UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Not For Publication

In re:	:	Chapter 11
ENRON CORP., *et al*.	:	Case No. 01 B 16034 (AJG)
	:	(Confirmed Case)
Reorganized Debtors.	:	

OPINION SUSTAINING REORGANIZED DEBTORS' OBJECTION TO PROOF OF CLAIM FILED BY MIDLAND COGENERATION VENTURE LIMITED PARTNERSHIP (CLAIM NO. 24829)

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ARTHUR J. GONZALEZ
United States Bankruptcy Judge

Commencing on December 2, 2001 (the "Petition Date"), and from time to time continuing thereafter, Enron Corp. (the "Debtor") and certain of its affiliated entities, including Enron North

America Corp. ("ENA"), (collectively, the "Debtors") filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). On July 15, 2004, the Court entered an Order (the "Confirmation Order") confirming the Debtors' Supplemental Modified Fifth Amended Joint Plan of Affiliated Debtors (the "Plan") in these cases. The Plan became effective on November 17, 2004.

On or about May 25, 2004, Midland Cogeneration Venture Limited Partnership ("Midland") filed a proof of claim in the amount of $55,727,312.00 against ENA which was assigned claim number 24829 (the "Amended Claim") and which purports to amend a previously filed proof of claim that was dated September 30, 2002 (the "Initial Claim"). The basis of both filings is a Natural Gas Purchase Agreement, dated as of May 26, 1993 (as subsequently amended, the "Purchase Agreement"), between Midland and Union Pacific Fuels, Inc. ("Union Pacific"). ENA is the successor to Union Pacific's rights and obligations under the Purchase Agreement pursuant to the terms of an Assignment and Assumption Agreement, effective as of June 1, 1996 (the "Assignment Agreement").[1]

Pursuant to the terms of the Purchase Agreement, Union Pacific agreed to supply natural gas to Midland at a fixed base price, as increased from year to year and as adjusted for local delivery points, through September 30, 2006. The Purchase Agreement further provided that in the event of a failure to deliver natural gas, Midland's exclusive remedy was to purchase alternate supplies of natural gas and

[1] In connection with the assignment of the Purchase Agreement to ENA, Enron Corp. executed a Guaranty, dated May 7, 1996, in favor of Midland (the "Guaranty"). On April 24, 2003, Midland filed a motion with the Bankruptcy Court seeking permission to amend Claim No. 24829 to include a claim for the Guaranty or, in the alternative, to allow it to file a late claim against Enron with respect to the Guaranty. By order, dated September 17, 2003, the Court denied Midland's request, which order was affirmed by order, dated May 24, 2004, of the District Court for the Southern District of New York (the "District Court Order") and subsequently by judgment, dated August 16, 2005, of the United States Court of Appeals for the Second Circuit.

that damages were to be calculated based on an amount equal to the difference between the contract price and the higher price at which Midland, "in good faith and in the exercise of reasonable judgment," purchased the alternate natural gas.[2] The Purchase Agreement further provides that it is to be construed in accordance with the laws of the state of Michigan.

Subsequent to entering into the Assignment Agreement, by letter agreement dated February 27, 1997, Midland and ENA amended certain terms of the Purchase Agreement. Pursuant to the amendment, Midland paid ENA $15,750,000 in exchange for a reduction in the price of the natural gas to be delivered by ENA under the Purchase Agreement for the remaining nine years of the contract.

After the Petition Date, Midland and ENA continued performance under the Purchase Agreement until March 31, 2002. In response to Midland's nomination for natural gas for the month of April 2002, ENA notified Midland, by letter dated March 22, 2002, that it had elected not to deliver natural gas to Midland under the Purchase Agreement in April 2002. ENA did not, however, indicate that it intended to reject the contract. ENA rejected the Purchase Agreement, pursuant to section 365 of the Bankruptcy Code, effective as of April 19, 2002 (the "Rejection Date").

