Ingrid Palermo, Esq.
Harter Secrest & Emery, LLP
Attorney for Debtor
1600 Bausch & Lomb Place
Rochester, New York 14604-2711

Neil M. Gingold, Esq.
Scolaro, Shulman, Cohen, Fetter & Burstein, P.C.
Attorneys for Gaffney Communications, Inc.
90 Presidential Plaza
Syracuse, NY 13202-2200

Guy A. Van Baalen, Esq.
Assistant U.S. Trustee
10 Broad St.
Utica, New York 13501

Re: Crouse Health Hospital, Inc.
Crouse Health, Inc;
Crouse Health Properties, Inc.
Crouse Health Enterprises, Inc.
CIMH Management Services Corp., Inc.
Alliance Information Technologies, Inc.
Case No. 01-60785- 0160790 Chapter 11
Jointly Administered

LETTER DECISION AND ORDER

Before this Court is a motion by which Debtor, Crouse Health Hospital, Inc. d/b/a Crouse Hospital ("Crouse") seeks, *inter alia*, this Court's approval to reject a contract it has with Gaffney Communications, Inc. ("Gaffney"), asserting that it is still executory, so that it may reject it pursuant to §

365 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"). In opposition, Gaffney asserts that the contract (1) is not executory in nature, (2) was assumed by conduct, and (3) contains an automatic renewal provision, so that Crouse may not now reject it.

The motion was argued at the February 25, 2003, motion term of this Court and following oral argument, the motion was adjourned to the March 4,2003 motion term for resolution by the Court.

The basic facts underlying the motion are as follows. Prior to filing a petition with this Court, Crouse had entered into a Maintenance Agreement with Gaffney on or about October 25, 1994 ("Agreement"), pursuant to which Gaffney was to maintain and service the telephone system at Crouse. The Agreement itself appears as Exhibit A to the opposing papers filed by Gaffney. The provision relevant to the issues raised in this motion is found at ¶ 2, "Term," which provides:

> The term of this Agreement shall be for one (1) year commencing on July 1st, 1994, and shall be deemed to be renewed automatically from year to year, unless terminated prior thereto as herein provided, on the terms and conditions set forth in this Agreement.

Paragraph 6.1, "Termination – Customer," provides, in relevant part:

> This agreement may be terminated by the customer (i) upon written notice to the company not later than sixty (60) days prior to the expiration of the initial term or any renewal then in effect . . . .

Among the issues raised by the parties in their respective papers, Crouse alleges that the Agreement is still executory, therefore, it may reject it pursuant to Code § 365, whereas Gaffney asserts that the Agreement is executed.

Code § 365 provides, in relevant part:

> (a) . . . [T]he trustee,[1] subject to the court's approval, may assume or reject any executory contract . . . of the debtor.

Gaffney asserts that the Agreement between it and Crouse, which covered the initial period of July 1, 1994, through June 30, 1995, and was subsequently renewed for additional one-year periods pursuant to the automatic renewal provision, is an executed agreement and not executory. Gaffney asserts that it was providing telecommunications services to Crouse 24 hours a day, seven days a week, had a technician available to perform any repairs and had in stock all replacement parts needed.

> To determine whether or not a given contract is executory, "many courts, including courts in this [circuit], have relied on the Countryman Test, [*Shoppers World Community Center, L.P. v. Bradlees Stores, Inc.*, No. 01 Civ. 3934(SAS)], 2001 WL 1112308, at *7 [S.D.N.Y. Sept. 20, 2001] , under which the [term] 'executory contract' means a contract under which the obligation 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. Vern Countryman, Executory Contracts in Bankruptcy: Part 1, 57 Minn. L. Rev. 439, 460 (1973). The materiality of the breach under the Countryman Test is a factual question resolved through the application of state law.

In re Teligent, 268 B.R. 723, 730 (Bankr. S.D.N.Y. 2001)

It is clear that, under this definition, the Agreement at issue was still executory at the time of the filing of the bankruptcy petition on February 21, 2001. The Agreement provided, *inter alia*, that Gaffney "agrees to service and maintain the Northern Telecom Meridian System located at 736 Irving Avenue . . . in Syracuse, New York." If, on the day before Crouse filed its petition in this Court, the telephone system

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[1]Code § 1107(a), with limitations not pertinent here, vests the debtor in possession in a chapter 11 case with all the powers of the trustee, including the power to assume or reject an executory contract. *See, e.g., United Food & Commercial Workers Union, Local 328, AFL-CIO v. Almac's*, 90 F.3d 1, 4 (1st Cir. 1996).

had failed such that Crouse could neither place nor receive calls and Gaffney had refused to repair it, Crouse could at that point have maintained successfully a suit for breach. Indeed, the very definition of the word "maintain," "to keep in a condition of good repair or efficiency," envisions an ongoing obligation, not one that is performed once and never again.

