

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re: Chapter 11 Case
Brutger Equities, Inc., BKY Case No. 3-90-5937
f/k/a Brutger Companies,
Inc., itself and as MEMORANDUM ORDER
successor by merger to
Brutger Companies, Inc., et al,
Debtor.

This matter came before the Court June 6, 1991 on motion by the Debtor to reject as an executory contract its pre-petition agreement with Chy Motel, Ltd. Christopher A. Elliott appeared for the Debtor. Ronald J. Walsh appeared for Chy Motel, Ltd. This is a core proceeding under 28 U.S.C. Sections 1334 and 157(a) and Local Rule 103(b). The Court has jurisdiction to determine this matter under 28 U.S.C. Section 157(b)(2)(O). The Court, having received and reviewed written arguments, having heard oral arguments, and now being fully advised in the matter, makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
FACTS

The subject of this disputed motion is a pre-petition agreement entitled "Contract for Deed" executed November 30, 1988 between Brutger Companies, Inc. (now Brutger Equities, Inc. - "Brutger") and Chy Motel, Ltd. ("Chy").(1) Under the agreement, Chy intends to purchase Wyoming property known as the Cheyenne Days Inn Motel from Brutger for a total purchase price of \$2,677,700. On that date, Brutger received \$145,000 as a downpayment, and agreed to accept an additional downpayment in the principal amount of \$255,000, plus agreed-upon interest, in two installments of \$55,000 due January 1, 1989, and \$200,000 due November 30, 1989. In order to enable Brutger to make monthly payments against a "First Mortgage" and a "Land Mortgage", acknowledged to be liens on the property, Chy must pay \$1,693,657.55 of the purchase price in monthly installments of \$16,970.07, and \$224,866.70 in monthly installments of \$2,212.66. Under Clause No. 28 of the agreement, Chy's interest is subordinated to the interests of the mortgages.

Footnote 1

Brutger also submitted as an exhibit to its motion an agreement between it as Operator and Chy Motel, Ltd. as Owner for management of the Cheyenne Days Inn. The Agreement, however, was not executed by a representative of Chy Motel Ltd., and therefore was not considered in reaching this decision.
End Footnote

Chy must pay the \$359,175.75 of the purchase price in monthly installments of \$3,500, and prepay this portion of its debt to Brutger "from and to the extent of the first \$100,000 of Net Operating Income" generated, beginning with fiscal year 1989. The agreement

contains a formula governing Chy's payment to Brutger to the extent net operating income exceeds \$100,00. Additional terms govern Chy's obligations regarding insurance, Brutger's management of the property, continued operation under its Days Inn franchise, taxes, escrow, property maintenance, etc.

first and land mortgages from funds received from Chy, to fund any "Operating Cash Flow Deficits" until a maximum amount of \$200,000 is funded, or until November 30, 1992. Brutger also agrees to a "hold harmless" clause to protect Ronald L. Kopeska ("Kopeska"), Chy's President, in connection with future action by Days Inns of America Franchising, Inc., the franchisor. The agreement includes additional provisions regarding remedies on default, and other standard clauses, such as requirements for modifications, etc.

Brutger also entered into a second agreement with both Chy and Kopeska under which it guaranteed a \$100,000 loan from Security Financial Bank & Savings, F.S.B. ("Lender"), the proceeds of which were used to fund Chy's purchase of the Cheyenne Days Inn. Under the terms of this agreement, Chy is obligated to repay Brutger should Brutger be required to fulfill its guarantee to Lender. Kopeska personally guaranteed repayment of Chy's obligation to Brutger. According to the parties, Lender demanded, and Brutger paid, in accordance with its guarantee. No evidence was submitted concerning amounts recovered by Brutger from either Chy or Kopeska.

Brutger argues that its agreement with Chy should be interpreted under the laws of Wyoming as an executory contract, which Brutger seeks to reject under 11 U.S.C. Section 365. Brutger argues that the appropriate test to use in determining whether the agreement should be rejected is the business judgment test. Applying that test, Brutger argues that continuing to meet its obligations under the agreement both hampers Brutger's reorganization effort, and depletes, rather than enhances, its bankruptcy estate.

Chy argues that even if the agreement might be construed as an executory contract which Brutger might otherwise be entitled to reject under 11 U.S.C. Section 365, Chy's obligations to Brutger under the contract confer substantial benefit to the bankruptcy estate. Furthermore, Chy asserts that the burdensome property test, rather than the business judgment test should be applied in reaching a decision regarding Brutger's right to reject the contract. Chy's position is that if Brutger wishes to terminate the agreement, it should be limited to the remedies provided in the agreement itself, namely, its cancellation in accordance with applicable state law.

II.

ISSUES

1. Is the agreement between Brutger and Chy an executory contract under the applicable state law?
2. Has Brutger shown that rejection of the contract is in the best interest of the bankruptcy estate?

III.

DISCUSSION

1. Executory contract. 11 U.S.C. Section 365(a) (12) permits a debtor the expedient alternative of terminating pre-petition contracts by motion in bankruptcy court, rather than requiring it to commence litigation outside bankruptcy. Such a remedy prevents the estate from being depleted, and the debtor's attention diverted, by time-consuming and often expensive litigation outside the bankruptcy process, while the debtor attempts to reorganize its financial affairs in bankruptcy. In order for the debtor to take advantage of this remedy in bankruptcy, however, the bankruptcy

court must find the contract the debtor seeks to terminate is an executory contract.

