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Keeping Score When Bankruptcy Principles and the Federal Anti-Assignment Act Collide: Government Contractors' Options Concerning Executory Contracts

Tanya M. Kiatkulpiboone

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KEEPING SCORE WHEN BANKRUPTCY PRINCIPLES AND THE FEDERAL ANTI-ASSIGNMENT ACT COLLIDE: GOVERNMENT CONTRACTORS' OPTIONS CONCERNING EXECUTORY CONTRACTS

TANYA M. KIATKULPIBOONE

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I. INTRODUCTION

U.S. companies facing bankruptcy risk losing government contracts vital to their business operation or government capture of ownership interests – neither of which is favorable to the nation's economy.¹ Popular government contracts

¹ See Jacob Pankowski & Kate Bouquard, President Obama Authorizes Major Changes to Federal Procurement Rules, GT ALERT (Greenberg Traurig LLP), March 2009, at 2, available at <http://www.gtllaw.com/portalresource/lookup/wosid/contentpilot-core-401->

involve matters ranging from technology and defense to pharmaceutical and transportation industries, none of which are immune from national emergencies, natural disasters, or the economic downturn.² More companies, overall, are recognizing the need to reorganize or restructure under bankruptcy procedures in light of the alternatives of a buyout or having to cease operations altogether.³ In recent news, it has only been all too typical that a businesses operating primarily on government contract(s) struggle to stay afloat. For example, pharmacogenomics company Perlegen Sciences, Inc. (“Perlegen”) closed its operations on October 30, 2009, just after making preparations to go public and announcing the launch of BREVAGen, a clinical test to identify women with intermediate risk for breast cancer.⁴ It was unable to remain solvent, due in large part to losses related to a government contract compounded by R&D disappointments and exacerbated by the economic crisis.⁵ Similarly, a technology and management consulting firm, BearingPoint, accumulating \$2.23 billion in debts⁶ filed for bankruptcy protection in February 2009, despite its status as a top 100 contractor with the Federal government.⁷ BearingPoint fears its Chapter 11 filing will hinder government work, which accounts for the bulk of its business and accordingly, its future viability.⁸ Since BearingPoint’s clients include “15 U.S. federal cabinet level-departments, 23 U.S. states and all of the top 10 global drug and biotechnology companies,”⁹ it is arguably a creditable debtor to receive a second chance to adapt to unforeseeable marketplace trends and avoid premature dissolution.

Such a second chance is offered to many businesses through bankruptcy reorganization procedures as set forth by the Bankruptcy Code (“Code”).¹⁰ While the concept of bankruptcy is appealing to debtors as a “fresh start,” it is not a cost free process, even to a debtor wholly lacking in securable assets.¹¹ While debtors tend to benefit from a discharge of their debts through the bankruptcy process, the

11103/pdfCopy.pdf?view=attachment (reporting federal procurement spending in excess of over \$500 billion in 2008).

² Peter Cockerell & Robert A. Bartlett, A Government Contract and Bankruptcy Law Conundrum: Interpretation of the Anti-Assignment Act and Related Matters, 43 PROCUREMENT LAW. 1, 13 (2007).

³ See U.S. Businesses File for Bankruptcy at a Faster Rate, INT’L HERALD TRIB., July 2, 2008, available at <http://www.iht.com/articles/2008/07/02business/02bankrupt.php> (indicating that as of June 2008, bankruptcy filings rose thirty-three percent from 2007. The number of companies filing for Chapter 11 bankruptcy alone also increased to 8,400 from 6,241 in 2007).

⁴ Turna Ray, *Perlegen Defunct: PGx Firm Shuttters Doors After R&D Disappointments, Mounting Losses*, PHARMACOGENOMICS REPORTER, Jan. 13, 2010, available at <http://www.genomeweb.com/dxpgx/perlegen-defunct-pgx-firm-shuttters-doors-after-rd-disappointments-mounting-losse>.

⁵ *Id.*

⁶ Phil Wahba & Andre Grenon, *US Judge OKs \$350 Million BearingPoint Sale to Deloitte*, REUTERS, Apr. 17, 2009, <http://www.reuters.com/article/idUSTRE53G4I620090417> (last visited Mar. 7, 2010).

⁷ Matthew Potter, *Bankruptcy for BearingPoint*, BNET, Feb. 19, 2009, <http://industry.bnet.com/government/1000562/bankruptcy-for-bearingpoint/> (last visited Mar. 7, 2010).

⁸ Alejandro Lazo, *BearingPoint Seeks Bankruptcy Protection: McLean Consulting Firm Says It Has No Immediate Plans for Layoffs*, WASH. POST, Feb. 19, 2009, <http://www.washingtonpost.com/wp-dyn/content/article/2009/02/18/AR2009021801973.html>.

⁹ See *supra* note 7.

¹⁰ See generally, 11 U.S.C. (embodying United States bankruptcy law).

¹¹ MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY 3-6 (1995).

debtor's bankruptcy record may remain on the debtor's credit report for 10 years, permitting lenders to refuse credit and private companies to refuse business.¹² Likewise, courts have not found the principle of debtor enablement exclusive. In 1988, the United States Court of Appeals for the Third Circuit in *In re West Electronics Inc.* ("*West Electronics*") held that the government was entitled to terminate a defense contract despite a Code provision enabling debtors to assume valuable contracts in its effort to reorganize.¹³ The court relied primarily on the Federal Anti-Assignment Act to assert that the government can prevent a debtor from assuming any federal contracts without its consent thereby retaining the right to terminate the contract for its convenience.¹⁴ This Comment takes issue with the legal conflict concerning businesses that contract heavily or primarily with the U.S. Government and that seek to reorganize under bankruptcy procedures. This dispute concerns whether such entities are entitled to classic debtor protection under the Code, or whether federal law protecting fundamental government interest in terminating pre-petition contracts supersede.

This Comment's analysis requires a look at statutory language, congressional intent and case precedent to support the following position: in order for a U.S. Government entity to refuse to recognize the assumption of an executory contract¹⁵ by a debtor party, or the transfer of an executory contract to a third party assignee, a holistic look at the factual circumstances between the parties, both pre-petition and post-petition, is a more valuable legal analysis than the mechanical application of imprecise statutes like the Federal Anti-Assignment Act. Part II of this Comment provides background concerning bankruptcy law's favoritism towards debtor objectives in light of existing non-debtor safeguards. Part III addresses conflicts in the Code language, tests derived from the inconsistencies and applied by the judiciary culminating in a review of *stare decisis*. Part IV proposes a four-factor test to guide judicial interpretation in future circumstances involving executory government contracts within a bankruptcy reorganization context.

II. BACKGROUND

A. The Bankruptcy Code Favors Debtors through Application of the Automatic Stay

To a debtor, filing a bankruptcy petition is analogous to asking a referee to call time. The automatic stay pursuant to section 362(a) of the Bankruptcy Code is a protection mechanism that is triggered immediately upon the filing of a bankruptcy petition.¹⁶ As a result, a debtor's pre-petition property and possession are entrusted to an estate, and in a Chapter 11 proceeding, the assets are held until

¹² *Id.* at 6.

¹³ *In re W. Elecs. Inc.*, 852 F.2d 79, 79 (3d Cir. 1988).

¹⁴ *Id.* at 82 (citing 41 U.S.C. § 15).

¹⁵ Professor Vern Countryman defined an executory contract as a "contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." See Simpson, *infra* note 30, at 190.

¹⁶ See 11 U.S.C. § 362(a) (2006).

a plan of reorganization is confirmed and a collective solution is derived to “provide adequate protection of the property interest of others, such as secured creditors.”¹⁷

While the automatic stay may benefit creditors from having to collect their debts on a first come, first serve basis, some property interests are at risk.¹⁸ For example, “the secured creditor who is prevented from foreclosing and the landlord who is prevented from evicting the delinquent debtor suffer a burden on their property rights.”¹⁹ Sometimes, though the stay may protect the assets in the debtor’s estate, creditors might wield impact on the debtor’s business in other ways.²⁰ The principle means for non-debtors to get around the stay is to petition for relief through the courts under section 362(d).²¹ A non-debtor, typically a creditor, attempts to show that their secured interest in their collateral would suffer depreciation without relief from the automatic stay.²² Non-debtor motions for relief from the automatic stay brought before the court forces a balancing of the creditor’s interest with the debtor’s opportunity to reorganize. Consequently, “the Code and the courts balance them by demanding good faith on the part of the debtor, by demanding . . . ‘adequate protection’ of the secured creditor’s property interest, and demanding (in some cases) that there be a reasonable possibility of a successful reorganization within a reasonable time.”²³ Therefore, for the purposes of analyzing successful reorganization for government contractors, the automatic stay, more importantly, “operates to prevent the non-debtor party from undertaking unilateral action to terminate an executory contract.”²⁴ In this way, the Code ensures that the mere filing of a bankruptcy petition does not constitute contractual breach.²⁵

Other ways around the automatic stay entail applying explicit statutory exceptions such as governmental regulatory actions.²⁶ This article will examine other ways the courts have treated the U.S. Government as party to bankruptcy proceedings. At this time, it is important to remember that although the automatic stay is not fatal to non-debtors, a recent judicial determination concluded that, “this Court has recognized the automatic stay’s broad application and noted that such breadth reflects a congressional intent that courts will presume protection of

¹⁷ MARK S. SCARBERRY ET AL., *BUSINESS REORGANIZATION IN BANKRUPTCY*, 11 (3d ed. 1996) (2006).

¹⁸ *Id.*

¹⁹ *Id.* at 14.

²⁰ *Id.* at 18. This text questions the scope of protection afforded by the automatic stay. It infers that even with the stay in place, it may do little to “prevent creditors from harassing or suing the debtor’s managers, who may have guaranteed the debts or may be alleged co-tortfeasors.” *Id.*

²¹ See 11 U.S.C. § 362(d) (2006).

²² SCARBERRY, *supra* note 17, at 18.

²³ *Id.* at 19.

