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Triangle USA: Post-Effective Date Assumption or Rejection

Section 1123 of the Bankruptcy Code provides that a plan may, “subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section.”¹ Given this language, the question arises as to what it means to “provide for” the assumption or rejection of an executory contract or unexpired lease in a plan. Some might argue that, in order to provide for the assumption or rejection, a plan must contemplate the assumption or rejection of a contract or lease upon the effective date of the plan. Others might take the position that § 1123 permits assumptions or rejections to take effect *after* the effective date of a plan in certain circumstances.

The U.S. Bankruptcy Court for the District of Delaware recently became one of few courts to consider this issue. Ruling from the bench at a plan-confirmation hearing for Triangle USA Petroleum Corp. (TUSA) and its affiliates (together, the “debtors”), Hon. **Mary F. Walrath** held that the debtors’ plan sufficiently provided for the rejection of certain pipeline contracts, even though the rejection was conditioned upon the occurrence of future post-confirmation events.² Although the decision is a bench ruling rather than a precedential opinion, it is significant to the extent that it might be relied upon to justify the use of post-confirmation conditional assumptions or rejections.

Debtors’ Relationship with Caliber

The debtors comprised an oil and gas exploration and development company that focused on the acquisition and development of shale oil and natural gas resources in the Williston Basin of North Dakota and Montana, which is among the largest shale oil reservoirs in North America.³ Oil and gas production in the Williston Basin is inhibited by substantial technical and economic challenges due to, *inter alia*, limited gathering infrastructure and limited long-distance pipeline capacity.⁴

To alleviate these challenges, the debtors and their nondebtor affiliates entered into a joint

venture to form Caliber Midstream Partners LP and certain affiliated entities (together, “Caliber”) with the purpose of constructing a pipeline system in the Williston Basin.⁵ Caliber provided services to TUSA pursuant to several midstream service agreements, the most significant of which (the “Caliber contracts”) provided that Caliber was to be the exclusive provider of midstream services for certain TUSA-operated drilling-space units referred to as “dedicated properties.”⁶

Although the economic terms of the Caliber contracts presumably made sense when the contracts were signed, in the debtors’ view the terms of the contracts became substantially above market due to prevailing commodity prices. As such, a principal objective of the debtors’ restructuring was to renegotiate terms and enter into new midstream contracts that were in line with the current market.⁷

In the time period leading up to the debtors’ bankruptcy filing, Caliber sought to enforce its contracts with TUSA. On May 27, 2016, it filed a complaint against TUSA in North Dakota state court (the “North Dakota action”) for a declaratory judgment that certain “dedications” of oil and gas set forth in the Caliber contracts are valid and enforceable covenants that “run with the land” under North Dakota law. The outcome of the North Dakota action is significant because such covenants that run with the land create property interests that cannot be extinguished in bankruptcy.

Debtors’ Bankruptcy Filing and Chapter 11 Plan

The debtors filed for bankruptcy on June 30, 2016, approximately one month after the commencement of the North Dakota action. Following unsuccessful efforts to remove and transfer the North Dakota action to the bankruptcy court, the debtors filed a proposed plan in January 2017,⁸ which contained provisions specifically addressing the treatment of the Caliber contracts. The plan provided, among other things, that the Caliber contracts would be deemed automatically rejected pursuant to §§ 365 and 1123 of the



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¹ 11 U.S.C. § 1123(b)(2).

² See Tr. of Hearing, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017), at 112; see also Order Confirming Third Amended Joint Chapter 11 Plan of Reorganization of Triangle USA Petroleum Corp. and Its Subsidiary Debtors, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017), at D.I. 825, p. 22 (the “Confirmation Order”).

³ See Declaration of John R. Castellano in Support of Chapter 11 Petitions and First-Day Papers, Case No. 16-11566 (Bankr. D. Del. June 30, 2016), D.I. 13, at ¶¶ 7, 10.

⁴ *Id.* at ¶ 12.

⁵ *Id.* at ¶ 19.

⁶ *Id.* at ¶ 20.

⁷ *Id.* at ¶ 22 n.10.

⁸ See Third Amended Joint Chapter 11 Plan of Reorganization of Triangle USA Petroleum Corp. and Its Affiliated Debtors, Case No. 16-11566 (MFW) (Bankr. D. Del. Jan. 13, 2017), at D.I. 795 (as amended and/or supplemented, the “Plan”).

