

In the United States Bankruptcy Court

for the Northern District of Iowa

HAROLD V. JOHNSTON and CLAUDINE
JOHNSTON
Debtors.

Bankruptcy No. X88-00898S

Chapter 13

ORDER RE: DEBTORS' MOTION TO REJECT EXECUTORY CONTRACT

Debtor Harold V. Johnston (JOHNSTON) seeks to reject an executory contract with Monona County Sanitary Landfill (COUNTY).

Johnston and his wife Claudine filed their joint voluntary petition under Chapter 13 of the Code on June 3, 1988.

The motion to reject by Johnston was filed the same day.

Notice setting hearing on the rejection, with a bar date for objections, was served on all creditors and parties-in-interest.

Objecting to the rejection was the United States of America on behalf of the Small Business Administration. Hearing was held in Sioux City, Iowa on July 6, 1988.

This is a core proceeding under 28 U.S.C. 157(b)(2)(A).

Johnston operates a sanitary landfill operation for the County under contract which was originally entered into September 27, 1971.

The contract was amended by agreements dated March 19, 1973, February 22, 1974, and November 15, 1984.

The most recent amendment (plaintiff's exhibit no. 1) extended the term of the agreement to July 1, 1990. It also provided that the price to be paid for Johnston's performance would be negotiated annually between the parties. It appears from the contract that the annually negotiated compensation would be effective July 1 of each year.

As an assignee of Onawa State Bank, the United States of America on behalf of its agency, the Small Business Administration (SBA) claims a security interest in contract payments by County to Johnston to the extent of \$1,547.32.

This security agreement was apparently established by a "collateral pledge agreement" dated January 21, 1985. It was assigned to SBA by Onawa State Bank on September 24, 1987.

Johnston has reached a new agreement with County which provides for the rejection of the existing contract and the execution of a new contract.

The new contract (plaintiff's exhibit 3) would take effect upon the court's approval of the rejection of the old. Further, according to a letter executed by the chairman of the Monona County Landfill Agency (plaintiff's exhibit 2), compensation to Johnston would increase effective July 1, 1988 to the sum of \$6,208.33. This is an increase of \$500.00 per month above the amount agreed to under the previous contract. Under the previous contract, County paid \$4,162.01 directly to Johnston and \$1,546.33 to State Bank of Onawa under the assignment.

II.

This court will apply the "business judgment test" in determining whether to permit assumption or rejection of executory contracts. In re Rath Packing Co., 36 B.R. 979, 990 (Bankr. N.D. Iowa 1984). Under this flexible standard, trustee or debtor-in-possession must demonstrate that rejection of the contract is likely to benefit the estate. In re W. & L. Associates, Inc., 71 B.R. 962, 966 (Bankr. E.D. Pa. 1987); In re Huff, 81 B.R. 531, 537 (Bankr. D. Minn. 1988).

One criteria to be considered is whether rejection of the executory contract would benefit unsecured creditors. In re ChiFeng Huang, 23 B.R. 798, 801 (Bankr. App; 9th Cir. 1982).

Deference is given to the business discretion of the debtor-in-possession unless the decision that rejection will be advantageous is "so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." Lubrizol Enterprises v. Richmond Metal Finishers, 756 F.2d 1043, 1047 (4th Cir. 1985).

III.

Debtor argues that the rejection of the contract with County in order to substitute a new and better contract with County will be beneficial to the unsecured creditors.

SBA argues that the only purpose of the rejection is that debtor seeks to rid itself of the assignment of contract payments which has attached itself to the old contract.

Even if this were so, this should not hamper debtor's rights under 11 U.S.C. 365(a) to reject an executory contract. See In re W. & L. Associates, Inc., 71 B.R. 962, 967 (Bankr. E.D. Pa. 1987). The question is, as previously stated, whether there is a likely benefit to the estate or unsecured creditors arising from the rejection.

Debtor Johnston has introduced evidence that the new contract will provide an increase in compensation to Johnston of \$500.00 per month. It is arguable that Johnston may have been able to negotiate this same increase under the old contract as the old contract provided for negotiated annual increases.

However, there was no showing by SBA that this same increase could have been negotiated under the new contract.

The court finds that the rejection of this executory contract is likely to benefit the estate, and that the debtor-in-possession should be permitted under 11 U.S.C. 365(a) to reject the contract.

ORDER

IT IS THEREFORE ORDERED that the debtor's motion to reject his executory contract with Monona County Sanitary Landfill is granted.

SO ORDERED ON THIS 15TH DAY OF AUGUST, 1988.

William L. Edmonds
Bankruptcy Judge

Filed Stamped 8/15/88