²⁴ Richard F. Broude, *Executory Contracts and Unexpired Leases in Bankruptcy*, A.L.I. 471, 475 (Aug. 26, 1993).

²⁵ HERBERT, *supra* note 11, at 144 (articulating that even explicit ipso facto clauses stipulating that a contract is breached based on bankruptcy or insolvency alone are not enforceable).

²⁶ *Id.* at 18. The text cites to an example in which a debtor who “is violating air pollution regulations, the automatic stay will not prevent the state or federal regulatory agencies from shutting down the debtor’s business.” *Id.*

[debtor's] property when faced with uncertainty and ambiguity."²⁷

B. Debtors Rights Through Reorganization Procedures

In a Chapter 11 reorganization proceeding, the debtor's first steps entail identifying executory contracts, determining its status, and making an assessment as to whether it should preserve the contract for the survival of debtor's business.²⁸ A debtor-in-possession ("DIP")²⁹ or the Chapter 11 trustee has powerful advantages of four post-petition actions concerning executory contracts: "(1) reject the contract; (2) assume the contract; (3) assume and assign the contract. . . ; or (4) do nothing and let the contract 'ride through' the bankruptcy."³⁰

Pursuant to section 365(a), the trustee may assume or reject any executory contract so long as there is no pre-petition default, or if such default arises, section 365(b)(1)(A) allows the trustee to cure the default at the time of assumption or provide adequate assurance to the court that the trustee will promptly cure the default.³¹ The guidelines for assumption include obtaining court approval for the action and assuming the executory contract in its entirety. As a result, assumption treats the pre-petition contract as a new one in which any breach of this "new" contract will lead to damages that must be paid out by the estate as priority expenses.³² Courts tend to evaluate a debtor's worthiness to assume a contract based on a "business judgment" standard (in which the debtor must simply assert that assuming the contract is a smart business decision) and the court will grant authority to assume the contract so long as there is no evidence of "bad faith or abuse of discretion."³³

Like assumption, rejection also requires a court order. However, an important consideration in seeking rejection of a contract is the risk that filing a bankruptcy petition in bad faith may be grounds for judicial dismissal of debtor's request.³⁴ Bad faith may be found if a court determined that the "rejection of an important executory contract [was] essentially the sole motive for filing the Chapter 11 case."³⁵ While such review for bad faith motives could unfairly penalize more individual debtors with a single or few contracts over corporate debtors with numerous contracts, it does force the debtor and debtor's counsel to be cautious in identifying their motives for filing Chapter 11.³⁶ Notably, a

²⁷ Kristin S. Simpson, *Fifth Circuit's Executory Contract Standards Deconstructed: The Mirant Lessons*, 26 MISS. C. L. REV. 225, 250-51 (2007) (quoting *Bonneville Power Admin. v. Mirant Corp.*, 440 F.3d 238, 251 (5th Cir. 2006)).

²⁸ DANIEL J. FLANIGAN, UNDERSTANDING THE LEGAL ISSUES BEHIND EXECUTORY CONTRACTS IN BANKRUPTCY, 3-5 (2006).

²⁹ See 11 U.S.C. §§ 1107, 1108. A debtor-in-possession is the descriptive title for a post-petition debtor who is authorized by the court to continue his business.

³⁰ Simpson, *supra* note 27, at 226.

³¹ See 11 U.S.C. § 365(a) (2009).

³² Simpson, *supra* note 27, at 230.

³³ Michelle M. Harner et al., *Debtors Beware: The Expanding Universe of Non-assumable/Non-assignable Contracts In Bankruptcy*, 13 AM. BANKR. INST. L. REV. 187, 193-95 (2005).

³⁴ Broude, *supra* note 24, at 529-30.

³⁵ FLANIGAN, *supra* note 28, at 6.

³⁶ *Id.*

rejection does not relieve the debtor from the contract obligations altogether.³⁷ It is also not accurate to equate rejection to the “debtor’s breach, rescission, cancellation or modification of the contract.”³⁸ Instead, a rejection in bankruptcy constitutes a pre-petition breach³⁹ which entitles the non-debtor party to an unsecured claim as distributed from the bankruptcy estate. Unsecured claims are subject to a pro rata distribution which enables a DIP’s creditors to collect some damages.⁴⁰ This distribution system entitles unsecured creditors to monetary recovery—a chance they might not otherwise have had absent the automatic stay. At the same time, it is a necessary tool for insolvent debtors owing legal damages.⁴¹

Assigning an executory contract has become an extremely controversial issue. Such assignment requires assumption as a prerequisite. Authorization to assign the contract allows the debtor’s estate to “sell the contracts to generate capital for a reorganization or cash for distribution to creditors.”⁴² For some companies, assumption and assignment of executory contracts may be the only means to a feasible reorganization.⁴³ A bankruptcy principle of free assignability can be extracted from Code section 365(f).⁴⁴ Some legal analysts suggest that the principle is so powerful that it trumps state laws.⁴⁵ The controversy lies, however, with respect to enumerated anti-assignment provisions and certain federal non-bankruptcy laws.

C. Non-Debtor Safeguards

1. Relief from Automatic Stay

There are two bases for petitioning relief from the automatic stay.⁴⁶ Creditors seek relief when the stay prevents them from asserting rights to property of the debtor, debtor’s estate, or property simply in the possession of the debtor.⁴⁷ Or, creditors may appeal to the court to have the stay lifted or modified when they

³⁷ *Id.*

³⁸ Simpson, *supra* note 27, at 227.

³⁹ See 11 U.S.C. § 365(g) (2006).

⁴⁰ Simpson, *supra* note 27, at 227.

⁴¹ “As an illustration, if a contract provides for \$175,000 in liquidated damages for breach, and the debtor’s estate will pay out \$0.10 on the dollar to general unsecured claims, the non-debtor contracting party will have a \$175,000 general unsecured claim but receive \$17,500 for the breach claim.” *Id.*

⁴² David R. Kuney, *Restructuring Dilemmas for the High Technology Licensee: Will “Plain Meaning” Bring Order to the Chaotic Bankruptcy Law for Assumption and Assignment of Technology Licenses?*, 44 GONZ. L. REV. 123, 135 (2008).

⁴³ See *In re Carolina Parachute Corp.*, 108 B.R. 100, 102 (M.D.N.C. 1989).

⁴⁴ See generally Kuney, *supra* note 42, at 134–37; 11 U.S.C. § 365(f) (2009).

⁴⁵ “This right to freely assign contracts creates a business result that cannot be obtained under normal state-law rules, and in this sense, bankruptcy notions have pre-empted state law.” Kuney, *supra* note 42, at 136–37.

⁴⁶ DON CAMPBELL ET AL., CREDITORS’ RIGHTS HANDBOOK 424 (Clark Boardman Callaghan 1993–94).

⁴⁷ *Id.*; see also FED. R. BANKR. P. 4001(a)(1).

want to bring some other adverse action to the debtor.⁴⁸ Any adjustment to the automatic stay must be substantiated with “cause.”⁴⁹ Eligible “cause” ranges from proving “absence of harm to the estate or severe harm to the creditor or other parties in interest,” in addition to showing a lack of adequate protection of a creditor’s interest, or in the alternative, a debtor’s lack of equity in the property coupled with the property’s dispensability for reorganization purposes.⁵⁰ The non-debtor party seeking this relief must anticipate evidentiary demands of the court in proving the value of contested property, the lack of adequate protection, the likelihood of the debtor’s reorganization, and possibly even financial statements to substantiate grounds that relief from stay is necessary for the continued existence of the creditor’s business.⁵¹ While the automatic stay provides immediate assistance to insolvent debtors who file bankruptcy, the legislature was careful to limit its scope to afford the DIP or trustee the opportunity to arrange the property of the estate in a manner that balances the priorities of creditor’s rights.⁵² Just as quickly as a stay is imposed upon the filing of a bankruptcy petition, termination of the stay is automatically triggered when the purpose of its scope ceases.⁵³

2. *Financial Accommodations Contracts*

Some express limitations to assignability are listed in the Code. For example, Code section 365(c)(2) classifies financial accommodation contracts as exempt from the principle of free assignability.⁵⁴ According to the Eleventh Circuit:

The term ‘financial accommodations’ is not defined in the statute; however, the legislative history of §365 provides insight into Congress’ intent in using this term: Characterization of contract to make a loan, or extend other debt financing or financial accommodations, is limited to the extension of cash or a line of credit and is not intended to embrace ordinary leases or contracts to provide goods or services with payments to be made over time.⁵⁵

The exemption is a logical one; a debtor who enters into a loan agreement prior to filing bankruptcy should not be able to bind the non-debtor to go forward and issue the loan knowing that repayment in full by the debtor’s estate is almost impossible.⁵⁶

⁴⁸ CAMPBELL ET AL., *supra* note 46, at 424. An example of such action cited by the test is “a state court action.” *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at 424–25; 11 U.S.C. § 362(d) (2009).

⁵¹ CAMPBELL ET AL., *supra* note 46 at 427–28.

⁵² HERBERT, *supra* note 11, at 117.

⁵³ *Id.*

⁵⁴ *See* 11 U.S.C. § 365(c)(2).

⁵⁵ SCARBERRY ET AL., *supra* note 17, at 373.

⁵⁶ *Id.*

3. *Personal Service Contracts*

A general tenet in the law of contracts concerning the assignment of rights and delegation of duties is that the “duty to perform a personal service contract cannot be delegated.”⁵⁷ This tenet is encompassed in Code section 365(c)(1)(A), which authorizes a non-debtor, in certain circumstances, the right to prohibit the debtor or DIP from assigning the right of performance on the contract.⁵⁸ Somewhat redundantly, Code section 365(c)(1)(B) adds the requirement that the non-debtor party does not consent to any assignment.⁵⁹ The reasoning behind the ban on a transfer of a personal service contract to a third party assignee is the pivotal concern that the performance of the contract terms by the debtor or DIP was so specific and narrowly tailored to the non-debtor party that any substitute would change the intended or original term(s) of the contract. Parties who enter into personal service contracts tend to “rely on ‘qualities such as the character, reputation, skill, or discretion of the party that is to render’ performance,” and therefore, any delegation of the contract term to a third party is an unlikely substitute.⁶⁰

4. *“Applicable Law” Limitations*

Aside from financial accommodation contracts, personal services contracts, and certain leases, there are also contracts made non-delegable or non-assignable by law.⁶¹ Where a debtor possesses the power to assume or assign an existing contract even if prohibited by “applicable law,” the general consensus is to interpret “applicable law” as “applicable non-bankruptcy law.”⁶² The “applicable law” at issue in this Comment with respect to executory government contracts is the Federal Anti-Assignment Act. To understand how non-bankruptcy laws like the Federal Anti-Assignment Act affect the general bankruptcy provisions governing executory contracts, an overview of Code section 365 is necessary.