In the Initial Claim filed by Midland for damages purportedly arising from ENA's rejection of the Purchase Agreement, Midland calculated its rejection damages based on the actual costs of securing replacement natural gas up to the time it filed the Initial Claim, plus estimated future replacement cost for the remaining term of the Purchase Agreement (the "Cover Costs"). The estimated future replacement costs were based on then-current forward price curves, i.e., the

[2] In addition, the Purchase Agreement permitted Midland to terminate the contract upon Union Pacific's failure to provide at least 90% of the natural gas nominated by Midland for at least 120 days.

replacement costs for natural gas it would have been able to purchase for the remaining term of the Purchase Agreement assessed as of just prior to and around the date it filed the Initial Claim. Thus, Midland did not calculate prices based on the Petition Date. Rather, it calculated based on the date that it filed the Initial Claim.

Midland filed the Amended Claim to update its damage calculation to reflect the actual cost of replacement gas purchased after the date of filing the Initial Claim, plus estimated future Cover Costs. The Amended Claim was for $55,727,312. In calculating the Amended Claim, Midland used a combination of prices obtained in the spot market prior to and as of the date it filed the Amended Claim, and (ii) forward market prices obtained as of the that date. Midland also did not discount its damages to present value. Midland further maintained that $243,817.50 of the amount of the Amended Claim was an administrative priority claim (the "Administrative Claim"), pursuant to section 507(a) of the Bankruptcy Code, reflecting the added cost of replacement gas between April 1, 2002 and the effective date of rejection of the Purchase Agreement. Midland stated that the balance of the Amended Claim was a general unsecured claim.

On November 17, 2004, the Reorganized Debtors filed their Sixty-Seventh Omnibus Objection Filed in Aid of Consummation of Joint Plan to Reclassify Proofs of Claim Filed as Administrative and Priority Claims, in which, *inter ali*a, the Reorganized Debtors objected to the Amended Claim on the grounds that the Administrative Claim was not entitled to administrative priority treatment under sections 507 or 503 of the Bankruptcy Code. Midland and the Reorganized Debtors resolved the objection to the Administrative Claim by, among other things, reclassifying and allowing the Midland Administrative Claim as a non-priority, general unsecured claim in the amount of $121,908.75.

The settlement did not affect either party's rights regarding the remaining $55,483,494.50 of the Amended Claim.

On March 2, 2005, the Reorganized Debtors filed an objection to the Amended Claim alleging that based upon a review of the Amended Claim and a review of their books and records, the Amended Claim is inflated. The Debtors assert that this is because Midland applied a methodology that is inconsistent with the Bankruptcy Code to determine its Amended Claim. The Debtors maintain that a damage claim resulting from the rejection of an executory contract should be determined as if such claim had arisen before the date of the filing of the petition. Therefore, the Debtors calculated Midland's claim as of the business day before the Petition Date and contend that as of that date, Midland's damages resulting from ENA's rejection of the Purchase Agreement would not exceed $6,120,869.00, which includes the amount allowed under the prior agreement between the parties concerning the Administrative Claim. Specifically, ENA compared the forward contract prices provided in the Purchase Agreement against the forward market prices for the remaining contract period, which was to end on September 30, 2006, as of the business day before the Petition Date. In addition, ENA discounted the claim to present value as of the Petition Date.

In addition, the Debtors also allege that they are entitled to a setoff of $213,188.00 for amounts purportedly owed by Midland under other contracts with the Debtors.[3] Therefore, the Debtors

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[3]The Debtors' Plan provides that

> The Reorganized Debtors may, pursuant to applicable non-bankruptcy law, set off against any Allowed Claim and the distributions to be made pursuant to the Plan on account thereof (before any distribution is made on account of such Claim), the claims, rights and causes of action of any nature the Debtors or the Reorganized Debtors may hold against the holder of such Allowed Claim . . . .

maintain that once this amount is set off, the amount due Midland (inclusive of the $121,908.75 already agreed to by ENA) is no greater than $5,907,681.00. The Reorganized Debtors request that the Court enter an order disallowing the Amended Claim as filed, and allowing it in a reduced amount of $5,907,681.00.

Thus, the Debtors do not challenge either the specific calculations made by Midland in determining damages or the reasonableness of how Midland secured replacement gas. Rather, the Debtors object to the methodology used by Midland in calculating its claim based on hindsight using actual Cover Costs and projected Cover Costs as of a date other than the Petition Date. A hearing on this matter was held before the Court on June 9, 2005.