Bankruptcy Code as of the effective date of the plan, *subject only to the satisfaction of each of the following conditions*: the entry of a (1) final order or judgment in the North Dakota action determining that the Caliber contracts do not constitute or contain a covenant running with the land; and (2) final order by the court determining or estimating the allowed amount of Caliber's rejection damages claims at less than \$75 million (the "toggle provision").⁹

The failure of either or both of these conditions to be satisfied would result in the assumption of the Caliber contracts and the payment of any cure amounts associated with such assumption.¹⁰ The plan provided that, pending a determination of whether these conditions had been satisfied, the reorganized debtors would perform under the Caliber contracts in accordance with their terms.¹¹

Finally, the plan provided that at any point from and after confirmation, Caliber had the right to stipulate to the satisfaction of the conditions. In this event, the Caliber contracts would be deemed rejected and Caliber's rejection-damages claim would be allowed in an amount to be determined by the court, not to exceed \$75 million.¹² Notably, this particular component of the toggle provision was added to the plan only three days prior to the confirmation hearing, and reflected an effort to rebut Caliber's contentions that (as further described below) the toggle provision provided the debtors with the option to "toggle" in favor of assumption if future market conditions dictated that choice (at which point the debtors could simply concede the North Dakota action). The revised provisions arguably addressed Caliber's concerns by giving it the ability to avoid further delays and uncertainty concerning its contracts by stipulating to the satisfaction of the conditions and causing the rejection of the contracts.¹³

Caliber's Plan Objection

Caliber objected to the plan. It argued, among other things, that the toggle provision would "eviscerate" statutory protections accorded to Caliber under §§ 1123(b)(2) and 365 of the Bankruptcy Code by allowing the debtors to have an unlimited post-confirmation extension of the time to assume or reject the Caliber contracts.¹⁴ Caliber asserted that when a debtor relies on § 1123 to assume or reject an executory contract, it must comply with § 365, which (Caliber argued) does not permit a debtor to defer its assumption/rejection decision beyond confirmation.¹⁵ Caliber further contended that the toggle provision would allow the debtors to emerge from bankruptcy while delaying for potentially years the decision to assume or reject, thus forcing Caliber to bear the uncertainty of not knowing whether customers and potential financiers will continue to do business with a company whose primary source of revenue could be rejected at an unknown date.¹⁶

⁹ *Id.* at § 6.03(b).

¹⁰ *See id.* at § 6.03(c).

¹¹ *See id.* at § 6.03(d).

¹² *See id.* at § 6.03(b).

¹³ *See Tr. of Hearing, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017)*, at 80-81.

¹⁴ Caliber's Objection to the Second Amended Joint Chapter 11 Plan of Reorganization of Triangle USA Petroleum Corp. and Its Affiliated Debtors, Case No. 16-11566 (MFW) (Bankr. D. Del. March 2, 2017), at D.I. 776, ¶ 2 ("Caliber Objection").

¹⁵ *Id.* at ¶ 21. Section 365 provides in relevant part that "the trustee may assume or reject an executory contract ... at any time before the confirmation of a plan." 11 U.S.C. § 365(d)(2).

¹⁶ *Id.* at ¶ 2.

Caliber argued that it was unaware that any court had previously permitted a post-effective date extension of the time to assume or reject contracts under terms similar to the toggle provision. To that end, Caliber distinguished the circumstances at issue from the facts of three cases in which courts granted post-confirmation extensions of time to assume or reject executory contracts. Caliber explained that unlike the present case, these cases involved either (1) the threshold question of whether the contracts at issue were executory; (2) a *post*-confirmation challenge to the legality of a provision that delayed assumption until after confirmation and limited rejection rights; and (3) circumstances under which the feasibility of the debtor's plan and the ability to reorganize would have been placed at risk if it was forced to immediately reject an agreement upon the effective date of the plan.¹⁷ Lastly, Caliber argued that the proposed toggle provision violated bankruptcy policy, reasoning that "[i]f permitted, rather than addressing executory contracts prior to confirmation, the door would be open for debtors to request a deemed assumption or rejection of such contracts in a plan of reorganization, receive a free option to wait out market conditions post-effective date, and determine then, with full information, whether rejection or assumption inures to their benefit."¹⁸

It seems clear that the conditions to assumption or rejection cannot be subjective; as *Triangle USA* demonstrates, if a debtor can point to objective criteria for conditional assumption or rejection, such provisions may be permissible.