III. DISCUSSION & ANALYSIS

A. *Inconsistencies*

1. *Code Conflict Within § 365*

Code section 365(a) grants a trustee the general right to assume or reject any executory contract or unexpired lease of the debtor.⁶³ In Chapter 11 cases, however, since the debtor is seeking to reorganize his business while maintaining current operations, the help of a trustee is unnecessary and one is rarely appointed

⁵⁷ *Id.* at 375.

⁵⁸ *See* 11 U.S.C. § 365(c)(1)(A).

⁵⁹ *See id.* § 365(c)(1)(B).

⁶⁰ Harner et al., *supra* note 33, at 206.

⁶¹ *See generally* SCARBERRY ET AL., *supra* note 17, at 373.

⁶² Cockerell, *supra* note 2, at 13.

⁶³ *See* 11 U.S.C. § 365(a).

to the debtor. (Contrastingly, trustees are court-ordered in most Chapter 7 cases.) Thus, Code section 365(a) may be read as referring directly to a debtor or DIP's rights. Logically, "there is no reason for precluding the DIP from assuming its own contract and continuing to render services or other performance called for by the contract or lease."⁶⁴ The first limitation to an assumption, indicated in Code section 365(b)(1), is a contractual default.⁶⁵ Essentially, in order to assume an executory contract in which the debtor failed to fulfill his terms of the contract, the provision requires him to cure the default or provide adequate assurance that the debtor will "promptly cure."⁶⁶ Thus far, the means to assume a contract are straightforward.

The provisions of section 365 become thorny in subsection (c). The language concerning explicit non-assignable contracts was covered in the discussion on financial accommodations and personal service contracts, but a more significant limitation concerns "applicable law" that excuses the non-debtor from accepting or rendering performance in accordance with the terms of his contract with the debtor or DIP.⁶⁷ Courts have identified "applicable law" to include patent law, copyright law, and the Federal Anti-Assignment Act.⁶⁸ These laws come into conflict with bankruptcy principles in several ways.

First, the scope of protection for intellectual property rights are found in the Constitution, specifically, Article I, Section 8, Clause 8, which grants a limited monopoly to authors and inventors for their creative expressions and novel inventions.⁶⁹ Therefore, there is clear rationale to support the Patent Act exegesis that "patents shall have attributes of personal property."⁷⁰ It follows that, with this view, patents and like intellectual property assets may share the same level of non-assignability as personal service contracts. Although more insightful legal commentary on the issue distinguishes between transfers involving an assignment versus a license or an exclusive license versus a non-exclusive license, the bottom line is that bankruptcy courts have agreed to the "notion that federal common law prohibits the assignment of a patent license without the consent of the licensor and that this federal common law pre-empts any state law or bankruptcy policy, which permits assignment despite the licensor's opposition."⁷¹ While some experts find patent licenses more analogous to commodities and not personal services, they concede to the reality that case precedent reflects a decision to value an economic policy that encourages invention over one that promotes business reorganization.⁷²

Judicial trends reveal that the Federal Anti-Assignment Act also trumps bankruptcy principles because "executory contracts and unexpired leases to which

⁶⁴ Jay R. Indyke et al., *Ending the "Hypothetical" vs. "Actual" Test Debate: A New Way to Read Section 365(c)(1)*, 16 J. BANKR. LAW & PRAC., Apr. 2007, at 3.

⁶⁵ 11 U.S.C. § 365(b)(1).

⁶⁶ *Id.*

⁶⁷ *Id.* at § 365(c)(1) (2006).

⁶⁸ 41 U.S.C. § 15 (2009).

⁶⁹ U.S. CONST. art. I, § 8, cl. 8 ("To promote the Progress of Science and Useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.")

⁷⁰ Kuney, *supra* note 42, at 128 (citing 35 U.S.C. § 261 (2000)).

⁷¹ *Id.* at 130.

⁷² *Id.* at 132–34.

the federal government is a party may not be assigned outside of bankruptcy.”⁷³ In many cases, pre-petition contracts between the U.S. government and a government contractor did not survive post-petition based on bankruptcy standing alone. Like the Patent Act, this is another example illustrating how “applicable law” is antithetical to promoting debtor reorganization.

The designation “applicable law” is found again in Code section 365(e).⁷⁴ While the statutory language almost mirrors that of section 365(c), the legal result is that section 365(e) bars the enforcement of contract clauses that terminate or modify an entire agreement based simply on the act of filing bankruptcy (*ipso facto* clauses),⁷⁵ but carves an exception for “applicable law” that excuses the non-filing party from accepting or rendering performance according to the terms of the contract regardless of any stipulated anti-assignment clause.⁷⁶ Basically, the exception allows a non-debtor asserting any “applicable law” to restore the effect of an existing *ipso facto* clause.⁷⁷ One distinction is that under section 365(c), the non-debtor party is exempted from accepting performance from or rendering performance to the “debtor or debtor-in-possession,” whereas under section 365(e), that phrase is replaced with “trustee or assignee.”⁷⁸ Many scholars have noted this distinction but fail to reach any unanimous perspective on its legal significance.⁷⁹

There is, however, an undisputed recognition that § 365(c) is at odds with section 365(f). While section 365(f) proposes to reinforce the rules set forth in subsections (b) and (c), it contends that, regardless of provisions in the contract or “applicable law” that hinder assignment of an executory contract, the trustee may assign so long as (1) the trustee assumes the contract and (2) provides adequate assurance of an assignee’s future performance.⁸⁰ Thus, the general principle of section 365(c) prohibiting a trustee from assuming or assigning an executory contract if dictated by “applicable law,” seems to be voidable by application of section 365(f) so long as the trustee can fulfill the two required prongs. The judiciary has tried to reconcile the provisions into one approach, but the outcome lead to two interpretations: the “Hypothetical Test” and the “Actual Test.”⁸¹

2. Hypothetical vs. Actual Tests

The hypothetical test looks to the plain statutory language in section 365(c) stating that “[t]he trustee may not assume or assign any executory contract . . . if

⁷³ Harner et al., *supra* note 33, at 223.

⁷⁴ See 11 U.S.C. § 365(e) (2009).

⁷⁵ *Ipsa facto* clauses are defined as contract or lease provisions that force “termination of the contract or lease in the event of the insolvency or weakening financial condition of one of the parties.” Harner et al., *supra* note 33, at 247.

⁷⁶ See Nancy C. Dreher, *Fifth Circuit Adopts the “Actual” Rather Than the “Hypothetical” Test for Application of 11 U.S.C.A. §365(e)(2)(A) and Holds that Government Agency Could Not Rely on Its Ipsa Fact[o] Clause to Terminate an Executory Contract with Debtor*, BANKR. SERVICE CURRENT AWARENESS ALERT, 2006.

⁷⁷ *Id.*

⁷⁸ Cf. 11 U.S.C. § 365(c), and § 365(e).

⁷⁹ Harner et al., *supra* note 33, at 233.

⁸⁰ 11 U.S.C. § 365(f)(1).

⁸¹ Harner et al., *supra* note 33, at 233.

applicable law excuses a [non-debtor] party,”⁸² and asserts that if a debtor cannot assign an executory contract because he is prevented by applicable law, then the debtor cannot assume the contract post-petition either. This view was made popular since the Third Circuit’s holding in *In re West Electronics, Inc.*,⁸³ and thus far, the Fourth, Ninth, and Eleventh Circuits have followed suit.⁸⁴ The Third Circuit held that a pre-petition executory contract between the United States and a defense contractor could not be assumed after the contractor filed for bankruptcy because the Federal Anti-Assignment Act as “applicable law” made assignment impermissible.⁸⁵ Thus, the logic was that if assignment was impermissible, and assignment required assumption, but a trustee, debtor, or DIP could not “assume or assign,”⁸⁶ it follows that assumption was likewise impermissible. The analysis in *West Electronics* was incomplete because it failed to consider whether the debtor had even intended to assign the government contract.

Almost a decade later, a countervailing approach, referred to as the “Actual Test,” interpreted the bankruptcy provision of section 365(c) to require actual intent to assign a contract.⁸⁷ Without a definite and immediate intent to assign an executory contract to a valid third party, the First Circuit in *Summit v. Leroux* determined that “section 365(c) did not prevent assumption.”⁸⁸ Notably, the court looked to the legislative purpose of section 365(c) and asserted that it served to balance support for a debtor’s chance at reorganization by “provid[ing] the counter-party with the benefit of its bargain.”⁸⁹ Further, courts have reasoned that Congress must have intended to allow otherwise non-delegable contracts to be assumed if the DIP and not any third party assignee is actually assuming it because even in an extreme case involving a personal service contract, the terms dictating performance remain between the two pre-petition parties.⁹⁰

Tracing the provisions from Code sections 365(a) to 365(f), it is possible to summarize a debtor’s right to assume or assign an executory contract as follows: (1) a debtor may assume a pre-petition executory contract as long as the debtor did not default or if the debtor took steps to cure the default; (2) if “applicable law” excuses a non-debtor party from recognizing the performance terms of a contract, it is only the non-debtor’s authorization that will allow a DIP to assume the executory contract; (3) consequently, the non-debtor’s explicit permission, waiver,⁹¹ or non-action may render an assignment of the contract by the DIP valid; (4) a caveat to non-debtor waiver or non-action validation of an assignment is the requirement that an assignment is subject to notice of assurance on future

⁸² 11 U.S.C. § 365(c)(1)(A).