DISCUSSION[4]

Pursuant to section 365(g)(1) of the Bankruptcy Code, the rejection of an executory contract or unexpired lease, that has not previously been assumed by the debtor, "constitutes a breach of such contract or lease . . . immediately before the date of the filing of the petition." Further, section 502(g) of the Bankruptcy Code provides that

> [a] claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 502(g).

[4]The Court issues this Opinion based on the same analysis as in its Opinion Sustaining Debtors' Objection to Claim Filed by Taunton Municipal Lighting Plant (Claim No. 24494), dated September 21, 2005, which involved the identical issue concerning the determination of a damage claim resulting from the rejection of an executory contract.

In *In re American Home Patient, Inc.*, 414 F.3d 614, 618 (6th Cir. 2005), the court concluded that the plain language of section 502(g) of the Bankruptcy Code requires that damages for rejection claims be fixed as of a date "before the date of the filing of the petition." The *American Home Patient* court reasoned that this was consistent with the language of the section which requires that the rejection claim be both *determined* and *allowed* as if the claim had arisen before the date of the filing of the petition. *Id*. The *American Home Patient* court rejected the contention that the only consequence of Bankruptcy Code section 502(g) was to classify a rejection claim as a pre-bankruptcy unsecured claim. *Id*. Rather, the *American Home Patient* court reasoned that if that were the only consequence intended, use of the two words, "determine" and "allow," would be unnecessary as that effect would be accomplished by the use solely of the term "allowed." *Id*. In its analysis, the *American Home Patient* court noted that one of the definitions of the term "determine" was "to fix the boundaries of." 414 F.3d at 618 (citing, *Merriam-Webster Online Dictionary*, at http://www.m-w.com). The *American Home Patient* court further noted that the term "allow" was defined to mean "permit." *Id.* Thus, the *American Home Patient* court concluded that "the word 'allow' would be sufficient to 'permit' a rejection damage claim to be classified as a pre-bankruptcy unsecured claim, and the word 'determine' would serve no apparent purpose whatever." *Id*., at 618. Consequently the *American Home Patient* court determined that the inclusion of both terms in section 502(g) required that both be given effect and, consistent with section 365(g) of the Bankruptcy Code, the court concluded that the appropriate time to fix or determine damages was as of the time of the deemed breach - i.e., immediately before the date of the filing of the petition. *Id*.

The Claimant argues that the damages should be calculated based upon the difference between

the contract price and Midland's Cover Costs during the remaining term of the Purchase Agreement as provided under the terms of the Purchase Agreement and as assessed when it files its claim and then discounted to present value as of the Petition Date.

In *Medical Malpractice Ins. Ass'n v. Hirsch (In re Lavigne)*, 114 F.3d 379, 386-87 (2d Cir. 1997), the Second Circuit noted that while rejection is treated as a breach that qualifies for a remedy, such breach is not a complete termination of the contract. In *Lavigne*, a chapter 7 trustee did not assume or reject a doctor-debtor's malpractice insurance coverage within the statutory time permitted for such election. *Id*. at 382.[5] As a result, the insurance contract was deemed rejected. *Id*. at 387. The insurance contract included a provision that permitted a covered entity to purchase certain additional coverage within 60 days after the termination of the primary policy period that would extend the primary malpractice coverage benefits to claims asserted after the termination of the primary policy period to the extent of additional coverage purchased. *Id*. at 382. Within 60 days of the deemed-rejection date, the trustee sought to obtain that additional coverage. *Id*. The insurance company countered that the trustee's request was time barred because the rejection of the contract related back to the date immediately prior to the filing of the petition and the trustee's request was more than 60 days after the filing of the petition. *Id*. The Second Circuit concluded that while rejection is treated as a breach, the contract itself is not completely terminated. *Id*. at 386-87. The Second Circuit

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[5]Section 365(d)(1) of the Bankruptcy Code provides that