Further, even viewing the assertion of Gaffney that it had already performed because "[i]f the debtors . . . did not make any further requests of Gaffney, Gaffney had . . . fully performed" demonstrates that the Agreement was indeed still executory as of that point. The whole purpose of the Agreement was so that *if* Crouse's telephone system failed, then it *would* make a "further request" of Gaffney and would, in fact, expect Gaffney to come and repair it.

The nature of this Agreement is one similar to a warranty commonly given by manufacturers with the products they sell. At least one court has held that the mere fact that the obligations of the party giving the warranty are contingent upon the other party having need to avail itself of the services promised does not render the contract nonexecutory. *See In re Smith Jones, Inc.*, 26 B.R. 289, 292 (Bankr. D. Minn. 1982) ("obligation to . . . supply replacement parts as failures may occur constitutes a future commitment and is in itself executory until performed").

Accordingly, the contention of Gaffney that the Agreement was no longer executory at the time of the bankruptcy petition would appear to be without merit.

The second basis alleged by Gaffney in support of its contention that Crouse should not be permitted to reject the Agreement is that it was assumed by conduct. Specifically, Gaffney asserts that, by virtue of having continued to pay quarterly payments as provided in the Agreement beyond the expiration date of the prior renewal, June 30, 2002, Crouse has by its conduct agreed to the renewal for

an additional year and has thereby assumed the Agreement.

This argument, that a debtor's post-petition conduct with respect to an executory contract constituted assumption, has been made by other creditors in other bankruptcy cases; however, it has been uniformly rejected. "[B]ecause the plain language of the Code provides that an executory contract cannot be assumed without court order, the notion of 'assumption by conduct' is almost universally rejected." *Houbigant, Inc. v. ACB Mercantile, Inc.*, 188 B.R. 347, 356 (Bankr. S.D.N.Y. 1995). *See, e.g., Matter of Whitcomb & Keller Mortg. Co., Inc.*, 715 F.2d 375 (7th Cir. 1983); *Texas Importing Co., Ltd. v. Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966); *In re Treat Fitness Center, Inc.*, 60 B.R. 878 (9th Cir. B.A.P. 1986); *In re Lew Mark Cleaners Corp.*, 86 B.R. 331 (Bankr. E.D.N.Y. 1988).

In *In re A.H. Robins Co., Inc.*, 68 B.R. 705, 707, 711 (Bankr. E.D. Va. 1986), the court rejected a creditor's request for an order declaring that debtor, by its actions, had assumed various contracts. *See also In re Kings Terrace Nursing Home & Health Related Facility*, No. 91-B-11478 (FGC), Adv. No. 94/8912A, 1995 WL 65531 (Bankr. S.D.N.Y. Jan. 27, 1995) ("It is *well settled* that obligations in a contract cannot be assumed by conduct. *See In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687, 712 (Bankr. S.D.N.Y. 1992). A Debtor may assume a contract only if the requirements of Section 365 of the Bankruptcy Code are satisfied." (Emphasis added.))

In this case, the debtor has made no effort to assume the Agreement; indeed, to the contrary, Crouse seeks to reject it, which Code § 365 provides that it may do. Accordingly, the contention of Gaffney that Crouse has assumed the Agreement by conduct, in the face of evidence that the Crouse is seeking to reject the Agreement, cannot be sustained.

The third and final basis alleged by Gaffney in support of its claim that Crouse ought not be permitted to reject the Agreement is that it has been renewed by operation of a provision contained within the Agreement that it would automatically renew, upon expiration, for another year, absent timely notice by either party of a desire to end the contractual relationship.

The concept of contracts containing automatic renewal provisions and their effect on the debtor's right under Code § 365 to reject an executory contract is not a novel one. In *In re Country Club Estates at Ventura Maintenance Association, Inc.*, 227 B.R. 565 (Bankr. S.D. Fla. 1998) (hereinafter *In re Country Club Estates*), the court was faced with a contract remarkably similar to that at issue here. As summarized by the court in that case:

> The debtor . . . filed a Chapter 11 petition in June 1996. In October 1995, the Debtor entered into the contract at issue with a security guard company . . . . The contract has a one-year term, but also provides that the agreement automatically renews on the one-year anniversary for an additional one-year period unless either side provides written notice of an intent to terminate. Neither side provided such notice and thus, the contract automatically renewed in October of 1996, during the pendency of this Chapter 11 case.

Id., 566.