⁸³ See generally 852 F.2d 79 (3rd Cir. 1988).

⁸⁴ Kuney, *supra* note 42, at 145.

⁸⁵ *Id.* at 146.

⁸⁶ 11 U.S.C. § 1107 (2006).

⁸⁷ Kuney, *supra* note 42, at 146.

⁸⁸ *Id.* at 149 (citing *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 612 (1st Cir. 1995)).

⁸⁹ Kuney, *supra* note 42, at 150.

⁹⁰ SCARBERRY ET AL., *supra* note 17, at 377.

⁹¹ See *Delmarva Power & Light Co. v. United States*, 542 F.3d 889 (Fed. Cir. 2008) (holding that the United States properly waived its right under the Anti-Assignment Act to invalidate assignments).

performance.⁹² Ultimately, the only firm guarantee for any debtor or DIP to assume and assign an executory contract rests with non-debtor permission.⁹³

B. Code and Congress Conflict

1. Legislative Intent Behind the Federal Anti-Assignment Act

This Comment is primarily concerned with the interpretation of the Federal Anti-Assignment Act as “applicable law” excusing a non-debtor government party from pre-petition contractual obligations. The Anti-Assignment Act provides, “No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States is concerned.”⁹⁴

The legislative intent to draft such a statute has been articulated as a concern to ameliorate inconveniences to the government if the potential exist for contractual obligations to be modified.⁹⁵ For example, without the statute, a government contractor might assign the contract to multiple subcontractors and not the party it sought to deal with on an exclusive basis. Additional speculation concerning the purpose of the Anti-Assignment Act entails a wariness for deception, specifically, “persons obtaining claims against the government and using them to influence officers of the government.”⁹⁶

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⁹² See 11 U.S.C. §§ 365(a)–(f) (2009).

⁹³ This contention is presumed by this Author.

⁹⁴ Simpson, *supra* note 27; *In re Mirant Corp.*, 440 F.3d 238, 246 (5th Cir. 2006) (citing 41 U.S.C. § 15(a) (2009)).

⁹⁵ Lucantonio N. Salvi & Marko W. Kipa, “Standing Novation,” THE DEAL (February 8, 2008), <http://www.governmentcontractslawblog.com/Standing%20Novation.pdf> (explaining that “Congress was clear about the rationale behind this statutory regime: The government should only deal with the contracting party with whom it entered into an agreement and should not be put in a position of having to deal simultaneously with other entities, including in the context of litigation and “claims emanating from multiple sources. However, as is the case with most rules, the prohibition contained in the Anti-Assignment Act is not absolute and the Government is permitted expressly to consent to the assignment of a government contract”).

⁹⁶ Harner et al., *supra* note 33, at 224. See also *United States v. Shannon*, 342 U.S. 288, 291-92 (1952) (asserting the purposes of the Anti-Assignment Act as “undoubtedly to prevent persons of influence from buying up claims against the United States, which might then be improperly urged upon officers of the Government,” and that a second purpose was ‘to prevent possible multiple payment of claims, to make unnecessary the investigation of alleged assignments, and to enable the Government to deal only with the original claimant.’ Other courts have found yet another purpose of the statute, namely, to save the United States ‘defenses which it has to claims by an assignor by way of set-off, counterclaim, etc., which might not be applicable to an assignee”).

⁹⁷ Lucantonio N. Salvi & Marko W. Kipa, *Standing Novation*, THE DEAL (February 8, 2008), <http://www.governmentcontractslawblog.com/Standing%20Novation.pdf>

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government contractor might assign the contract to multiple subcontractors and not the party it sought to deal with on an exclusive basis. Additional speculation concerning the purpose of the Anti-Assignment Act entails a wariness for deception, specifically, “persons [] obtaining claims against the government and using them to influence officers of the government.”⁹⁸

In cases like *West Electronics*, where a government contract involved supplies for missile launching to the U.S. Air Force, it is rational to maintain a policy of non-assignability in the interest of national security. The *West Electronics* court has been subsequently criticized for its failure to limit the application of the Anti-Assignment statute to contracts involving the production of military equipment.⁹⁹ Instead, the case set a broad precedent in cases involving government contracts, whereby the Anti-Assignment Act “applies regardless of whether (a) the contract is one for personal services or (b) the identity of the party is material to the contract.”¹⁰⁰

2. Judicial Application

Established in 1953, the premise, that “[i]f the contract is of the sort where the government depends upon certain characteristics or abilities of the contractor, then the prohibition of 41 U.S.C. §15 will apply,”¹⁰¹ should remain the appropriate judicial standard for determining the possibility of assumption and assignment notwithstanding the Anti-Assignment Act. While it is important at times to come up with bright-line rules to maintain consistency of judicial interpretation, looking to case precedent provides a better indication of where the courts are headed, what the courts have missed, and how our knowledge from retrospect allows legal practitioners to shape a more uniformed legal analysis.

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Id.

⁹⁸ Harner et al., *supra* note 33, at 224. See also *United States v. Shannon*, 342 U.S. 288, 291-92 (1952). The purposes of the Anti-Assignment Act are:

[U]ndoubtedly to prevent persons of influence from buying up claims against the United States, which might then be improperly urged upon officers of the Government,” and that a second purpose was “to prevent possible multiple payment of claims, to make unnecessary the investigation of alleged assignments, and to enable the Government to deal only with the original claimant.” Other courts have found yet another purpose of the statute, namely, to save the United States “defenses which it has to claims by an assignor by way of set-off, counter claim, etc., which might not be applicable to an assignee.”).

Shannon, 342 U.S. at 291-92.

⁹⁹ Cockerell, *supra* note 2, at 14.

¹⁰⁰ Harner, *supra* note 33, at 225.

¹⁰¹ See *In re Adana Mortgage Bankers, Inc.*, 12 B.R. 977, 984 n.2 (Bankr. N.D. Ga. 1980) (citing *Thompson v. C.I.R.*, 205 F.2d 73, 77 (3d Cir. 1953)).

C. Any Resolve Found in Case Precedent?

The conflict between bankruptcy law and federal common law is complicated. The analysis inevitably leads to the underlying dilemma as to whether the US economy would benefit more from protecting and encouraging debtor reorganization plans or support the government's discretion in common law contractual rights. This is of increasing concern due to the current economic environment; the government is bailing out banks; should it also "bail out" businesses which rely heavily on government contracts? On the other hand, there may be important health and safety considerations behind protecting government's right to deny assignment of contracts. *Stare decisis* sheds light on important considerations, or the lack thereof, in determining whether to allow a debtor in possession to assume and assign an executory contract.

1. Case History Champions Government Favoritism

The anchor to executory government contract cases is *In re West Electronics, Inc.*¹⁰² In that case, a Third Circuit court determined that the Anti-Assignment Act was "applicable law" for the purposes of Code section 365(c) which entitled the government to annul a contract for missile supply from a DIP.¹⁰³ The court reasoned that since the Code provision required consent by the non-debtor (government) party in order for the DIP to assume any executory contract, and a federal statute prohibits the transfer (or assignment) of a government contract for lack of the same consent, then the result is a foreclosure on debtor's right to assume any contract it is not entitled to assign.¹⁰⁴ On its face, the judicial logic seems reasonable. However, the court further narrowed its basis by pointing to the fact that the contract involved the production of military equipment and explained that "West could not force the government to accept the 'personal attention and services' of a third party without its consent" because the personal attention and service given to military equipment was what Congress had in mind when it passed the Anti-Assignment Act.¹⁰⁵ The reasoned specificity of this holding begs the consideration of assignments involving government contracts having nothing to do with military supply. Interestingly, the bankruptcy judge who first deliberated over the facts in this case denied the government's legal position because "there were no exigent circumstances arising from national defense considerations requiring lifting of the stay."¹⁰⁶ On appeal at the district court level, however, the judicial determination affirming the bankruptcy court decision rested on a the notion that as long as West Electronics, Inc. ("West") represented that it "had the capacity and intention to cure the default" the automatic stay protection should remain enforced.¹⁰⁷ Unconvinced, the Third Circuit applied the literal application

¹⁰² See *In re W. Elecs. Inc.*, 852 F.2d 79, 79 (3d Cir. 1988).

¹⁰³ *Id.* at 82.

¹⁰⁴ *Id.* at 83. This line of reasoning follows because like the Federal Anti-Assignment Act which prohibits the transfer of a government contract to a third party, Code section 365(c)(1) excuses the government from accepting performance from third party.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 81.

¹⁰⁷ See *In re W. Elecs. Inc.*, 852 F.2d at 81.

of the Anti-Assignment Act and accepted the government's assertion that any capacity or intent to cure was irrelevant.¹⁰⁸

Similarly, the Fifth Circuit, in a case involving an unexpired lease,¹⁰⁹ held that federal aeronautics and space regulations set forth by the Federal Aviation Administration ("FAA") were "applicable law" for the purposes of Code section 365(c) which gave the FAA discretionary powers in refusing to allow assumption of an airport terminal facilities lease or reserve airport landing slots by a DIP.¹¹⁰ The court asserted that because the FAA had specific standards for assigning use of navigable airspace which meet vital requirements of national defense, no party may lease airport terminal space without FAA permission.¹¹¹ More specifically, the court noted that the prospective assignee, PSA, was not among the approved air carriers to operate at a national airport.¹¹² Also, the airport landing slots formerly allocated to Braniff were denied to Braniff when the company became a DIP because it was necessary for the FAA to "minimize the effect of Braniff's abandonment of service on the traveling public" resulting from Braniff's decision to "abruptly ceased all operations" prior to filing a bankruptcy petition.¹¹³ Under the Federal Aviation Act,¹¹⁴ the FAA retains all rights of assignment concerning navigable airspace including the discretion to "modify or revoke such assignment when required in the public interest."¹¹⁵ While the case at hand illustrates again, how "applicable law" under Code section 365(c) works in conjunction with federal rules designating assignment powers to one party prohibiting debtor's traditional assumption and assignment rights, the holding clearly attributes the outcome to reasons beyond the mechanical application of the statutory provisions.¹¹⁶

¹⁰⁸ *Id.* at 82. Although the case articulates the government's position insofar as it asserts that "West should not be permitted to cure its default even if it is capable of doing so," the more appropriate party that the government should contend is not allowed to cure is the assignee. *Id.* The case points to conflicting interpretation over the precise type of assignment prohibited by the Code. The Third Circuit emphasizes the literal reading of Code section 365(c)(1) and concludes that "West as a debtor" is a distinct entity from "West as a debtor in possession." *Id.* at 83. The dissenting opinion, however, reinforces West's argument that the correct interpretation concerning the purpose of the Anti-Assignment Act was the possibility of binding the U.S. government to a "wholly separate" and unknown defense contractor. *Id.* at 84.