Confirmation Hearing¹⁹ and Court's Ruling

At the plan-confirmation hearing, the debtors argued that the plan, consistent with § 1123, "provided for" the rejection of the Caliber contracts.²⁰ The debtors further argued, among other things, that the need, under the plan, for the court to determine the amount of Caliber's rejection claim after the conclusion of the North Dakota action was akin to a court's determination of a disputed cure claim after a contract is assumed.²¹ The debtors also contended that the toggle provision was acceptable and fair to Caliber because it (1) enabled the debtors, which

¹⁷ *Id.* at ¶¶ 23-27; *see also In re Simplot*, 2007 WL 2479664, No. 06-00002 (Bankr. D. Idaho Aug. 28, 2007); *Alberts v. Humana Health Plan Inc. (Greater Se. Cmty. Hosp. Corp. I)*, 327 B.R. 26 (Bankr. D.D.C. 2005); and *In re Gunter Hotel Assocs.*, 96 B.R. 696 (Bankr. W.D. Tex. 1988).

¹⁸ Caliber Objection at ¶ 3.

¹⁹ In advance of the plan-confirmation hearing, the court approved a joint stipulation among the debtors and Caliber to defer certain factual issues related to the potential rejection of the Caliber contracts in order to streamline the issues to be raised and argued at the confirmation hearing. *See Order Approving Joint Stipulation to Defer Factual Issues Related to the Potential Rejection of the Specified Caliber Contracts*, Case No. 16-11566 (MFW) (Bankr. D. Del. March 7, 2017), at D.I. 791. For example, Caliber reserved the right to object, at a later date, to the rejection of the Caliber contracts on the grounds that such a rejection is not a reasonable exercise of business judgment.

²⁰ *See Tr. of Hearing, Case No. 16-11566 (MFW) (Bankr. D. Del. March 10, 2017)*, at 70, 82.

²¹ *Id.* at 71-72.

continued on page 74

Triangle USA: Post-Effective Date Assumption or Rejection

from page 25

were Caliber's customers, to accomplish their restructuring; (2) allowed the North Dakota action to proceed and the rejection damages issue to be litigated sequentially; (3) allowed Caliber to vote the full extent of its potential rejection claim and participate in the rights offering provided for under the plan; and (4) provided for the debtors to continue to honor their obligations under the Caliber contracts during the litigation of the North Dakota action and rejection claim.²²

The court agreed with the debtors that the treatment of the Caliber contract was sufficiently "provided for" in the plan and ultimately entered an order confirming the plan. The court acknowledged that this was a unique case and that the debtors were asking for something that had never been done before. However, the court indicated that the fact that this had never been done before did not necessarily mean that it was prohibited.²³

The court agreed with the debtors that the language of §§ 365(d)(2) and 1123 was permissive, stating that "Congress knows when to set an absolute deadline, and I don't think the language used by Congress in these two provisions is that."²⁴ The court explained that "the debtor simply has to provide in the plan whether a contract is going to be assumed or rejected, and the debtor has done so."²⁵

The court recognized that the policy behind §§ 365 and 1123 of the Bankruptcy Code "is that the debtors' rights to assume or reject a contract are bankruptcy rights and should not be rights that a debtor can hold onto forever, even after

it exits bankruptcy."²⁶ At the same time, however, the court determined that relevant case law — namely the cases sought to be distinguished by Caliber — supported the proposition that "the absolute decision made by the debtor to assume or reject can be conditioned on a future event."²⁷

The court also disagreed with Caliber's suggestion that the conditions for rejection in the toggle provision were purely market-driven, finding that the conditions were "simply a recognition that the debtor is not in a position to reject without knowing the effect of that rejection." The court explained that "it's not unrealistic for the debtor to, like the debtors in the cases cited, know whether or not it will be paying more than a certain amount, if it makes its decision to assume or reject."²⁸ Lastly, significant to the court was the fact that under the plan, the debtors would be fully performing under the Caliber contracts pending the resolution of the conditions.²⁹

Conclusion

Triangle USA is a bench ruling. Nevertheless, it prompts interesting and important questions about the manner in which executory contracts and unexpired leases can be provided for in a plan and whether debtors can create provisions that permit them to assume or reject contracts post-confirmation, on a conditional basis. It seems clear that the conditions to assumption or rejection cannot be subjective; as *Triangle USA* demonstrates, if a debtor can point to objective criteria for conditional assumption or rejection, such provisions may be permissible. **abi**

²² See *id.* at 78-79.

²³ *Id.* at 111.

²⁴ *Id.* at 111-12.

²⁵ *Id.* at 112.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 113.

²⁹ *Id.*

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