

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

In re)
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TRANSIT GROUP, INC.,) Case No. 01-12820-6J1
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Debtor.)
)
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MEMORANDUM OPINION SUSTAINING ACE AMERICAN INSURANCE COMPANY'S
OBJECTION TO CONFIRMATION OF DEBTOR'S AMENDED JOINT PLAN OF
REORGANIZATION

This case came on for hearing on October 21, 2002, on the Objection to Confirmation of Debtor's Amended Joint Plan of Reorganization (Doc. No. 665), filed by Ace American Insurance Company. The debtor, Transit Group, Inc., filed a Response to Ace's Objection (Doc. No. 751). In its objection, Ace argues that the debtor's proposed plan of reorganization is not feasible because the plan neither requires the debtor to assume certain automobile liability insurance agreements ("Policies") under 11 U.S.C. §365¹, nor guarantees performance of all conditions of coverage under the Policies to ensure that the Policies remain in full force and effect.

Transit, in response, argues that the Policies are not executory contracts and cannot be assumed pursuant to 11 U.S.C. §365. Despite its inability to assume the Policies, Transit argues that it will continue voluntarily to comply with the various duties of cooperation imposed under the Policies as conditions to coverage, and, even though Transit has not paid all premiums due to Ace, Ace must continue to provide coverage under the Policies. Therefore, Transit argues its plan is feasible. For the reasons stated below, the Court sustains Ace's Objection to confirmation of the debtor's plan.

¹ Unless otherwise stated, all references to the Bankruptcy Code refer to Title 11 of the United States Code.
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Transit operates a large fleet of trucks making deliveries nationwide. In 1998, Ace and Transit entered into the critical automobile liability policies Transit needs to conduct its business. Transit would violate numerous state laws and regulations if it operated even one hour without automobile liability insurance. On December 28, 2001, Transit filed this Chapter 11 case. Three days later, on January 1, 2002, the Policies expired pursuant to their own terms. As of the filing date, Transit owed to Ace (i) \$697,157 for the last monthly premium installment payment, payable on December 1, 2001, and (ii) \$69,263 for a revised premium payable after an audit for the 2000 policy year.² Additional retrospective premium adjustments may result after an audit of the 2001 policy year.

Despite the expiration of the Policies, according to the terms of the Policies, both Ace and Transit are required to comply with certain continuing duties.³ Transit's continuing duties include the duty of cooperation; the duty to provide notice of claims; the duty to assist in enforcing any rights of contribution or indemnity; the duty to refrain from making voluntary payments or assuming obligations; the duty to assist in the defense of claims; the duty to provide documents and witnesses for litigation of claims; and the duty to deliver documents in exchange for payment of damage claims. Transit must comply with all its continuing duties under the Policies as a condition to coverage. If Transit fails to perform any one of these continuing duties, such as failing to notify Ace of a pending claim, Ace can refuse to pay that particular claim. Ace's continuing duties are straight-forward and include the duty to defend and to pay claims that arose while the Policies were in effect.

Under Transit's proposed plan of reorganization, Transit intends to pay all claims covered by the Policies, known or unknown, by proceeds supplied by Ace pursuant to the

² The Policies include a retrospective premium component pursuant to which the annual premiums are adjusted based upon the insured's past claims experience and annual audits conducted by Ace.

³ Under the Policies, the filing of this bankruptcy case does not automatically relieve Ace from its obligations under the Policies.

Policies. Transit segregated these claims into Class 8. If Ace fails to provide insurance coverage for one or all of the pending Class 8 claims, which collectively constitutes a large total dollar amount, perhaps exceeding several million dollars, Transit is required to treat Class 8 claims as Class 7 claims. Class 7 claims are general unsecured claims in amounts greater than \$100,000. Each holder of a Class 7 claim will become beneficiaries of a liquidating trust, the Transit Creditor Trust, and receive a pro rata share of any distribution based on the total amount of allowed unsecured claims.

In its objection to Transit's plan, Ace argues that Transit could incur substantial and currently undisclosed additional liability to Class 8 claim holders, if insurance coverage is unavailable. Specifically, Ace asserts that any plan that relies upon the existence of insurance coverage for the payment of claims must, at a minimum, require the debtor to assume the Policies pursuant to 11 U.S.C. §365. Assumption ensures full compliance with all of the insured's affirmative duties under the Policies, which, in turn, ensures payment of Class 8 claims. Ace argues that if the Policies are not expressly assumed under the plan, they are deemed rejected and coverage is no longer available for payment of Class 8 claims.