As in *In re Country Club Estates*, the renewal term which Gaffney contends renders the Agreement now non-rejectable (for lack of a better term) began post-petition, on July 1, 2002. In *In re Country Club Estates*, the court provided a thorough analysis of existing caselaw on the question at issue before this Court:

The majority of published caselaw holds that there is a continuation of the original contract when the contract is renewed under an automatic renewal clause. Affirming the district court's reasoning, the Fifth Circuit stated in *Gurley v. Carpenter*, 855 F.2d 195, 195 (5th Cir. 1988),

> [T]he Mississippi insurance policy with its renewal provision is a continuous policy rather than a sequence of independent policies. This conclusion is drawn because the insurance contract calls for automatic renewal if, by twenty days before the end of the term, the insurer does not notify the insured of its intent to terminate, and if the premium is timely paid.

Several other courts have also found that automatic renewal provisions result in the continuation of the original agreement. *See, e.g., Williams Petroleum Comany v. Midland Cooperatives, Inc.*, 679 F.2d 815, 818 (10th Cir. 1982) ("Renewal and extension are concepts closely allied to one another, normally involving a continuation of the relationship on essentially the same terms and conditions as the original contract.") *citing Seymour v. Coughlin Co.*, 609 F.2d 346, 350-351 (9th Cir.1979), *cert. denied*, 446 U.S. 957, 100 S.Ct. 2929, 64 L.Ed.2d 816 (1980); *East Bay Union of Machinists, Local 1304 v. Fibreboard Paper Prods. Corp.*, 285 F.Supp. 282, 287 (N.D.Cal.1968), *aff'd mem.*, 435 F.2d 556 (9th Cir.1970); *Mutual Paper Co. v. Hoague-Sprague Corp.*, 297 Mass. 294, 8 N.E.2d 802, 806 (1937); *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 802-803 (Tex.1967); *see also, Ray Larsen Associates v. Nikko America, Inc.*, 1996 WL 442799 (S.D.N.Y.1996) (holding that automatic renewals are not creations of new contracts and do not alter the original date of formation), *quoting, Trans-Orient Marine Corp. v. Star Trading & Marine, Inc.*, 925 F.2d 566, 570 (2d Cir.1991) ("Renewal normally involves a continuation of the relationship on essentially the same terms and conditions as the original contract."); and *United States Aviation Underwriters, Inc. v. Preservatrice-Fonciere*

Compagnies D'Assurance, No. 83 Civ. 3935, 1986 WL 3779, at 2 (S.D.N.Y. March 21, 1986) (noting that renewals of insurance contracts are generally viewed "as an extension of the original policy, not a new contract"), aff'd, 801 F.2d 391 (2d Cir.1986). *Id.*, 567-68.

The Country Club court went on to "adop[t] the majority position that a contract which is renewed pursuant to an automatic renewal provision is merely a continuation of the original contract." *Id.*, 568. The court noted that there were no new or modified terms in the renewal agreement, and concluded that "the renewal period constitutes a continuation of the original prepetition executory contract and is subject to 11 U.S.C. § 365." *Id.*

Based on the reasoning of the court in *In re Country Club Estates*, and the plethora of authority cited therein for the proposition, the Court concludes that the automatic renewal provision contained in the Agreement between Crouse and Gaffney was nothing more than a continuation of their original Agreement, on the same terms as that original Agreement. Accordingly, it would give Gaffney no greater rights in this bankruptcy proceeding than it would have had if its Agreement with Crouse had been for, say, ten years. In the latter case, Crouse would have the right under Code § 365 to reject that executory contract; the result under the particular Agreement between the parties should be no different.

Based on the foregoing, the Court reaches the following conclusions concerning the contentions advanced by Gaffney in support of its opposition to Crouse's motion to reject its Agreeent with Gaffney:

1. The Agreement remains executory in nature, there existing further obligations on Gaffney's part, namely, to provide services in the event Debtor requests it.

2. The mere fact that Crouse continued to make the quarterly payments provided in the Agreement, even after filing this petition, does not constitute an

assumption of the Agreement by conduct, a notion which itself is disfavored as a general proposition.

3. Although the Agreement did renew, by virtue of the automatic renewal provision, that renewal is not tantamount to assumption by Crouse, but should be regarded merely as a continuation of the original Agreement.

Having reached these conclusions, it is clear that Crouse has the right to reject this Agreement, and, having filed this motion seeking Court approval for same, would be entitled to an order approving such rejection, subject, of course, to Gaffney's right to file a proof of claim against the estate for damages for the breach of the Agreement that said rejection would constitute pursuant to Code § 365(g).

IT IS SO ORDERED.

Dated at Utica, New York

this 17th day of March 2003

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge