payment amounts required under the Final Utility Order were paid by the Debtor to NMPC ($480,000.00) as well as the security deposit ($50,000.00) for a total amount of $530,000.00.

10. As a result of the Debtor's more efficient shutdown of its operations at the Mill than was anticipated, the actual post-petition utility usage by the Debtor was substantially reduced.

11. On April 5, 2001, NMPC issued a six day bill to the Debtor for charges incurred during the period March 25, 2001 through March 31, 2001 pursuant to the ESA in the amount of $493,087.70. (NMPC's Ex. 6.)

12. During the post-petition period of operations, NMPC also invoiced the Debtor for actual post-petition utility usage in the total sum of $249,432.83.

ARGUMENTS

The Debtor contends that it should be refunded the difference between the pre-payment amounts for post-petition electricity usage under the Final Utility Order, and the actual post-petition electricity invoiced amount at the market rate ($480,000 - $249,432.83 = $230,567.17), plus the amount of the unapplied deposit under the Final Utility Order ($50,000), for a total amount of $280,567.17 with interest from October 1, 2002 (the "Refund Amount").

NMPC contends that during the six day period between the petition date, March 25, 2001, and the date the ESA expired by its own terms on March 31, 2001 electricity usage should be calculated at the rate required by the ESA or $493,087.70, not at the market rate. Using NMPC's calculations, NMPC has a claim against the Debtor in the sum of $288,588.46.

The Debtor's belief that it is entitled to the Refund Amount is premised upon the theory that the ESA was terminated pre-petition as a result of the Debtor's pre-petition breach of the ESA, NMPC's issuance of a final termination notice, and NMPC's rejection of a replacement agreement or, in the alternative, the Final Utility Order constituted a defacto rejection of the ESA. In addition, the Debtor argues it should be permitted to reject the ESA effective immediately prior to its petition date pursuant to 11 U.S.C. § 365(a) and (g).

NMPC takes the position that because the ESA expired prior to the filing of the Debtor's motion seeking to reject the same, the Debtor's motion is moot. As such, NMPC asserts the ESA controls the pricing of the electricity supplied to the Debtor during the post-petition period the ESA was in effect, namely March 26, 2001 - March 31, 2001.

DISCUSSION

The Debtors' first argument is that the ESA was terminated pre-petition as a result of the Debtors's non-payment, NMPC's issuance of a final termination notice to the Debtor on or about March 20, 2001 (NMPC's Ex. 5), and NMPC's rejection of the Debtor's proposed forbearance agreement. The court is unable to agree with this contention.

Executory contracts or leases that are terminated pre-petition are no longer available for assumption or rejection under 11 U.S.C. § 365 because there is nothing left for the debtor to assume or reject. *In re Greenville American Limited Partnership,* 2000 WL 33710874, at *4 (Bankr. D.S.C. 2000) The termination, however, must be complete and not subject to reversal, either under the terms of the contract or under state law. *Id.* (citing *Gloria Manufacturing Corp.*, 734 F.2d 1020 (4th Cir. 1984); *Moody v. Amoco Oil Co.,* 734 F.2d 1200 (7th Cir. 1984), *cert. denied,* 469 U.S. 982; *In re Fontainbleau Hotel Corp.,* 515 F.2d 913 (5th Cir. 1975)).

Here, the termination notice provided the Debtor with an opportunity to cure its default.

On its face, the final termination notice appears to be a form letter indicating that the electricity supply to the Debtor's facilities may be terminated as of March 26, 2001, if payment or mutually acceptable arrangements for payment are not made. (NMPC's Ex. 5.) The final termination notice makes no mention of termination of the ESA or the MOU. In addition, on or about the same date the termination notice was issued, the Debtor and NMPC entered into an agreement dated March 20, 2001 extending the MOU between the parties, which essentially extended the ESA until March 31, 2001. (NMPC's Ex. 4.)

The termination of a contract is not presumed and the burden of establishing that a contract has been terminated rests upon the party who asserts it. *Armour, Inc. v. Celic*, 294 F.2d 432 (2d Cir. 1961). The Debtor has failed to meet this burden. While the Debtor established its utility service was at risk of being shut off for nonpayment, there has been no showing that the underlying ESA was terminated pre-petition.

The court is also not persuaded by the Debtor's second argument, that the Final Utility Order constitutes a defacto rejection of the ESA. Almost immediately upon filing for bankruptcy protection, the Debtor moved for an order pursuant to 11 U.S.C. § 366 to establish an adequate assurance of payment for future utility services and to prevent its utility companies from discontinuing, altering, or refusing services. An interim § 366 order was entered on or about March 30, 2001, and the Final Utility Order was entered on or about May 14, 2001. The Debtor's § 366 motion did not seek rejection of the ESA, nor do the interim order or the Final Utility Order reject or amend the terms of the ESA.

