UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: BKY 4-90-5759

CPT CORPORATION, ORDER REGARDING OBJECTION TO CLAIM 905

Debtor.

At Minneapolis, Minnesota, September 21, 1992.

The above-entitled matter came on for hearing before the undersigned on the 22nd day of April, 1992, on the debtor's objections to claims 901 through 905 filed by Arun K. Dubé. Appearances were as follows: William I. Kampf for the debtor, and Arun K. Dubé on his own behalf.

At the April 22nd hearing, Dubé withdrew claims 901 and 902, claim 903 was allowed in the amount of $267,280, and claim 904 was disallowed in its entirety. In an order dated April 22, 1992, I so ordered, and directed the parties to submit written briefs regarding allowance of claim 905.

STATEMENT OF FACTS

On May 23, 1990, Arun K. Dubé was retained as CEO of the debtor, CPT Corporation ("CPT"), and received three convertible debentures of even date. Each debenture was convertible into 725,000 shares of CPT common stock upon CPT's attaining certain cash flow and operating profit goals under Dubé's management. The debentures were also convertible in the event that Dubé was terminated without cause. On September 6, 1990, the terms and conditions of Dubé's employment, including a reference to the debentures as compensation, were memorialized in a written employment agreement which bore an effective date of May 23, 1990.

NOTICE OF ENTRY AND FILING ORDER OR JUDGMENT
Filed and Docket Entry made on 9/21/92
Patrick G. De Wane, Clerk, By KK

Under Dubé's management, CPT was able to remedy its financial woes somewhat, but eventually had to resort to the protections of chapter 11 in order to reorganize its business. During the reorganization, the debtor negotiated with the bondholder's committee to develop an acceptable plan of reorganization. At a CPT board of directors' meeting, held on April 1, 1991, the board was informed by counsel that the bondholders' committee would accept an earlier proposed plan if the debtor would terminate the employment contracts of Dubé and another officer. The board determined that the employment contracts should not be rejected, and it approved motions that the proposed plan should instead reaffirm such contracts in addition to proposing certain members of the board of directors. Dubé then apparently left the meeting to discuss these proposals with representatives of the bondholders' committee, and subsequently returned informing the board that the committee had rejected the proposals to reaffirm the employment contracts and appoint certain directors. Anticipating that Dubé's employment contract would therefore have to be rejected in any plan of reorganization suitable to the bondholders' committee, the board subsequently approved a motion to immediately convert Dubé's debentures into common shares, but to make the shares "restricted and conditional upon approval of the Bankruptcy Court or confirmation of the company's Plan of Reorganization." Debtor's Exhibit 5, at p. 1299.

Accordingly, in a letter dated April 5, 1991, CPT authorized its corporate transfer agent to issue 2,175,000 shares of common stock to Dubé with the direction that:

> This issuance is to be made now with the usual insider restriction, and with the further restriction that the same are issued and transferable upon confirmation by the U.S. Bankruptcy Court by order or through a plan of reorganization evidenced by an opinion of counsel.

Debtor's Exhibit 6. A share certificate stating that Dubé was the owner of 2,175,000 shares, dated April 2, 1991, was delivered to Dubé bearing two restrictive legends. The first legend restricted transfer of the shares absent an effective registration statement or an opinion of counsel that such registration was not necessary. The second legend stated:

> This certificate is issued subject to ratification by the U.S. Bankruptcy Court for CPT Corporation pursuant to court order or confirmation of a plan of reorganization.

Debtor's Exhibit 7.

Rather than retaining the stock certificate that had been delivered to him, Dubé returned the certificate to CPT requesting that CPT hold the certificate for him until it emerged from Chapter 11 as a "living corporation." Dubé testified that he believed that the transfer was completed when the certificate was delivered to him, and that he had no intention of transferring ownership of the shares back to CPT. His testimony on these points was credible, and is corroborated by the fact that he never executed the assignment on the reverse side of the certificate.

At a board of directors meeting on June 14, 1991, the board approved a motion that Dubé's termination in the proposed plan of reorganization be deemed not to have been the result of any dissatisfaction with his performance. On July 8, 1991, a plan of reorganization rejecting Dubé's employment contract and the three convertible debentures was confirmed. All parties have since stipulated that Dubé's termination was without cause. Dubé then made demand that the share certificate be returned to him since CPT had now emerged from chapter 11 with a confirmed plan. The board of directors has refused to deliver the certificate, precipitating claim 905.[1]

POSITIONS OF THE PARTIES

Given the treatment of equity security holders in CPT's plan of reorganization, the 2,175,000 shares of preconfirmation common stock translates into 435,000 shares of postconfirmation class B common stock, and Dubé therefore asserts a right to delivery of a certificate for 435,000 shares of such stock. Two grounds are asserted for such relief. First, Dubé argues that even though CPT rejected his employment contract, the convertible debentures are separate and distinct instruments which are not subject to rejection as executory contracts. Second, Dubé argues that regardless of whether the debentures could be rejected, CPT had

[1] Although this dispute is framed in the context of claims litigation, Dubé is seeking injunctive relief requiring the debtor to perform on post-petition obligations. His claims should probably have been asserted in a separate adversary proceeding. However, the debtor has not objected to the procedural posture of the case, and I therefore feel free to conclude the matter in the procedural context in which it was presented.

already delivered the share certificate to Dubé, and upon delivery the transaction was complete and title to the shares was vested in Dubé. Although he returned the certificate to be held by CPT until it emerged from chapter 11, title never transferred back to CPT.

