

**Help! I Think My Counter-Party
May Be Insolvent**

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§ 8.01. Introduction.

All commercial relationships involve the risk that an obligor or counterparty may become insolvent. Taking steps to minimize such risks when interacting with a financially distressed entity is of particular importance in today’s current energy market. The key to successful mitigation of risks is in anticipating potential issues resulting from troubled financial times and addressing those problems as proactively as possible. As detailed herein,

there are several ways to avoid undesirable consequences through various means both inside and outside of the bankruptcy process.

§ 8.02. The Automatic Stay.

Parties face several challenges when their contract counterparty files for bankruptcy relief. A key risk under any kind of agreement is that one party will file for bankruptcy and the automatic stay will prevent the exercise of the other party's rights. Specifically, upon a debtor's bankruptcy filing, the automatic stay — a statutory injunction imposed by the Bankruptcy Code — prohibits non-debtor parties from taking any action to collect a pre-bankruptcy debt or to exercise control over the debtor's property, including the exercise of remedies under contracts with the debtor.¹

§ 8.03. Oil and Gas Agreements as Executory Contracts or Unexpired Leases.

In addition to the imposition of the automatic stay, a bankruptcy filing may allow a debtor to alter “executory contracts” and “unexpired leases” as provided in Section 365(a) of the Bankruptcy Code. Although the term “executory contract” is not defined in the Bankruptcy Code, most courts, including the Fifth Circuit, generally hold that an “executory contract” is a contract under which the obligations of both the debtor and the non-debtor counterparty are so far unperformed that failure of either to complete performance would constitute a material breach excusing the performance of the other.² Stated differently, “[u]nless both parties have unperformed obligations that would constitute a material breach if not performed, the contract is not executory under § 365.”³ Notably, Section 365 of the Bank-

¹ 11 U.S.C. § 362.

² *NLRB v. Bildisco and Bildisco*, 465 U.S. 513 (U.S. 1984); *In re Murexco Petroleum, Inc.*, 15 F.3d 60, 63 (5th Cir. 1994); *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp.*, 872 F.2d 36 (3d Cir. 1989).

³ *See In re Columbia Gas Systems, Inc.*, 50 F.3d 233 (3d Cir. 1995). This definition of an executory contract, referred to as the “Countryman test,” was first articulated by Professor Vern Countryman in his article, “Executory Contracts in Bankruptcy: Part I,” 57 *Minn. L. Rev.* 439 (1974), and became part of the Bankruptcy Code's legislative history. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 347 (1977).