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Not For Publication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 DEBTORS' OBJECTION TO
CLAIM FILED BY PENNACO ENERGY, INC.
(CLAIM NO. 24578)

APPEARANCES:

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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 (the "Effective Date").

On October 15, 2002, Pennaco Energy, Inc. ("Pennaco") filed proof of claim (claim no. 13653) against ENA (the "Initial Claim") for amounts allegedly due and owing to Pennaco by ENA pursuant to a prepetition swap agreement between ENA and Pennaco, dated August 31, 2000 (the "Swap Agreement"). On August 6, 2003, ENA rejected the Swap Agreement by filing a Notice of Rejection of the Swap Agreement. On December 19, 2003, Pennaco filed an amended proof of claim (claim no. 24578) against ENA to include additional amounts allegedly owed to Pennaco under the Swap Agreement (the "Amended Claim"). The Amended Claim amended and superceded the Initial Claim.[1]

On December 17, 2004, the Debtors as reorganized debtors (the "Reorganized Debtors")[2] filed the Seventieth Omnibus Objection to Proof of Claim asserting, inter alia, that according to their books and records, no amount was due to Pennaco (the "Omnibus Objection"). On May 20, 2005, the Reorganized Debtors filed a supplement to the Omnibus Objection.

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[1]Inasmuch as the Initial Claim was amended and superceded by the Amended Claim, it was disallowed and expunged pursuant to this Court's Order Granting the Debtors' Thirty-Ninth Omnibus Objection to Proofs of Claim (Claims Based on Duplicate Claims and Amended or Superceded Claims), dated September 30, 2004.

[2]Pursuant to the Plan, the Debtors were deemed to have assigned the prosecution of objections to proofs of claim to the Reorganized Debtors from and after the Effective Date.

Pursuant to the terms of the Swap Agreement, each party was obligated to make a payment each month based on an agreed upon formula. The amount ENA was obligated to pay was calculated by multiplying an agreed upon fixed price per unit of natural gas by a specified amount (the "Notional Amount") of natural gas (the "Fixed Price"). Pennaco was obligated to pay an amount calculated by multiplying a floating index price per unit of natural gas by the Notional Quantity (the "Floating Price"). The index price used was the Colorado Interstate Gas Co. - Rocky Mountain Index price. The parties would then net out the payments each month and only the entity with the net payment obligation would make payment. The Swap Agreement set the termination date of the Swap Agreement as October 31, 2003. The Swap Agreement further provided that upon an event of default (as defined in the Swap Agreement), the non-defaulting party could, its sole discretion, designate an early termination date (the "Early Termination Date") on notice to the defaulting party. Upon designation of an Early Termination Date, the Swap Agreement set forth the method to calculate damages.[3]

In the Amended Claim, Pennaco alleges it is owed $5,810,540.00 by ENA under the Swap Agreement. In determining the amount of the Amended Claim, Pennaco calculated the amount that each party was obligated to pay to the other under the terms of the Swap Agreement for each month from December 2001 through October 2003 and totaled the amounts into a net number. Pennaco had used the same formula in calculating the Initial Claim and, thus, in calculating the Amended Claim, it made no adjustment for the rejection of the Swap Agreement. Rather, Pennaco calculated its damages based upon the actual amounts that would have been paid under the Swap Agreement from the petition

[3]To calculate the damages from the Early Termination, the non-defaulting party was directed to (i) aggregate its gains or losses and costs with respect to all "Payment Dates" which would have occurred after the Early Termination Date and (ii) notify the defaulting party of the net amount owed to it or by it.

date until the October 31, 2003 date set for termination by the terms of the Swap Agreement.

The Reorganized Debtors object to Pennaco's calculation as improper and argue that the Bankruptcy Code requires that damages that arise from the rejection of an executory contract be calculated as of the Petition Date. The Debtor maintains that the Swap Agreement is a bilateral executory contract requiring each party to pay a sum and receive a sum on a periodic basis. The Reorganized Debtors note that although the payment obligations are netted out and only a single payment is made, nevertheless both parties have an obligation as one party has an obligation to pay a fixed amount and the other has an obligation to pay the floating amount. The Reorganized Debtors further contend that Pennaco calculates the damages as if the rejection of the Swap Agreement had no legal effect.[4]

Pennaco contends that it may calculate its damages based upon the actual post-petition performance in the commodities market. A hearing on this matter was held before the Court on June 2, 2005.

DISCUSSION[5]

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

[4]The Debtors also contend that using Pennaco's method of calculation, the amount of damages could not be ascertained until the contract expired by its terms because that is when the net values on a month-to-month basis for the entire period would be known, Therefore, the Reorganized Debtors argue that if it were a 20-year contract, calculation of the damages would have to wait until after the 20-year period.

[5]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, *See In re Enron,* --- B.R. ----, 2005 WL 2292703 (Bankr. S.D.N.Y. 2005), which involved the identical issue concerning the determination of a damage claim resulting from the rejection of an executory contract.

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).

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[6] argues that because the rejection of a contract constitutes a breach of the contract but does not terminate it, the damages should be calculated in accordance with the terms of the contract. Pennaco further argues that the damages are properly calculated by ascertaining the actual performance of the commodities market, post-petition. Thus, Pennaco maintains that it may take post-petition realities into account in calculating its damage claim[7]

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

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[6]The Claimant's response to the objection to the Amended Claim was filed on its own behalf and on behalf of Longacre Master Fund Ltd., the entity to which the Claimant previously transferred and assigned its claim against ENA, pursuant to a Transfer of Claim Agreement, dated July 23, 2003 (the "Transfer Agreement"). Pursuant to the Transfer Agreement, Pennaco is entitled to take any action to defend Pennaco's claim against ENA for a certain period of time, which period the parties may extend by agreement.