CPT responds to Dubé's first argument by stressing that the convertible debentures were an integral part of the overall terms of Dubé's employment. Since the employment contract itself was executory at the time the chapter 11 petition was filed, the debentures can be rejected along with the other terms of Dubé's employment. In response to Dubé's second argument, CPT takes the position that title to the shares never vested in Dubé because CPT had no authority to issue the certificate in the first place, and because the restrictive legend on the certificate made the issuance conditional on bankruptcy court approval which was never obtained.[2]

DISCUSSION

A. The Debentures as Executory Contracts.

The debentures, standing alone, are not executory contracts under the definition adopted by Professor Countryman. 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

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[2] Curiously, these arguments were made by CPT in a very cursory fashion in its original memorandum and at oral argument. CPT made no mention of these arguments in its post-hearing brief. Perhaps CPT intended to abandon them and perhaps not; its position is unclear. Suffice it to say that making such arguments without benefit of authority and counsel's failure to brief or even address the issue has made resolving this matter more difficult.

> would constitute a material breach excusing the performance of the other.

Countryman, Executory Contracts in Bankruptcy, 57 Minn. L. Rev. 439, 460 (1973). The debentures in the present case are not contracts at all because there is no promise of performance of any type on the part of Dubé. Rather the debentures are merely instruments, issued "for value received," which are convertible to common stock upon the occurrence of specified events. These debentures are akin to promissory notes where the only performance due is payment by one party. Given that no performance is required by the other party, such promissory notes have been held not to be executory contracts. See In re Cochise College Park, Inc., 703 F.2d 1339, 1348 (9th Cir. 1983); In re Kash & Karry Wholesale, Inc., 28 B.R. 66, 69 (Bankr. D.S.C. 1982). The only appreciable difference between a promissory note and the convertible debentures in the present case is that performance by CPT under the debentures was conditional. There is nothing that Dubé could have done or failed to do that would constitute a breach of anything in the debentures.

However, I agree with CPT that these debentures cannot be read in a vacuum. The cases cited by CPT are somewhat instructive, stating the basic principles that documents executed as part of the same transaction must be construed together and that a rejected contract must be rejected in its entirety. See Silk Plants, Etc. Franchise Systems, Inc. v. Register, 100 B.R. 360, 362 (M.D. Tenn. 1989); In re Constant Care Community Health Center, Inc., 99 B.R. 697, 702 (Bankr. D. Md. 1989); In re Rovine Corp., 6 B.R. 661, 666

(Bankr. W.D. Tenn. 1980); Marso v. Mankato Clinic, Ltd., 153 N.W.2d 281, 288-89 (Minn. 1967); In re Grayson-Robinson Stores, Inc., 227 F. Supp. 609 (S.D.N.Y. 1964). However, they fail to address the question whether instruments such as the debentures in the present case can be rejected when such instruments are executed as part of an overall contract. I find the case of In re Cochise College Park, Inc., 703 F.2d 1339 (9th Cir. 1983), a case cited by neither party, to be instructional. In Cochise, the Ninth Circuit held:

> Since payments on a promissory note are merely the performance of one side of the bargain, the note must be examined in conjunction with the other undertakings that, together with the promissory note, constitute the relevant contract of which the promissory note is but a part to determine what commitments remain to be performed by the parties.

Cochise, 703 F.2d at 1348 (emphasis in original); see also Burley v. American Gas & Oil Investors (In re Heafitz), 85 B.R. 274, 283-84 (Bankr. S.D.N.Y. 1988).

In the present case, the debentures are an integral part of Dubé's employment agreement. Dubé argues that there is no evidence in this case that suggests that the debentures were intended to be part of his employment contract, but this argument is refuted by the evidence. The debentures were executed on the same date that his employment began, and the employment agreement listed the debentures as a form of compensation and bore an effective date identical to the date of the debentures. Even though the written agreement itself was not finalized until several months after the debentures were executed, the debentures are still part and parcel of the terms under which Dubé was employed by CPT; they are a form

of an executive perquisite given in return for Dubé's services. Accordingly, the debentures themselves are part of Dubé's employment contract which was executory on the date the chapter 11 petition was filed, and can be rejected as part of that contract.

However, the debtor in the present case chose to perform on its executory contract with Dubé. The board of directors resolved postpetition to honor the debtor's obligation under the debentures and converted them when it became apparent that Dubé's employment would be terminated. After delivering the share certificate, Dubé returned it to the corporation to be held until a plan was confirmed. Now, CPT seeks to undo its postpetition performance by rejecting the convertible debentures. This it cannot do.