> [i]n a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

determined that the rejection merely relieves the estate of the obligation to perform but that the contract does not disappear. *Id*. at 387. Further, the Court concluded that not all contract obligations are terminated. *Id*. at 387. The Second Circuit reasoned that the debtor's obligations under the contract were unaffected and provided the basis for a claim that would be treated as a pre-petition claim for purposes of its priority. *Id*. at 387. However, the Second Circuit concluded that the parties rights under the contract and its breach were not determined by the Bankruptcy Code. *Id*. at 387. Rather, the court looked to state law to determine the parties rights under the contract. *Id*. With respect to the insurance contract, the Court determined that while it was considered breached as of the date immediately prior to the filing of the petitions, the contract terminated when it was deemed rejected upon the trustee's failure to assume or reject it within the statutory period. *Id*. As a result, the trustee's request for extended coverage was timely. *Id*.

The Claimant contends that in accordance with Second Circuit precedent, the rejection damages must be determined under state law and pursuant to the terms of the parties' agreement. As such, the Claimant argues that its rejection damages is based on its Cover Costs because of the breach. According to the Claimant, at the time of assessing the damage claim, the amount owing would be calculated based upon its actual Cover Costs up to that time in addition to future Cover Costs for the remaining term of the contract, which would be based on forward contract rates at the time of the assessment.[6]

However, it is only necessary to look to state law when there is a "gap" in federal bankruptcy

[6]Presumably, the proof of claim would be updated periodically to reflect the actual cost to cover the contract.

law. *American Home Patient* F.3d at 620. Where, however, "the Bankruptcy Code specifically fixes the date of breach for rejection damages purposes as the date immediately before the date of the filing of a bankruptcy petition" and "also specifically provides that any claim arising from a rejection shall be 'determined' as if such claim had arisen before the date of the filing of the bankruptcy petition," there is no "gap" and the Bankruptcy Code provisions control in relation to conflicting provisions of state law. *American Home Patient* F.3d at 620. Therefore, the provisions of the Bankruptcy Code control the timing of the fixing of the boundaries of the rejection claim irrespective of state law or the terms of the contract.

In *Lavigne*, the Second Circuit looked to state law to determine when the contract terminated for the purpose of selecting the appropriate date from which to calculate the period for electing the option to purchase additional coverage benefits. There is no provision in the Bankruptcy Code that specifically addresses the issue of the commencement date for the running of a contractual limitations period. As the parties' contract was not completely terminated upon its deemed breach, it was appropriate to look to state law to determine the relevant date from which to commence to count the option period. This is distinct from determining a damage claim stemming from a rejected contract where the Bankruptcy Code does not have a gap as it contains specific direction concerning the time frame at which to allow and fix the boundaries of such claim. The Bankruptcy Code specifically provides that a rejection claims is to "be determined [and] allowed . . . the same as if such claim had arisen before the date of the filing of the petition."

Moreover, determining the amount of damages as of the petition date is consistent with the historical fiction that a debtor's affairs are to be wound up as if settled on the date of the petition with all

of the debtor's assets ratably distributed on that date. *Addison v Lanston (In re Brints Cotton Marketing, Inc.)*, 737 F.2d 1338, 1342 (5th Cir. 1987) (citing, *Sexton v. Dreyfus*, 219 U.S. 339, 344-45, 31 S.Ct. 256, 55 L.Ed. 244 (1911)). Further, determining the damage claim as of the petition date is perceived as providing both the fairest treatment to similarly situated creditors and the most administratively efficient method to calculate the various claims. *Brints*, 737 F.2d at 1342.

The Claimant argues that it was precluded from terminating the contract by the automatic stay and therefore it should not be penalized for not seeking to procure a replacement contract as of the Petition Date. It claims it would be inequitable for it to be penalized for not seeking to mitigate its damages when it was not in a position to terminate the contract. In essence, the Claimant is seeking to achieve, through equity, the statutory protections Congress limited to, among others, a forward contract merchant.