[7]In support of their respective views, the parties direct the Court's attention to the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"). However, the 2005 Act only applies to cases filed after October 17, 2005 and, therefore, does not have application to this matter. Moreover, any provisions contained in the new legislation would not be dispositive as to the state of the law prior to the adoption of the new provision, as such provision could equally evidence amendments to a prior-contrary law or clarification of a prior-consistent law.

for such election. *Id*. at 382.[8] 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 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

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[8]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.

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 Swap Agreement and that it is proper to calculate the damages based on the post-petition realities in the relevant market.

However, it is only necessary to look to state law when there is a "gap" in federal bankruptcy 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.[9]

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

[9]The Claimant argues that under the Swap Agreement, its damages are properly calculated by aggregating Pennaco's gains or losses based on actual market performance during the period when monthly payments would have been due until the Swap Agreement's termination date of October 31, 2003. Upon the rejection of a contract in bankruptcy, however, the Bankruptcy Code preempts any such provision and requires that the damages be determined for damage assessment purposes as if the claim had arisen before the date of the filing of the petition.

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.

In essence, the Claimant is seeking to achieve, through equity, the statutory protections Congress limited to, among others, a participant in a swap agreement who, based upon the bankruptcy, elects to terminate the swap agreement as provided under section 560 of the Bankruptcy Code.[10] To

[10]Section 560 of the Bankruptcy Code provides that
The exercise of any contractual right of any swap participant to cause the termination of a swap agreement because of a condition of the kind specified in section 365(e)(1) of this title or to offset

avail itself of the "safe harbor" provisions of the Bankruptcy Code, however, the swap participant must opt for the early termination of the swap agreement based upon one of the reasons enumerated in section 365(e)(1) of the Bankruptcy Code and if based upon the bankruptcy filing, the election to terminate must be made fairly contemporaneously with the bankruptcy filing. *See In re Enron Corp.*, 306 B.R. 465, 473 (Bankr. S.D.N.Y. 2004). Here, Pennaco could not have opted for the safe harbor protection when the rejection notice was provided because it was more than one year after the bankruptcy filing and therefore any termination would not be because of a condition of the kind specified in section 365(e)(1) the Bankruptcy Code. Further, the record supports a finding that the termination was not prompted by the financial condition of the debtor since such condition was present for nearly two years and Penaco never took any action to terminate the contract such as, for example, availing itself of the Early Termination provisions. Instead it merely ignored the rejection and calculated the damages as of the date set forth in the agreement for termination. Having failed to act prior to the rejection, the mandate to calculate damages was set by the Bankruptcy Code and cannot be

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> or net out any termination values or payment amounts arising under or in connection with any swap agreement shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title. As used in this section, the term "contractual right" includes a right, whether or not evidenced in writing, arising under common law, under law merchant, or by reason of normal business practice.
> Section 365(e)(1) of the Bankruptcy Code provides, in turn, that
> (e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on–
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> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
> (B) the commencement of a case under this title; or
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

circumvented by ignoring the consequences of rejection. Once it did not timely elect to terminate the contract, the contract was just another ordinary executory contract.[11]

While the provisions of the Bankruptcy Code precluded the Claimant from terminating the Swap 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, a party to such contract 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.[12] *See 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.

[11]Pennaco's also argues that the Swap Agreement was not an executory contract because after the parties netted out their obligations, the Swap Agreement only required the payment of money by one party. At the Hearing, the Court rejected Pennaco's argument in this regard. Although after netting out the payment obligations, only a single payment would be made in any particular month, nevertheless, under the Swap Agreement the parties had mutual performance obligations - each party was obligated to make a payment each month based upon an agreed upon formula. ENA was obligated to make payment based upon a fixed amount and Pennaco was obligated to make payment based on a floating amount. As there were mutual obligations under the Swap Agreement, it was an executory contract.

[12]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 reject such contract or lease.

2002).[13]

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 established here.[14]

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[13]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. As previously noted, Congress chose to otherwise protect certain parties in the "safe harbor" provisions. However, if a party does not come within the ambit of the protection afforded there or does not timely elect to avail itself of the protection afforded there, it is not the role of this Court to expand those provisions to include such non-covered parties. Indeed, in the 2005 Act, Congress has acted to expand certain "safe harbor" protections to apply to the termination of the types of contract at issue here. However, the provisions of the 2005 Act only apply to cases filed after October 17, 2005 and, therefore, do not have application to the matter before this Court.

[14]The Reorganized Debtors also contend that the Amended Claim was untimely. The Amended Claim, however, arose out of the same agreement and transaction that was attempted to be set forth in the Initial Claim and

CONCLUSION

The Court concludes that the proper time to determine the amount of Pennaco's claim resulting from the rejection of the Swap Agreement is as of the day 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 as to the proper calculation for Pennaco's Amended Claim as of the day before the Petition Date. If the parties are unable to reach agreement on the calculation, a further hearing should be scheduled with the Court.

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

Dated: New York, New York
October 5, 2005

s/ Arthur J. Gonzalez
UNITED STATES BANKRUPTCY JUDGE

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therefore relates back to the date of the Initial Claim and is deemed timely filed. *See* BANKR. R. CIV. P. 7015(c)(2).