A party to an executory contract is placed in a precarious position upon the filing of a chapter 11 case. Such party holds no claim against the estate, yet its contract is subject to rejection upon confirmation of the debtor's plan of reorganization. Section 365 allows the debtor to use its business judgment in continuing to perform and compel performance under executory contracts prior to assumption or rejection thereof. See generally, Buschman, Benefits and Burdens: Post-Petition Performance of Unassumed Executory Contracts, 5 Bankr. Dev. J. 341 (1988). While the debtor is ultimately free to reject the executory contract, the debtor cannot have it both ways. Where the debtor elects to perform on an executory contract, its rejection of the contract upon confirmation of its plan does not effectively undo its postpetition performance.

That is exactly what the debtor is attempting to do in the present case.

B. Dubé's Ownership of the Shares.

Since CPT's delivery of the certificate cannot be undone by rejection of the debentures, I must decide whether Dubé obtained title to the shares when the share certificate was delivered to him. Section 302A.417, subd. 6 of the Minnesota Statutes provides that a signed stock certificate is prima facie evidence of ownership of the shares, and in the present case the signed stock certificate stating that Dubé is the owner of the shares was received into evidence.

CPT's first argument in opposition to Dubé's case is that as debtor-in-possession it had no authority to issue stock absent court approval, and therefore the issuance is avoidable as an unauthorized postpetition transfer under section 549 of the Bankruptcy Code. 11 U.S.C. § 549. Typically in a corporate chapter 11 case, the bankruptcy court does not interfere in the debtor's internal matters and the board of directors is free to run the corporation as it sees fit. The honoring of an obligation to deliver a stock certificate according to the terms of a prepetition convertible debenture seems to be exactly such a matter. The only case that I have found on point is Intramerican Oil & Minerals, Inc. v. Mid-American Petroleum, Inc. (In re Mid-American Petroleum, Inc.), 71 B.R. 140 141 (Bankr. N.D. Tex. 1987). In Mid-American, the court held that a bankruptcy trustee (or, as here, a debtor-in-possession) can issue authorized but unissued shares of

a corporate debtor's stock because such shares are not assets of the corporation and hence not property of the estate. Since they are not estate property, the trustee is free to sell them outside the ordinary course of business. In the present case, CPT executed convertible debentures prepetition and the board of directors elected to honor the debtor's obligation under those debentures postpetition by converting the debentures to stock. Based on Mid-American I see no reason that the board would need my authorization to do so.

Even if court authorization were required, CPT has cited no authority suggesting that the avoidability of the transaction negates Dubé's ownership. On the contrary, a finding that the issuance is avoidable would merely entitle the trustee to recover the certificate or its value from Dubé or any immediate transferee. 11 U.S.C. § 550. Furthermore, a separate adversary proceeding would be required to determine the avoidability of the transfer, and such a proceeding has not been brought.

CPT's second argument is that the restrictive legend on the certificate rendered the issuance of the shares contingent upon court approval, and since court approval was never obtained the issuance was ineffective. I know of no authority suggesting that the board of directors of a corporation has the power to place such restrictions on the issuance of shares. On the contrary, restrictions are imposed either by federal or state law, or by a separate document such as the articles, bylaws or a shareholder resolution. See Minn. Stat. Ann. § 302A.429, subd. 1 (1985).

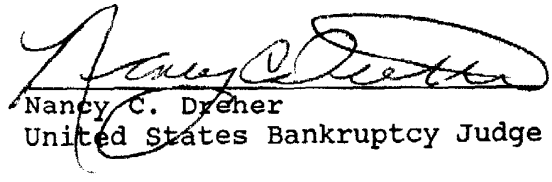
There is no separate written document in the present case imposing the restriction that was placed on the certificate, nor is there any applicable federal or state law imposing such a restriction. Absent such a document or statutory provision, the restrictive legend itself does not render the transfer of the stock certificate contingent. Restrictive language in a stock certificate serves merely as a warning to purchasers that such a restriction exists. The language itself has no effect on the ownership of the shares, nor does it make the transfer of the shares contingent.

Furthermore, and most importantly, even if the restrictive legend legitimately subjected the transfer to ratification by the bankruptcy court, I would ratify the transfer via my order today.

CONCLUSIONS

The debentures were an integral part of Dubé's overall employment agreement and therefore were subject to rejection as part of the agreement. However, between the time the case was filed and a plan of reorganization was confirmed, the debtor chose to perform on the contract in part by delivering the share certificate to Dubé. Having done that, its purported rejection of the debentures has no force and effect. When the certificate was delivered to Dubé, he effectively obtained title to the shares, and CPT's arguments that it lacked authority to issue the shares and that the issuance was made conditional by the restrictive legend are unavailing.

ACCORDINGLY, IT IS HEREBY ORDERED: Claim 905 is ALLOWED, and CPT shall transfer to Dubé 435,000 shares of class B common stock of CPT corporation.



Nancy C. Dreher
United States Bankruptcy Judge