¹⁰⁹ Section § 365(c) applies to both executory contracts and unexpired leases of a debtor.

¹¹⁰ *In re Braniff Airways, Inc.*, 700 F.2d 935, 942-43 (5th Cir. 1983).

¹¹¹ *Id.* at 943. The *Braniff* court conveys a three-fold purpose behind the FAA control over airspace: (1) centralizing the administrative power over the safe and efficient use of airspace (2) national security concerns, and (3) competitive air transportation that is responsible to the needs of the public. *Id.* at 941. In this case, Braniff entered into a proposed agreement with its creditors referred to as the "PSA Transaction" which represented an understanding between the parties that Braniff would transfer the landing slots and airport lease to PSA. *Id.* at 939.

¹¹² *Id.* at 943.

¹¹³ *Id.* at 940.

¹¹⁴ See 49 U.S.C. § 1348(a) (2009).

¹¹⁵ *In re Braniff Airways, Inc.*, 700 F.2d at 941.

¹¹⁶ In contrast to the *West Electronics* case, the judicial discourse in *Braniff* does not summarize its holding by stating that Code section 365(c) excuses a non-debtor party from accepting performance from an assignee so long as applicable law enumerates such and the lessor does not convey any consent. Instead, the court rationalizes two circumstances that gave rise to repeal of the PSA Transaction. First, because PSA was not authorized to operate at a national airport, the government's contractual benefit of the initial bargain between it and Braniff would be lost; the FAA's objective was to serve the public in its capacity as a competitive enterprise that operates within the confines of national security measures.

Next consider *In re Adana Mortgage Bankers, Inc.*¹¹⁷ Here, Government National Mortgage Association (“GNMA”)¹¹⁸ obtained relief from automatic stay in bankruptcy court after asserting that the mortgage-backed security or guarantee agreement it had with a mortgage lender was a non-assignable executory contract terminable at GNMA’s discretion for various legal reasons. The opinion discusses in great depth the legal conclusions in support of contract termination. First, the guaranty agreements are non-assignable under applicable law as articulated by Code section 365(c) and such qualifying law could be the statute governing guarantee agreements under 12 U.S.C. §1721(g)¹¹⁹ or the federal Anti-Assignment Act. Second, GNMA’s appropriate basis for relief from automatic stay came in the form of the adversary proceeding it initiated whereby its foundational argument rests on the fact that preserving the automatic stay does not help the debtor.¹²⁰ Ultimately however, the *raison d’être* lies in the conclusion that “[t]he Guarantee Agreements are executory contracts to make financial accommodations for the benefit of the debtor, and therefore the debtor is prohibited from assuming them without GNMA’s consent” and it did not consent.¹²¹ Financial accommodation contracts are strictly prohibited from assignability.¹²² While the case could have been decided solely on the financial accommodation classification, the court seemed to have found it imperative to reference the interplay between Code section 365(c) and the Anti-Assignment Act. In doing so, the court elaborated on the purpose of the Anti-Assignment Act likening the guarantee agreements to personal service contracts.¹²³ Additionally, because GNMA considered the debtor in default for failure to reach net worth requirements which correlated with the “viability of its program, and indirectly to the housing industry of this nation,” the implication

Id. at 941. PSA’s decision not to apply to, or failure to qualify under the U.S. Government’s air carrier approval process, deemed it a liability to the government whose practice is to allocate landing slots to air carriers that meet the safety and security standards as set by the Department of Transportation and FAA. *Id.* at 938. Additionally, Braniff could not assume the terminal lease, much less assign the lease to PSA, due to pre-petition default. *Id.* at 939. Similarly, the facts in *West Electronics* point to debtor’s pre-petition problems in performing the terms of the contract, yet the court circumvented the breach as a basis for its holding.

¹¹⁷ See *In re Adana Mortgage Bankers, Inc.*, 12 B.R. 977 (Bankr. N.D. Ga. 1980).

¹¹⁸ GNMA is a corporate entity owned and controlled by the United States Government. *Id.* at 980.

¹¹⁹ *In re Commonwealth Mortgage Co., Inc.*, 145 B.R. 368 (Bankr. D. Mass. 1992) (concluding that the automatic stay does not apply to GNMA actions when it is exercising its statutory duties under 12 U.S.C. § 1721(g), which provides that no state, local or federal law (except federal law expressly referring to this subsection) shall limit GNMA exercise of contractual rights; thus, GNMA could declare default and require turnover of pooled mortgages backing mortgaged backed securities serviced by debtor).

¹²⁰ See *In re Adana*, 12 B.R. at 988. The court explains that it is “inevitable” that termination of the guarantee agreements will be granted according to Code section 365(e)(2) for lack of GNMA consent to any assignment or assumption by Adana and therefore, Adana will be left without any means for an effective reorganization. *Id.* Essentially, Adana is simply another “thinly capitalized” mortgage lender whose success is dependent on its participation in and adherence to the rules of the GNMA mortgage-backed securities program. *Id.* at 987.

¹²¹ *Id.* at 987 (emphasis added).

¹²² See *supra* text accompanying notes 55-57.

¹²³ The court quotes a Third Circuit case asserting that “[i]f the contract is of the sort where the government depends upon certain characteristics or abilities of the contractor, then the prohibition of 41 U.S.C. § 15 will apply.” *In re Adana*, 12 B.R. at 984 n.2. For the GNMA, the court believes that certain necessary characteristics a qualified mortgage lender include “integrity, efficiency and management capabilities.” *Id.*

made was that a material requirement of the contract was not met and the GNMA's program objective to benefit the public welfare was put at risk.¹²⁴

A few years after *In re Adana*, a district court in New York faced a similar controversy involving a DIP and a government benefits contract. Instead of mortgaged-backed securities to benefit the U.S. housing market, *In re Nitec Paper Corporation* involved low-cost electric power supply in the Niagara region.¹²⁵ The factual disposition of this case begins with the congressional enactment of the Niagara Redevelopment Act ("NRA").¹²⁶ The NRA gave the Federal Energy Regulatory Commission ("FERC") the authority to endow an entity called the Power Authority of New York ("Power Authority") to allocate "replacement power" (equivalent power supply lost from the destruction of a hydro-electric plant attributed to natural disaster) to Niagara-Mohawk ("NMO") a public utility power company.¹²⁷ Nitec Paper Corporation ("Nitec") contracted with NMO to purchase low-cost electric power supply in bulk.¹²⁸ When Nitec filed Chapter 11 bankruptcy, the corporation moved to assume its contract with NMO and transfer two-thirds of its power supply to a third party, Occidental Chemical Corporation ("OCC") for a term of six months.¹²⁹ The transfer stipulated that OCC would pay the low-cost price to NMO and a "surcharge of \$35,000 per month" to Nitec.¹³⁰ Power Authority refused to approve the transfer.¹³¹ The New York district court deferred to Power Authority's decision to deny Nitec's assumption and

¹²⁴ *Id.* at 982. The guarantee agreement listed conditions that would lead to automatic default and other conditions that allude to possible default. *Id.* at 980. The "(1) failure to make monthly payments on the certificates as they become due and (2) the application by the issuer for an advance from GNMA to pay the certificate holder" were obligations that had to be met by the issuer, or would constitute breach. *Id.* Other likely events leading to default included "(1) failure to give advance notice of bankruptcy, (2) failure to maintain a specified minimum net worth established by GNMA, and (3) the actual filing of a petition in bankruptcy." *Id.* GNMA claimed that Adana's decision to file bankruptcy triggered two of the optional default conditions; the failure to maintain minimum net worth and failure to give notice prior to filing a bankruptcy petition. *Id.* at 981-82. When GNMA acted to terminate debtor's rights as issuer under the Guarantee agreements and take ownership and custody of related Adana bank accounts, Adana responded by filing a motion for contempt in court on the basis that GNMA's acts were violations of the automatic stay. It is the perspective of this author that these facts support the contention that the court's detailed discussion concerning Code section 365(c) and the Anti-Assignment Act was unnecessary to the court's holding. First, if GNMA is faulting Adana for failure to give advance notice of the bankruptcy filing, then Adana committed a pre-petition breach of the guarantee agreement and the automatic stay could not prevent its termination and the analysis would end here. On the other hand, if the notice requirement was considered a post-petition default then the automatic stay prevents GNMA from taking any action on that basis and the remaining basis for termination would be the net worth requirement. The problem here, however, is that imposing strict compliance to the net worth requirement seems harsh when Adana continued to make payments as required to mortgage certificate holders and because GNMA's primary reason for having this optional default requirement was because it threatened a debtor's ability to make payments. *Id.* at 981-92 (emphasis added). This court's decision appears to set a trend followed by the West court to overlook a debtor's ability to perform.

¹²⁵ *In re Nitec Paper Corp.*, 43 B.R. 492, 493 (Bankr. S.D.N.Y. 1984).

¹²⁶ *Id.* at 494.

¹²⁷ *Id.*

¹²⁸ *Id.* at 493.

¹²⁹ *Id.*

¹³⁰ *Id.* at 493.