Footnote 2

11 U.S.C Section 365(a) reads in pertinent part: "...the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor...."

End Footnote

Item 17 on page 7 of the agreement between Brutger and Chy reads as follows:

"...Controlling Law. This Agreement has been made under the laws of the State of Minnesota and such laws will control its interpretations except insofar as Wyoming law shall apply with respect to matters of real property law...."

The plain language of the pre-petition agreement between the parties clearly intended that Minnesota law was to govern their respective rights and responsibilities under it. Without additional evidence, even assuming the Court could consider such evidence in view of the clear language in the agreement, Brutger is not entitled to a presumption that on November 30, 1988, approximately two years pre-petition, the application of Wyoming law in item 17 was intended by the parties to control the issue of whether their agreement is an executory contract. It is more likely that in 1988 the parties intended the reference to Wyoming law to be nothing more than an acknowledgement that necessary acts pertaining to the real estate itself must be performed in accordance with Wyoming real estate law because the real estate is located there.

In this jurisdiction, contracts for deed are not executory contracts for purposes of rejection under 11 U.S.C. Section 365(a). In re Adolphsen, 38 B.R. 776, 778 (Bankr. D.Minn. 1983) aff'd 38 B.R. 780 (D.Minn. 1983). And see Heartline Farms v. Daly, CV No. 90-L-236 (D.Neb. Sept. 24, 1990) (WL 299281). Neither the fact that this contract for deed provided for the vendor to manage the commercial property sold under a separate agreement, nor the various financial adjustment provisions calling for the vendor to finance certain deficits make the contract for deed executory. The agreement is basically a lending device. Accordingly, Brutger is not entitled to reject its agreement with Chy as an executory contract by motion in Bankruptcy Court.

2. Burdensome property or business judgment test. Even if this contract for deed were an executory contract, its rejection would not be justified on the present record. The parties acknowledge that there appears to be no controlling caselaw in this jurisdiction concerning the application of the burdensome property test versus the business judgment test under the circumstances of this case.

Chy urges the Court to apply the burdensome property test as appropriate where, as here, the vendee under a contract is likely to be harmed if the debtor rejects the contract. The burdensome property test requires the debtor to show that its continued performance under the contract will generate an actual loss to the estate. In re Huff, 81 B.R. 531, 537 (Bankr. D.Minn. 1988). And see In re Stable Mews Assoc., 41 B.R. 594, 596 (Bankr. S.D.N.Y. 1984) and cases cited therein. In this case, according to Chy, based upon Brutger's estimate of the property's value, its right to payment under the contract for deed will produce a substantial benefit to the estate. Furthermore, Chy represents that it is willing to release Brutger from its management responsibilities

under the separate management agreement. Chy asserts that even if application of the more flexible business judgment test is appropriate under the circumstances of this case, the debtor should not be permitted to finance its reorganization by imposing its costs upon a non-debtor vendee. In re Booth, 19 B.R. 53, 57 (Bankr. D.Utah 1982).

Brutger argues that the business judgment test should be applied. That test requires only that the debtor show that rejection is likely to benefit the bankruptcy estate. See In re Rath Packing, 36 B.R. 979, 990 (Bankr. N.D.Iowa 1984). And see N.L.R.B. v. Bildisco & Bildisco (In re Bildisco), 465 U.S. 513 (1984) - business judgment test "traditional" when considering rejection of pre-petition executory contract. Brutger maintains that it has demonstrated the contract will not only not be of benefit to the bankruptcy estate, but that compliance with the agreement will hamper its effort to reorganize. Accordingly, it has met its burden under the proper test, and its motion to reject should be granted.

In each of the cases discussing the application of the business judgment test, the deciding Court had substantial evidence before it to assist in reaching its decision. Here, the Court has only Brutger's conclusion based upon the terms of its agreement with Chy that its burdens under the Agreement substantially outweigh the potential benefit to the estate from performance under the agreement. No evidence is in the record concerning how much of the operating deficit guarantee has been paid out by Brutger; no evidence was presented concerning Chy's inability to perform in accordance with the terms of the contract for deed; and, Brutger's own valuation of the property contradicts its conclusion that the value of payments to be received under the contract is less than the value to the estate of rejecting the contract. Furthermore, since Chy's interest in the property is subordinated to the interests of the first and land mortgagees, it is not clear that rejection of the contract will confer a benefit to the unsecured creditors of this estate. Courts recognize that benefit to the unsecured creditors may justify permitting the debtor to reject a contract. Booth, 19 B.R. at 58. Stable Mews, 41 B.R. at 596. In this case, however, benefit to unsecured creditors from rejection of the contract has not been shown. Furthermore, rejection may entitle Chy to damages which will add to already existing claims against the estate.

Because it is unclear that Brutger's burdens under the agreement outweigh its potential benefit from rejection, it is not entitled to reject the agreement applying the business judgment test.

NOW, THEREFORE, IT IS ORDERED:

Brutger Equities' motion to reject its agreement with Chy Motel is hereby denied.

Dated:

Dennis D. O'Brien
U.S. Bankruptcy Judge