While the provisions of the Bankruptcy Code preclude the Claimant from terminating the Purchase Agreement unilaterally, the Bankruptcy Code provides a mechanism for an entity to seek a determination concerning an executory contract. Although a debtor in a chapter 11 case is afforded an opportunity to make a determination concerning assumption or rejection of an executory contract until confirmation of a plan of reorganization, the non-debtor party may seek to reduce the time within which the debtor must make such election by filing a motion seeking to compel the debtor to make a determination concerning assumption or rejection of the contract within a specified period of time.[7] *See*

[7]Section 365(d)(2) of the Bankruptcy Code provides that
[i]n a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or

In re Enron Corp., 279 B.R. 695 (Bankr S.D.N.Y. 2002) (noting that "[u]nder § 365(d)(2), any party to an executory contract may request that the court fix a time within which the debtor must assume or reject an executory contract.") *In re Enron Corp.*, 279 B.R. 695 (Bankr S.D.N.Y. 2002).[8]

Finally, the Court must apply the plain meaning of a statute unless such application would "produce a result demonstrably at odds with the intentions of its drafters." *United States v. Ron Pair Enters.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, L.Ed.2d 290 (1989). Here, the fact that EPMI's bankruptcy filing alters or preempts the Claimant's rights under the contract is a reflection of the overall policy rationale of the Bankruptcy Code and not a justification for ignoring the plain language of the provision. Absent a showing that it produces a "result demonstrably at odds with the intentions of its drafters," there is no basis to ignore the plain language of the Code. No such showing has been

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reject such contract or lease.

[8]In fixing the time for a debtor to assume or reject a contract, the standard applied by the court is whether a debtor has been afforded a reasonable time within which to make its determination on assumption or rejection of the contract. *Enron Corp.*, 279 B.R. at 702. The decision as to whether a reasonable time has been afforded is within the court's discretion as considered under the facts of the particular case. *Id*. The factors considered by a court in reaching its conclusion include (1) the damage the non-debtor will suffer beyond the compensation available under the Bankruptcy Code; (2) the importance of the contract to the debtor's business and reorganization; (3) whether the debtor has had sufficient time to appraise its financial situation and the potential value of its assets in formulating a plan; and (4) whether exclusivity has terminated. *Id*. at 702-03 (citing *Theatre Holding Corp. v. Mauro*, 681 F.2d 102, 105-06 (2d Cir.1982)). In addition, a court must consider the complexity of the case, including the number of contracts to be evaluated, and the need for a court to determine the validity of the contract. *Id*. at 703 (citing *South Street Seaport Ltd. P'ship v. Burger Boys, Inc. (In re Burger Boys, Inc.)*, 94 F.3d 755, 761 (2d Cir.1996).

Regarding factor (1), the difference in the damages calculation resulting from its being determined at the deemed rejection date, instead of the actual rejection, is the type of non-debtor damages that arguably would be considered as not compensated by the bankruptcy code in determining whether such factor, in conjunction with the other factors, may warrant setting a specific time within which the debtor would have to assume or reject a particular executory contract. While consideration of factor (1) may be outweighed by some or all of the other factors, especially at the early stages of a complex case; seeking to compel an election by a debtor as to its intent concerning assumption or rejection of a contract is the only remedy available to a non-debtor, counter-party to an executory contract that is not otherwise protected by another section of the Bankruptcy Code. Congress chose to otherwise protect certain parties, including forward contract merchants, in the "safe harbor" provisions. However, if a party is not included within the ambit of the protection afforded there or is determined to have waived its rights under the safe harbor, it is not the role of this Court to expand those provisions to include such party.

established here.

CONCLUSION

The Court concludes that the proper time to determine the amount of Midland's claim resulting from the rejection of the Purchase Agreement is as if the rejection arose before the Petition Date and in that regard the Debtors' Objection to the Amended Claim is sustained. The parties are to confer to attempt to reach agreement (i) as to the proper calculation for Midland's claim as of before the Petition Date and (ii) as to the proper amount, if any, to be applied for setoff. If the parties are unable to reach agreement on these issues, a further hearing should be scheduled for their consideration.

The Debtors' counsel is to settle an order consistent with this Opinion.

Dated: New York, New York
September 26, 2005

s/ Arthur J. Gonzalez
UNITED STATES BANKRUPTCY JUDGE