Bankruptcy Code § 365(a) provides, in part, that "the trustee, subject to the court's approval, may assume or reject any executory contract..." 11 U.S.C. §365(a). "Executory contract" is not defined in the Code. Although the Debtor would have the court apply the

"functional approach" to determine whether a contract is executory, as the court indicated in *Whitten v. Aquatic*, Case No. 95-13501 (Mar 6, 1997), it believes the classic definition of executory contract is controlling. As discussed in the *Whitten* decision:

> The court is persuaded by Judge Duberstein's opinion in *In re Bluman*, 125 B.R. 359 (Bankr. E.D.N.Y. 1991)... As Judge Duberstein states in *Bluman*,
>
> > The term "executory contract" is not defined in the Code. The legislative history of § 365 states that the term executory contract "generally includes contracts on which performance remains due to some extent on both sides" ... The problem with the above stated definition is if it is to be stretched, it becomes evident that all contracts could be considered executory... Therefore the mere fact that there are obligations on both sides of the contract yet to be performed... does not persuade this Court that this Contract is executory for purposes of § 365.
> >
> > Courts have repeatedly utilized the definition formulated by Professor Vern Countryman, the respected authority on contracts and bankruptcy law... Countryman defines an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." ... The Countryman definition clearly requires that material future performance obligations remain on both sides of a contract in order for the contract to be executory under §365 of the Code...*Bluman* at p. 361-2.

Whitten, supra, at 3-4. (*See also Spectrum Information Technologies, Inc.*, 193 B.R. 400 (Bankr. E.D.N.Y. 1996)).

Thus, the crucial factor for determining the executory nature of a contract is whether there remains unperformed mutual obligations of the parties at the time the bankruptcy petition is filed. Here, the Debtor had obligated itself to obtain electricity from NMPC and to pay for the same, and NMPC agreed to supply electricity to the Debtor at a certain price. As such, the court finds that as of the Petition Date, the ESA was executory under Professor Countryman's definition. *See In re Monroe Well Services, Inc.* 83 B.R. 317 (Bankr. E.D. Pa. 1988) (finding electric service agreements"executory contract" where the debtor agreed to purchase minimum amounts at agreed upon rates; *In re Sharon Steel Corp.*, 79 B.R. 627 (Bankr. W.D. Pa. 1987),

aff'd, 872 F.2d 36 (3rd Cir. 1989) (finding public utility contracts executory in nature and subject to the provisions of 11 U.S.C. § 365).

As clearly set forth in 11 U.S.C. § 365(a), the power of a trustee, or in this case, a debtor-in-possession, to reject a contract is dependent on court approval. *In re Harris Mgmt. Co. Inc.*, 791 F.2d 1412, 1414 (9th Cir. 1986); *Gloria Mfg. Corp*. 734 F. 2d 1020, 1022 (4th Cir. 1984); *In re Gamma Fishing Co., Inc.*, 70 B.R. 949, 951 (Bankr. S.D. Ca. 1987); *Kelly Lyn Franchise Co., Inc.*, 26 B.R. 441, 445 (Bankr. M.D. Tenn. 1983). The requisite court approval promotes the Bankruptcy Code's policy of maximizing the value of the estate for the benefit of all creditors, while maintaining certain rights of parties to contracts with the debtor. *In re Gamma Fishing Co., Inc.*, 70 B.R. at 952; *In re Kelly Lyn Franchise Co.*, 26 B.R. at 445. "Assumption or rejection by implication or by action leads inevitably to the kind of confusion and uncertainty exemplified by this case." *In re Kelly Lyn Franchise*, 26 B.R. at 444; *See also Boland v. Parmalee*, 1997 WL 642550, at *5 (N.D.N.Y. 1997). Likewise, informal rejections have been held to be ineffective. *In re California Steele Co.*, 24 B.R. 185, 187 (Bankr. N.D. Ill. 1982).

Nowhere in the Final Utility Order does the court approve the rejection of the ESA. The Final Utility Order provides for the continuation of utility services and for adequate assurance of future payment within the meaning of 11 U.S.C. § 366 and makes no mention of the ESA. Thus, the court is unable to conclude that the Final Utility Order in some way operates as a rejection of the ESA.

Lastly, with its pending 11 U.S.C. § 365 motion, the Debtor requests that the ESA be rejected effective immediately prior to the petition date pursuant to 11 U.S.C. § 365(g). The Debtor's motion was filed on or about July 3, 2002 and was originally returnable on July 19, 2002. Meanwhile, the ESA expired pursuant to its own terms on March 31, 2001.

Typically, the executoriness of a contract is determined as of the petition date. *In re Riodizio, Inc.*, 204 B.R. 417, 421 (Bankr. S.D.N.Y. 1997) (citing *In re Columbia Gas Sys., Inc.*, 50 F. 3d 233, 240 (3rd Cir. 1995); *In re Spectrum Info. Tech., Inc.* 193 B.R. 400, 404 (Bankr. E.D.N.Y. 1996)). Post-petition events, however, can alter the executoriness of a contract, such as a contract expiring post-petition. *Riodizio, supra; See Broaddus Hosp. Assoc.*, 159 B.R. 763 (Bankr. N.D. W.Va. 1993). In those instances, a court will look to the date the motion to assume or reject is made or heard rather than the petition date. *Riodizio,* supra (citing *In re Spectrum Info. Tech, Inc.*, 193 B.R. at 404; *In re Wang Lab, Inc.*, 154 B.R. 389, 391 (Bankr. D. Mass. 1993); *In re Childworld, Inc.*, 147 B.R. 847, 852 (Bankr. S.D.N.Y. 1992); *Cohen v. Drexel Burnham Lambert Groupo, Inc.*, 138 B.R. 687, 700 (Bankr. S.D.N.Y. 1992)).

The Debtor would have the court apply the "business judgment rule" to support its position that it should be permitted to reject the ESA. *See NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 79 L.Ed. 2d 482 (1984). Application of the "business judgment rule", however, is premature as the court must first conclude that the ESA was an executory contract capable of rejection under 11 U.S.C. § 365 at the time the Debtor made its motion.

Several courts have held that if an executory contract expires or terminates before the court considers the issue of assumption or rejection, the issue is rendered moot. *See Gloria Mfg. Corp., supra* (holding motion to reject collective bargaining agreement moot where agreement expired before debtor's motion was heard); *Broaddus Hosp. Assoc., supra* (holding motion to assume or reject insurance contract, which expired before court approved assumption, was moot); *B&K Hydraulic Co.*, 106 B.R. 131 (Bankr. E.D. Mich. 1989), *aff'd*, 935 F.2d 269, 1991 WL 93191 (6th Cir. 1991) (holding where life insurance policy terminated under its own terms, prior to trustee's acceptance or rejection, no contract existed for trustee to subsequently assume

or reject); *In re Pesce Baking Co., Inc.*, 43 B.R. 949, 957 (Bankr. N.D. Ohio 1984) (application moot where agreement expired under its own terms prior to the hearing on the application.

The court is persuaded by the reasoning of these cases and concludes that this case is analogous. The ESA expired pursuant to its own terms as of March 30, 2001. Thus, as of both the date the Debtor filed its motion to reject the ESA and the original hearing date, there was no contract left for the Debtor to reject. Accordingly, the Debtor's motion is rendered moot.

The Debtor cites *In re Child World, Inc.* 147 B.R. 847 (Bankr. S.D.N.Y. 1992) in support of its position that the Debtor may seek to reject the ESA after the same expired by its own terms. *Child World, Inc.*, supra, however, is distinguishable. In *Child World, Inc. supra*, the court found that the employment contract at issue was executory when the debtor's motion for rejection was heard because obligations under the contract remained for both the employee and employer, even though the employee's employment was terminated. Under the expired ESA no obligations remained to be performed by the Debtor or NMPC. Thus, once the ESA expired, the ESA was no longer executory.

The effect of neither accepting nor rejecting an executory contract is that the contract remains in force. *Boland v. Parmelee*, 1997 WL 642550, at *5 (citing *In re Shoppers Paradise, Inc.*, 8 B.R. 271 (Bankr. S.D.N.Y. 1980); *In re Yonkers Hamilton Sanitarium, Inc.* 22 B.R. 427 (Bankr. S.D.N.Y. 1982), *aff'd*, 34 B.R. 385 (S.D.N.Y. 1983)); *See In re Texaco, Inc.*, 254 B.R. 536 (Bankr. S.D.N.Y. 2000). As the ESA was neither assumed or rejected as an executory contract, the ESA remained in effect until it expired by its own terms.

Section 503(b) limits the valuation of administrative expenses to the actual and necessary costs of preserving the estate. *Sharon Steel Corp.*, 872 F.2d 36, 39 (3rd Cir. 1989). Where a contract exists, there is an initial assumption that the contractual rate is the reasonable value of

the goods or services provided to the estate. *Bethlehem Steel Corp*., 291 B.R. 260, 264 (Bankr. S.D.N.Y. 2003)(citations omitted). As the Final Utility Order provides that NMPC will be entitled to an administrative expense priority for any unpaid post-petition debts, the question remaining, before both parties' requests for summary judgment can be decided, is whether the Administrative Claim should be allowed at the full contractual rate or at some other reasonable or fair market rate. While the court acknowledges NMPC has submitted some argument to support its position that it is entitled to an administrative claim in the amount of $288,588.46 calculated at the contractual rate, the court will allow the parties additional time to address the appropriate amount of the Administrative Claim.

For all of the foregoing reasons, it is

ORDERED, that Debtor's motion to reject its electric supply agreement with Niagara Mohawk Power Corporation pursuant to 11 U.S.C. § 365 is denied; and it is further

ORDERED, that the parties are directed to appear at an 11 U.S.C. § 105 conference on July 2, 2003 at 10:30 a.m. to discuss setting an evidentiary hearing and/or briefing schedule in connection with the parties' pending summary judgment motions on the issue of the appropriate amount of NMPC's administrative expense claim.

Dated: July 1, 2003

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Hon. Robert E. Littlefield, Jr.

U.S. Bankruptcy Court Judge