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# On Executory Contracts, Precedent Carries the Day

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An interesting case study in the power of precedent is illustrated in *Unsecured Creditors Committee v. Southmark Corporation* (*In re Robert L. Helms Construction & Development Co. Inc.*) 97 Daily Journal D.A.R. 4759(April 14,1997).

Here, the 9th U.S. Circuit Court of Appeals reviewed a decision by a bankruptcy appellate panel regarding whether an option contract, under Section 365 of the Bankruptcy Code, could be assumed or rejected by a debtor-in-possession or a trustee.

Appeals from Bankruptcy Court decisions are heard by three-judge bankruptcy appellate panels, unless a party timely elects to have the appeal heard by the district court. 28 U.S.C. Section 158(d).

The Bankruptcy Code does not define the term "executory contract." However, a contract will be considered executory only if both parties have material obligations unperformed, according to *In re Wegner*, 839 F.2d 533,536 (9th Cir. 1988). In determining whether an agreement is an executory contract, the courts should examine each party's unperformed obligations. *In re Ointex v. Entertainment Inc.*, 950 F.2d 1492,1495 (9th Cir. 1991).

In *Helms*, Southmark gave $10 and other valuable consideration to a landowner for an option to purchase real property. The landowner had no remaining performance, and neither did Southmark, which was not obligated to exercise the option it purchased. But even if Southmark's ability to take further action was viewed as performance due, the optionor couldn't do anything to make the option come into existence or to cause its failure. 97 Daily Journal D.A.R. at 4760.

On review, the 9th circuit held that a contract's executory nature is determined when a bankruptcy petition is filed. If the optionee serves notice of its intent to exercise the option and the debtor then files bankruptcy before the optionee pays the purchase price and before title is conveyed, an executory contract exists. The optionee is obligated to pay the purchase price and the optionor is obligated to convey title. Either party's failure to perform would constitute a material breach, excusing the other party from performance. Id.

The *Helms* panel rejected and declined to follow a prior 9th Circuit decision in *Gill v. Easebe Enters*. (*In re Easebe Enters*.), 900 F.2d 1417 (9th Cir. 1990). That panel held that an option contract is an executory contract governed by Section 365 of the Bankruptcy Code. It was inappropriate to have a blanket rule deeming all option contracts as executory, the panel determined. Further, the panel said that it was proper to consider the mutuality of obligations to determine if the option was executory and that the key consideration was whether performance

remained on both sides. Because there was no performance due on both sides, the panel did not find an executory contract in *Helms*. 97 Daily Journal D.A.R. at 4760-61.

The 9th Circuit agreed with the bankruptcy panel's reasoning, stating: "To treat all option contracts, regardless of the unique characteristics, as executory in nature...in many cases will either result in an illogical contravention of bankruptcy policies, or force courts to create legal fictions and meaningless factual distinctions harmful to the development of the bankruptcy law." 900 F.2d at 1461.

Nevertheless, it reversed the panel's decision, stating: "Despite the clear logical and persuasive reasoning of the BAP decision, the BAP erred in straying from 9th Circuit authority. Given the plain language of *Easebe*, the BAP was not free to take a contrary position in accordance with its own, albeit better reasoned, analysis." Id.

In the 9th Circuit's view, the bankruptcy panel erred by not following the rule of intracircuit stare decisis. See United States v. Washington, 872 F.2d 874,880 (9th Cir. 1989). Ordinarily, appeals before the circuit courts are determined by panels of three judges. The only situation in which 9th Circuit panels are not bound by prior panel decisions directly on point is when the earlier decision is later undermined by a Supreme Court decision; an en banc 9th Circuit ruling (or when the chief judge and 10 additional active judges form a panel); or legislation. Helms, 97 Daily Journal D.A.R. at 4760-61.

As the 9th Circuit found in *Helms*, if the decision cannot be distinguished and has not been undermined, the earlier panel's ruling controls the decision of a subsequent panel. This is the case even when the later panel determines that the first decision is incorrect. Id. at 4761.

Under these circumstances, except for an appeal to the U.S. Supreme Court, the only available alternative is for a party or an active 9th Circuit judge to request en banc review. See Fed. R. App. P. 35. However, such review is infrequently granted: "Ordinarily [review] will not be ordered except (1) when considerations by the full court is necessary to serve or maintain uniformity of its decisions, or (2) when the proceeding involves a question of exceptional importance." Fed. R. App. P.35 (a).

Consequently, situations arise such as that in *Helms* where the panel determined it was required to reject "clear logic and persuasive reasoning" in favor of strict adherence to controlling, although flawed, circuit precedent.