¹³¹ *In re Nitec Paper Corp.*, 43 B.R. at 494. The bankruptcy court approved the transfer and Power Authority appealed to the New York district court.

assignability of the contract based on the following legal justifications: (1) NRA should not be “a method [of] financ[ing] a Chapter 11 debtor,¹³² (2) under Code section 365(c), the “applicable law” referring to the NRA vests the restoration of electric power supply with Power Authority so without its approval, Nitec’s proposed actions must be adjudicated invalid.¹³³ The court also adopted the view that the Code may allow assignment of an executory contract even if contractual provisions bar the assignment but not if an action violates a specific statutory mandate forbidding assignment.¹³⁴ The bottom line was that Nitec’s attempt to assume a contract involving federally subsidized electric power for sale at market price to a third party violated state, federal, and bankruptcy laws.

The court in *In re Pennsylvania Peer Review* returned to more simplistic grounds for government preclusion of contract assumption by a DIP.¹³⁵ Peer Review Organization entered into a contract with federal government’s Health Care Financing Administration (“HCFA”), to “review . . . health care services furnished under the Medicare program in Pennsylvania.”¹³⁶ Sometime after paying Peer Review for two months of work, Peer Review alleged that “HCFA withheld further payment and subsequently wrongfully terminated the contract.”¹³⁷ The facts further indicate that Peer Review filed bankruptcy seven months after entering into contract with HCFA.¹³⁸ Peer Review challenged the termination on the basis that (1) HCFA did not abide by statutory termination requirements of 42 U.S.C. §1320(c)-2(d)(1), and (2) HCFA committed a violation of Peer Review’s “[c]onstitutional right to due process” because no hearing was ever held and 42 U.S.C. §1320(c)-2(d)(2) lists a ninety-day notice requirement for prospective termination action.¹³⁹ The government invalidated Peer Review’s assertions by referencing 42 U.S.C. §1320(c)-2(f) mandating “[a]ny determination by the Secretary to terminate or not to renew a contract under this section shall not be subject to judicial review.”¹⁴⁰ Like the cases aforementioned, the government in Peer Review took the position that it is entitled to absolute contractual rights not

¹³² *Id.* at 495. While Nitec’s agreement with OCC seems to have a profit-making component, the court simply concluded that it wasn’t Congress’ intent for companies to benefit beyond affordable power supply that existed prior to the hydro-electric plant destruction. *Id.* The court does mention that although resale of such power supply may promote “the rehabilitation of bankrupt companies, [] it does so here by infusing into the [DIP’s] estate money to which the estate is not entitled.” *Id.* The court fails to address how customers of low-power electricity would be hurt by a resale of Nitec’s transfer to OCC, especially considering its proportional allocation and limited duration. *Id.*

¹³³ *Id.* at 495. Although Nitec’s unsuccessful attempt to make the argument that Code section 365(c) should be limited to personal service contracts is rebutted by the longstanding viewpoint that “[s]urely if Congress had intended to limit section 365(c) specifically to personal service contracts, its members could have conceived of a more precise term than ‘applicable law’ to convey that meaning,” a closer look that the purposes behind such laws correlate with personal service contract treatment. *Id.* at 497; *see also infra* Part V.

¹³⁴ *Id.* at 498.

¹³⁵ *Pa. Peer Review Org. v. United States*, 50 B.R. 640, 642 (Bankr. M.D. Pa. 1985).

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 641. The facts of the case are silent as to the timeframe in which HCFA payments made to Peer Review stopped and the contract was terminated. *Id.* at 642.

¹³⁹ *Id.* at 642. *See also* 42 U.S.C. § 1320(c)-2(d)(2) (2009).

¹⁴⁰ *Pa. Peer Review Org.*, 50 B.R. at 642.

limited to terminating a contract “at its convenience.”¹⁴¹ The government position almost implies federal statute may override due process. Without actually taking such an extreme position, the court directed Peer Review to bring a wrongful contract termination claim asserted in an action seeking damages in order for the constitutional violation issue to be adjudicated.¹⁴²

Similarly, in *In re Carolina Parachute Corp.*,¹⁴³ the district court overturned the bankruptcy court’s decision by granting relief from automatic stay to the United States Army seeking to terminate its contract with a government contractor that manufactured parachutes and held that because the Anti-Assignment Act would bar the assignment of the parties’ agreement without the consent of the government, that the debtor could not assume the contract. The debtor’s primary motive for seeking assumption was corporate vitality; the opinion cited, “This court is aware of the compelling facts of this case, not the least of which is that defense contracts with the government constitute debtor’s primary, if not only, source of revenue.”¹⁴⁴ The court in this case did not consider, however, whether the contracts were of a personal service nature or if the identity of the contracting party was material even though there were enough facts to weigh those considerations.¹⁴⁵ This is yet another illustration in a long line of judicial holdings contributing to a trend giving blanket affect to executory contract treatment by federal statute and possible judicial indolence.¹⁴⁶

The bankruptcy court in *In re Plum Run Service Corp.*¹⁴⁷ held that debtor’s executory contract with the United States Navy to provide maintenance services for the base in Guantanamo Bay, Cuba could not be assumed because the Anti-Assignment Act gave the Navy the unilateral right to reject further performance by debtor.¹⁴⁸ Yet, this case may be distinguished from *Carolina Parachute*, in that there was some evidence as to debtor’s underperformance on existing provisions to the government contract, even prior to filing bankruptcy, to which debtor failed to cure or provide assurance and default resulted. The debtor corporation, on the other hand, contended that it “performed satisfactorily . . . especially after the filing Chapter 11 . . . and that the Navy refused to exercise the option due solely, or

¹⁴¹ *Id.* at 644 n.4. The court’s interpretation of 42 U.S.C. § 1320(c)-2(f) (2009) was that “[t]his provision clearly affords the Secretary [of Health and Human Services] the absolute right to terminate a contract whether rightfully or wrongfully without fear that her actions will be reversed at a later date by the courts.” *Id.* at 644.

¹⁴² *Id.* at 644-45.

¹⁴³ U.S. Dept. of Air Force v. Carolina Parachute Corp. (*In re Carolina Parachute Corp.*), 108 B.R. 100, 100 (Bankr. M.D.N.C. 1989).

¹⁴⁴ *Id.* at 102.

¹⁴⁵ *Id.* at 101-102. “Carolina Parachute Corporation has manufactured parachutes and related items primarily for the United States Government under fixed price defense contracts since 1979.” *Id.* at 101. “The government presented evidence that as of November, 1988, debtor was 40% delinquent in performing under its modified delivery schedules. The government asserted that debtor’s failure to make timely deliveries paralyzed the parachute training program at Seymour-Johnson Air Force Base.” *Id.* at 101-102.

¹⁴⁶ *Id.* at 103-104. “Accordingly, following the legal reasoning of the Third Circuit in *Matter of West Electronics*, the Court determines that the automatic stay should have been modified to allow the government to terminate the contract with debtor, pursuant to the provisions of 41 U.S.C. §15.” *Id.*

¹⁴⁷ See *In re Plum Run Service Corp.*, 159 B.R. 496 (Bankr. S.D. Ohio 1993).

¹⁴⁸ *Id.* at 498.

in significant part to the Chapter 11 filing”¹⁴⁹ Because the Navy argued instead that there were problems “unrelated to the bankruptcy filing . . . from the inception of its performance . . . continuing to the present date,” this case should have been decided simply on the basis of pre-petition default and not post-petition “applicable law.”¹⁵⁰

Finally, in *In re TechDYN Systems*, the bankruptcy court simply concluded that because a debtor was prohibited from assigning contracts equipping military bases with telephone systems based on the plain language of the Anti-Assignment Act, the debtor could not assume or assign its six pre-petition contracts.¹⁵¹ Despite the fact that the debtor never intended to assign its contracts, this court applied the hypothetical test to the reading of the Bankruptcy Code 365(c) as first introduced in the *West Electronics* case.¹⁵² However, hidden in the opinion was the rationale in which “[t]he United States maintains that reliable, long-term telecommunication capabilities at each installation affected by the debtor’s bankruptcy is vital to the completion of ongoing military missions.”¹⁵³ Unlike the *West Electronics* and *Braniff* cases, the government clarified its position concerning the applicability of the Anti-Assignment Act by affirming that “national security interests at stake outweigh any benefit to the debtor and its estate from assumption of the contracts.”¹⁵⁴

2. Underdog Debtors May Be Gaining Headway

While the majority of cases seem to apply strict application of the Anti-Assignment Act in government contract cases, the few cases that do not, entail better legal reasoning and are more recent.

When Hartec Enterprises, Inc. (“Hartec”) filed a Chapter 11 bankruptcy petition in 1987, it had already entered into numerous production contracts with the Department of Defense.¹⁵⁵ The United States government set a deadline for Hartec to assume the executory contracts post-petition.¹⁵⁶ By 1990, all dispositions of the contracts were resolved except for one involving the Department of the Navy.¹⁵⁷ Hartec wanted to assume the contract but the government refused asserting its discretion to do so under Code section 365(c)(1) and the federal Anti-Assignment Act.¹⁵⁸ Like the cases already explicated, the courts have struggled with harmonizing competing provisions of the bankruptcy code: debtors’ right to assume or assign an executory contract with non-debtor rights to annul executory contracts post petition. Surprisingly, the Hartec opinion

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ See *In re TechDYN Sys. Corp.*, 235 B.R. 857, 863 (Bankr. E.D. Va. 1999).

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 859-60.

¹⁵⁵ See *In re Hartec Enters., Inc.*, 117 B.R. 865, 866 (Bankr. W.D. Tex. 1990).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*; But see *In re Hartec Enters., Inc.*, 130 B.R. 930 (Bankr. W.D. Tex. 1991) (vacating an interlocutory order and dismissing the motion because the parties had settled).

¹⁵⁸ *In re Hartec Enters., Inc.*, 117 B.R. at 866-67.

almost effortlessly strings together a logical argument asserting that “a debtor in possession is not prohibited by 11 U.S.C. §365(c)(1) from assuming an executory contract with the United States which is governed by 41 U.S.C. §15, with or without the government’s consent.”¹⁵⁹ The court basically rejected the Hypothetical Test in favor of the Actual Test because the former unduly overburdens a well-meaning debtor, and it “create[d] inherent inconsistencies” with certain bankruptcy provisions while falling short of “fulfill[ing] the purposes of the non-assignment statutes it seeks to enforce.”¹⁶⁰

The court in *In re Ontario Locomotive* echoed the Hartec decision and rejected the United States Navy’s assertion that the under the Anti-Assignment Act, the government may terminate any contract, including the present contract for the remanufacture of three locomotives, as a matter of convenience.¹⁶¹ The bankruptcy judge pointed to the government’s supporting papers which correctly premised a “cause” requirement in support of their motion to terminate the contract, but he rejected the proposal that Code section 365(c) and the Anti-Assignment Act that simply “barr[ed] transfer of public contracts . . . absent the consent of the Navy” automatically obstructed a debtor’s contract assumption rights.¹⁶² In other words, the convenience of the government was insufficient cause. The judge also reaffirmed the notions that the Anti-Assignment Act is only concerned with transfers to an entirely “new entity,” while correspondingly, the Bankruptcy Code section 365(c) was meant to prohibit assumption or assignment of executory contracts of a personal service nature; a contract “which calls for the performance of non-delegable duties.”¹⁶³

Three years later, the Navy attempted to make the same unsuccessful assertion that the Hypothetical Test under *West Electronics* governs any situation where a “party entering into a lease or executory contract that subsequently files bankruptcy would be precluded from assuming its own contract under Section 365(c)(1)(A) because bankruptcy created a third party in the form of a DIP as distinguished from the original contracting party.”¹⁶⁴ This case, *In re American*

¹⁵⁹ *Id.* at 873. The linchpin of this court opinion cites to *Thompson v. Comm’r of Internal Revenue*, 205 F.2d 73, for interpretation of the underlying purpose of the Anti-Assignment Act. It is interesting to note that that case takes the position that while the Anti-Assignment Act statutory language is broad, it nonetheless “has never been applied blindly.” *Thompson v. Comm’r of Internal Revenue*, 205 F.2d 73, 76 (3d Cir. 1953). It is this author’s perspective that the statement is contradicted by the *West Electronics* case, *Peer Review* holding, and *Carolina Parachute* decision. In *West Electronics*, although military considerations were cited for the enactment of the Anti-Assignment Act, the deciding court failed to rebut the lower court’s finding that at the time, no national defense concerns begged relief from stay. See *supra* text accompanying note 100. In *Peer Review*, the court denied a debtor’s attempt to assume an executory contract based solely on the power of the Secretary of Health and Human Services to do so. See *supra* text accompanying note 134. Then again in *Carolina Parachute*, the court denies debtor’s right to assume a similar contract based on the literal and mechanical application of the Anti-Assignment Act language while ignoring fact-specific considerations in support of the overarching bankruptcy principle to promote business reorganization efforts and at the same time, did not conflict with the purported purpose of the Anti-Assignment Act to avoid obliging any government party from dealing with unknown third parties. See *In re Carolina Parachute*, 108 B.R. 100, 102 (M.D.N.C. 1989).

¹⁶⁰ *In re Hartec Enters., Inc.*, 117 B.R. at 871.

¹⁶¹ See *In re Ontario Locomotive*, 126 B.R. 146, 146 (Bankr. W.D. N.Y. 1991).

¹⁶² *Id.*

¹⁶³ *Id.* at 147-48.

¹⁶⁴ *In re Am. Ship Bld. Co.*, 164 B.R. 358, 362 (Bankr. M.D. Fla. 1994).

Ship Building Co., Inc., in clear contrast to West Electronics, allowed a DIP to assume a pre-petition executory contract to build ships with the United States Navy despite the Anti-Assignment Act.¹⁶⁵

Most recently in 2006, the Fifth Circuit Court of Appeals held that because a debtor did not attempt to assign or transfer its executory contract involving the future purchase of electric power, the Actual Test was a better approach to determine whether the Anti-Assignment Act was “applicable law” for the purposes of Code section 365(c) enabling a federal power marketing agency to terminate the existing contract in violation of the automatic stay.¹⁶⁶ The court determined that the federal entity could not terminate the contract for the following factual reasons: (1) the debtor paid the government a monetary sum “as adequate assurance of its ability to perform;” (2) the government did not qualify as a forward contract merchant under Code section 362(b)(6) which would have entitled it to an exception from the imposition of the automatic stay; and (3) the government presented no basis for relief from stay.¹⁶⁷ This judicial opinion revisited the “cause” requirement necessary to support a relief from stay. Because the executory contract at issue involved the future purchase of electric power, the non-debtor “failed to demonstrate cause for relief where [it] would suffer no harm by the continued enforcement of the stay.”¹⁶⁸ The court also concluded that the government could not terminate the contract for the following legal reasons: (1) an valid ipso facto clause cannot be enforced against executory contracts;¹⁶⁹ and (2) the Anti-Assignment Act did not preclude contract assumption because there was no transfer or, in the alternative, the automatic stay take precedent over termination rights under that federal statute and section 365(e)(2)(A).¹⁷⁰ In fact, the judicial analysis clarified the logistics of the Anti-Assignment Act by stating

the Act does not provide for automatic rescission of the public contract upon transfer; annulment of the contract at issue requires a response by the United States . . . and its effect on a given executory contract, may be raised by the government after the entry of a bankruptcy court’s automatic stay under . . . the provision for stay modification.¹⁷¹

Therefore, it was wrong for the government to assume that it could declare the

¹⁶⁵ *Id.* at 358. Notably, however, the court does distinguish a contrary result if it were the case that the debtor wanted to assign the contract it entered into with the United States Navy. *Id.* at 362-63. The opinion subtly declares that the bankruptcy code provision and the federal statute were designed to prohibit this debtor to transfer its contractual rights to another debtor of like occupation, or in this specific instance, “any third party shipwright.” *Id.* Thus, unlike the *Ontario Locomotive* case where prohibition of assumption or assignment rights were contingent upon non-delegable duties, either this court is contending the work of one shipbuilder is so unique it is inherently non-transferable to another shipbuilder, or that generally, assumption is permitted but never assignment.

¹⁶⁶ See generally *In re Mirant Corp.*, 440 F.3d 238 (5th Cir. 2006).

¹⁶⁷ *Id.* at 242-45.

¹⁶⁸ *Id.* at 245.

¹⁶⁹ *Id.* at 242. The parties’ agreement included a provision whereby the government could terminate the contract if debtor filed bankruptcy. *Id.*

¹⁷⁰ *Id.* at 245-47.

¹⁷¹ *Id.* at 252.

debtor in default and demand a termination payment simply because debtor filed bankruptcy.¹⁷²

From the recent line of cases involving post-petition government contractors asserting rights to executory contracts, it is reasonable to foresee that holdings currying favor with government entities based on strict application of the Anti-Assignment Act will become an increasingly unlikely occurrence. It makes more sense and supports the interest of equitable considerations that the nature of the contract should play a role in deciding whether the debtor can maintain its rights to assumption or assignment of that government contract. In line with considering the purpose and nature of an executory contract, the Hypothetical Approach should be altogether eliminated. In *Johnson Controls World Services Inc. v. U.S.*, the court

determined that the Anti-Assignment Act did not apply to the transfer of a government contract in connection with a corporate reorganization, where the parent corporation that was the original signatory to the government contract transferred the corporate division that was performing the contract to a newly created wholly owned subsidiary.¹⁷³

Then later, in *United International Investigative Services v. United States*, the court “rejected the government’s argument that the corporation to which the contract had been transferred could not be the successor-in-interest to the original contractor because the original contractor continued to exist after the transfer.”¹⁷⁴ It is a fair assumption to rely on the fact that as long as a successor corporation maintained the same operations as its predecessor, the court would not treat the transfer as an assignment to a distinctly separate entity that carried the potential for barring the action under the Anti-Assignment Act. The assignee remaining in contention is wholly distinct third parties.

IV. IMPACT

A. Lessons Learned

In reverting back to the big picture of debtor versus government, the legal debate begs the question: What method of legal analysis is most conducive to the success of the U.S. economy? Throughout this article, it is evident that the Anti-Assignment Act should not be automatically enforced any time the question of assumption or assignment of a government contract is involved.

In an article by Patrick Jackson, the author discusses considerations to help determine the permissibility of executory contract modification, and refers to a “material and economically significant” standard taken from the case *In re Joshua Slocum, Ltd.*¹⁷⁵ The article reveals that the standard is notable for its attempt to

¹⁷² *Id.* at 242.

¹⁷³ Cockerell, *supra* note 2, at 19 (citing 44 Fed. Cl. 334 (1999), *appeal dismissed by consent*, 217 F.3d 853 (1999)).

¹⁷⁴ *Id.* (citing 26 Cl. Ct. 892 (1992)).

¹⁷⁵ *See generally*, Patrick A. Jackson, *Third Circuit Confirms Court’s Power to Modify Executory*

balance dual goals between parties in a bankruptcy proceeding: “preventing substantial economic detriment to the nondebtor contracting party and permitting the bankruptcy estate’s realization of the intrinsic value of its assets.”¹⁷⁶ So, in considering whether a contract term can be modified, the author suggests that the court in a 2005 case got it right when it evaluated individual contract terms based on whether it was integral or material to the bargain between the parties and if the term were breached, whether any party would suffer economic detriment.¹⁷⁷ This view supports the contention that bankruptcy code provisions, particularly with reference to section 365(f), should outweigh non-bankruptcy statutes in Chapter 11 proceedings. Again, the consensus remains that while applicable law like the Anti-Assignment Act can and should protect the US government in their contractual interests, it should not be applied without regard to the precise nature of the contract a debtor seeks to assume or assign.

To that end, there should be a nuanced analysis considering a totality of the circumstances. Regardless of the case holding, the judicial opinions discussed in great lengths above noted a spectrum of factual considerations. Many of those government contract cases involve the United States Navy and other entities under the control of the Department of Defense. Also, while many judges easily dismiss the scope of section 365(c) as being limited to “personal attention and services,” it is ironic that the reasons cited for government discretion concerning military-related contracts include a debtor’s unique position to render performance.¹⁷⁸ Promoting a holistic approach to these cases, without feeling compelled to establish a general sway in support of the government’s contractual rights, or alternatively, fostering a debtor’s plans for reorganization, would be more valuable to contracting parties in a complex economy.

If future cases follow current trends, this author believes that contracting parties can expect to find courts to be less convinced by the Hypothetical Test, more discerning to consider the application of the Anti-Assignment Act based on a comparison to legislative intents, and prone to rethink the long-standing interpretation of that section 365(c)’s “applicable law” designation was not specifically limited to personal service contracts. Thus, going forward, courts would be wise to consider a totality of the circumstances examination when faced with legal battles involving assumption and assignment of executory contracts involving government agreements. Many court opinions are in line with this holistic view but draft holdings to reflect a mechanical application of legal principles ignoring factual considerations mentioned. In an effort to foster this modest change, this Comment proposes that our holistic approach be referred to as the Actual Test Plus.

B. A New Test

While no single factor is determinative, some factors of the Actual Test Plus may be weightier than others. Courts should consider (1) whether there was actual

Contracts, Clarifies Joshua Slocum “Material and Economically Significant” Standard, 26 AM. BANKR. INST. J. 32, 32 (2007) (citing *In re Joshua Slocum, Ltd.*, 99 B.R. 250 (Bankr. E.D. Pa. 1989)).

¹⁷⁶ *Id.* at 74.

¹⁷⁷ *Id.*

¹⁷⁸ See *supra* text accompanying note 105.

intent to assign the contract or merely assume; (2) if the intent to assign exists, whether it constitutes a transfer involving the assignment of rights or delegation of duties to a wholly distinct third party; (3) what pre-petition circumstances are pertinent – if there was a default, whether the DIP cured, provided adequate assurance to cure the default or pledge future performance; and (4) why the government should be entitled to a relief from automatic stay.

As to prong one, because a DIP may assume a contract without assigning, the government party cannot assert a lifting of the stay or termination of the contract based on the uncertainty that it will have to deal with a party it did not contract with. For instance, in *Braniff*, the DIP attempted to assign the benefits of airport landing slots to a party that was not licensed to operate at a national airport.¹⁷⁹ Because the government would be placed at risk to deal with an assignee who did not meet the federal requirements, evidence of an actual assignment should weigh in favor of the government. Likewise, in the case of *Techdyn Systems*, because there was clear indication that the DIP never intended to assign its contracts, the analysis should have shifted to focus on the government's justification for barring assumption (prong four).¹⁸⁰

Concerning prong two, several courts have supported the interpretation that the Anti-Assignment Act was designed to protect the government from dealing with strangers. It is the foundational difference between the Hypothetical Test and the Actual Test. It should not be the case, referring to the Hypothetical Test, that a pre-petition debtor's contract is an assignment of rights or a delegation of duties when that debtor holds the same contract as a post-petition DIP. If it is the case that in filing bankruptcy, the DIP struggled to maintain current operations, then the government could again assert its risk of losing the benefit of its bargain in the original contract (prong four).

The consideration for pre-petition circumstances in prong three is prompted by cases like *Carolina Parachute* and *Plum Run*. Interestingly in *Carolina Parachute*, it was the government's "lack of outside working capital" that forced the company to file bankruptcy so it could reorganize.¹⁸¹ This is significant because when the company recommenced work on the government contracts it was able to provide consistent delivery of its manufactured items for a nine-month period.¹⁸² Unfortunately, after that nine-month period, when the company became delinquent in performance, the government asserted that it lost its benefit of the bargain.¹⁸³ However, when the court presented its holding, it cited the Anti-Assignment Act as authority for the government to terminate the contract notwithstanding "debtor's performance under its contracts with the government,

¹⁷⁹ *In re Braniff Airways, Inc.*, 700 F.2d at 941.

¹⁸⁰ The logic here is, if the government entered into the original contract, it obviously deemed the arrangement beneficial, so unless the debtor could not prove capacity to cure the default for assumption purposes, the government termination of the contract would not be in good faith (it could implicate the government's attempt to renegotiate better terms with a new party). Similarly, in an assignment arrangement, the government should be able to articulate reasons for rejecting third party performance of a pre-petition contract.

¹⁸¹ *In re Carolina Parachute Corp.*, 108 B.R. 100, 101 (Bankr. M.D.N.C. 1989).

¹⁸² *Id.*

¹⁸³ *Id.* at 102.

and the financial status of the debtor.”¹⁸⁴ The contention here is not that debtor’s post-petition breach would change the outcome of the court’s decision, but that the court performs a disservice to contracting parties looking to case precedent for basis to support its holding other than Anti-Assignment Act empowerment by judicial fiat. The facts of *Plum Run* are similar; there was clear proof that the debtor underperformed according to the terms of the contract and could not cure or provide assurance of its ability to cure.¹⁸⁵ Again, the pre-petition circumstances were vital to the government’s decision to file a relief from stay to terminate the contract, yet the judicial determination finds its authority in the Anti-Assignment Act and application of the misconstrued Hypothetical Test.¹⁸⁶ Instead, courts should look to the *Mirant* case as a guideline for pre-petition circumstances. In *Mirant*, the debtor provided the government with adequate assurance of its ability to continue performance on its existing contract which preempted the government’s ability to terminate or modify despite the existing federal anti-assignment statute.¹⁸⁷

With regard to prong four, a recurring observation from the case explication and analysis in this Comment fosters the strong belief that government parties should give substantive reasons for authorizing or rejecting assumption or assignment of executory contracts. The legislative intent behind the Anti-Assignment Act has been somewhat ambiguous. In reference to *West Electronics*, some scholars are adamant that avoiding assignment of military equipment contracts was precisely what Congress intended when it granted broad authority to governments involving their contractual rights and obligations. Of course, if that were the case, it implores the logical question as to why that Anti-Assignment Act was drafted in a more narrowly-tailored fashion. In the related cases this Comment has covered, the executory contracts have involved contracts for telephone services, parachute manufacturing, maintenance services, guarantee agreements, electric power, review of health care services, and the use of navigable airspace and terminal allotment. These goods and services do not seem to rise to the level of national security concerns inherent in military equipment contracts for missile defense.

It is reasonable to use the Anti-Assignment Act to protect the country from the assumption or assignment of military contracts when the civilian or non-government contracting party needs a license or certain security clearance to perform the contract terms. These considerations, however, are very much akin to personal service contracts and non-delegable duties.¹⁸⁸ On the other hand,

¹⁸⁴ *Id.*

¹⁸⁵ *In re Plum Run Serv. Corp.*, 159 B.R. 496, 500 (Bankr. S.D. Ohio 1993).

¹⁸⁶ *Id.* at 501.

¹⁸⁷ *In re Mirant Corp.*, 440 F.3d at 242.

¹⁸⁸ HERBERT, *supra* note 11, at 149. Michael J. Herbert clarifies that

[i]t is a staple of contract law that some duties cannot be delegated because they are fundamental to the underlying bargain. These duties are often misleadingly referred to as “personal services.” This is not quite accurate. Many personal services can be delegated and some non-delegable duties are not personal services. The real issue is whether performance by a particular person or organization is a fundamental part of the bargain. Personal services only come into it because it is easiest to find illustrations in certain types of personal service

performance in the form of review of health care services, in the *Peer Review* case, is likely to be transferable; it is a service that a third party could easily perform. It may be helpful to note that if we can infer that the government chose the original contracting party based on thorough examination, trust, or otherwise, it might make sense that the original contracting party would be in the best position to determine whether it could assume post-petition or to which entity it should assign its obligations. In Chapter 11 proceedings between a DIP and government entity, the overarching concern to determine the permissibility of a proposed assumption or assignment of pre-petition contracts between the parties should be whether such authorization would thwart the government's bargain. If the government is still getting the benefit of its bargain and its resources and national security concerns are not put to risk, a debtor party should be afforded the benefit of its executory contract rights under section 362(a), unless the government can substantiate cause to justify extreme measures such as lifting the automatic stay to terminate a pre-existing contract.

V. CONCLUSION

The best compromise between bankruptcy principles and antithetical federal laws that will serve the United States economy is that judicial decisions concerning executory contract treatment should operate by essentially maintaining a debtor in possession's right to assume and assign its contracts while giving the United States government veto power based on substantiated goals and important safety and welfare concerns. Maintaining the status quo under section 362(a) allows for more prompt and effective reorganization plans to be adopted while addressing the United States government concerns for quality assignees.

Contracting parties should keep in mind that while it is feasible for government contractors to enter into novation agreements with the government, it is possible that the mere proposal of such an arrangement would put the contractor at risk of losing the contract. Some scholars have proposed the following recommendation: when it is likely that the government has a strong vested interest in the executory contract, and it is possible to obtain government consent to assumption and assignment, contracting parties should do so. Such parties should recall from the above-referenced cases, that if the terms of their performance are akin to personal service contracts, are tied to national security concerns, or have a material impact on the economic position of the government party, it will be almost impossible to avoid a ban on transfer rights under the Anti-Assignment Act. However, looking to current judicial trends, it does seem clear that so long as a transfer does not force the government to deal with an entirely distinct third party assignee, the debtor in possession is more than likely to succeed in assuming the contract post-petition. Thus, a valid and acceptable transfer will include subsidiary or successor parties to the debtor.

contracts.

Id.

Furthermore, "rarer than non-delegable duties are non-assignable benefits. There are now very few circumstances under which a party to a contract is prohibited from assigning the benefit of its bargain to another. Many of the few restrictions that exist are in fact round-about ways of restricting delegation."

Id.

This Comment hopes the Actual Test Plus proposal would be recognized as a modest renovation to judicial interpretation of executory contracts involving government parties in a post-petition context. While it is unlikely that this Comment will be the last word on the issue, it is submitted as a contribution to provide some constructive ideas on balancing debtor interest with non-debtor concerns which play a vital role in the U.S. economy.