In the alternative, even if the Policies are not assumable executory contracts, Ace argues that the plan is not feasible because it fails to guarantee Transit's performance of all conditions of coverage under the Policies. Without affirmatively requiring Transit to satisfy all of its continuing duties under the Policies, Ace alleges that the plan will void any available coverage. For example, if Transit fails to perform any one of its duties as it relates to any Class 8 claim, Ace could deny coverage of that particular claim. To the extent the insurance coverage under the Policies purports to be the primary means for payment of covered Class 8 claims, Ace argues

that the plan fails to provide adequate assurance that insurance proceeds actually will be available to pay such claims.⁴

In response, Transit argues that, by seeking to treat the Policies as executory contracts, Ace is attempting to elevate a prepetition unsecured claim for \$766,420 for unpaid premiums to a postpetition administrative claim. According to Transit's plan of reorganization, Ace will receive payment for only a fraction of the premiums due, if Ace's claim is treated as a prepetition unsecured claim; however, Ace will receive payment in full, if its claim is treated as a postpetition administrative claim. Transit asserts that the Policies are not executory and that Ace is not entitled to an administrative claim. Yet, Transit argues that Ace is required to continue paying claims arising during the policy period. Transit acknowledges that the observance of its continued duties under the Policies is a condition to Ace's duty to pay these claims and promises to continue to perform its duties as it has done in the past. But, Transit asserts that it has no obligation to pay the outstanding premium to Ace for this coverage.

The initial issue raised by Ace's objection is whether the Policies were executory on the petition date or not. If the Policies were executory, Transit must assume the Policies under §365, cure all defaults, such as the failure to pay premiums, within a reasonable period of time, and provide adequate assurance of future performance. The difficulty here is that the unpaid premiums were due by Transit prepetition and that the Policies expired only three days after this case was filed. Does such a short postpetition "life" of only three days make the Policies executory or not?

⁴ Ace also argues that the plan is not feasible because it impermissibly modifies the terms of the Policies. The plan provides in Article III.8.b that Transit will "reasonably comply with the requests for cooperation by the insurance carriers of the Insurance Policies as modified hereby." This is less than what the Policies require. If Transit does not fully comply with its continuing duties to cooperate, Ace could deny coverage for the payment of some or all of Class 8 claims. In response, to this particular objection, Transit modified the plan to add language that expressly preserves all rights and duties under the Policies and deleted the phrase "as modified hereby." Transit's modification obviates Ace's argument as it relates to the impermissible modification of the Policies.

Under §365(a), a debtor may assume the duties of an executory contract subject to the court's approval. If the contract is assumed, the third party must perform and the debtor must render at full value the debtor's bargained for performance on which the third party's performance was conditioned. Section 365 is designed to give the debtor the option of assuming contracts where performance by a third party will benefit the estate. Here, Transit's plan of reorganization is premised on Transit's ability to pay Class 8 claims from insurance proceeds supplied by Ace. Therefore, if the Policies are executory, Transit clearly must assume the Policies to provide this coverage benefit to holders of Class 8 claims.

The Eleventh Circuit Court of Appeals has not decided when an insurance policy is or is not an executory contract. However, other courts have held that insurance policies that expire before a bankruptcy is filed are not executory contracts, despite continuing duties of cooperation on the part of either party, and, therefore, cannot be assumed by the debtor pursuant to §365. In re Sudbury, 153 B.R. 776 (Bankr. N.D. Ohio 1993); In re Firearms Import and Export Corp., 131 B.R. 1009 (Bankr. S.D. Fla. 1991). These courts used the Countryman definition of an executory contract when determining whether an expired insurance policy is executory. According to Professor Countryman, an executory contract is 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 the performance of the other." Vern Countryman, Executory Contracts in Bankruptcy, 57 Minn. L. Rev. 439, 460 (1973). Courts uniformly conclude that the continuing duty to cooperate with the insurer under expired insurance policies do not render expired policies executory primarily because nonperformance by the insured of one of the continuing duties does not excuse the performance of the insurer. Rather, if the insured fails to perform a continuing obligation under the policies, the insurer has a defense to refusing to pay on that particular claim, but not to deny payment of all pending claims.

The Court notes that the Eleventh Circuit has not specifically rejected the Countryman approach. However, it has adopted the “functional approach” to define executory contracts. In re General Development Corp., 84 F.3d 1364 (11th Cir. 1996). Under the functional approach, a court looks to the benefits a debtor and its estate would gain if a contract is assumed or rejected. Id.

Therefore, under the Countryman test, this Court must determine whether Transit and Ace have obligations so far unperformed on the petition date that the failure to perform would constitute a material breach. Under the functional approach, the Court must evaluate the benefits Transit or its estate would gain if the Policies were assumed or rejected.

The Court agrees that under either approach the continuing duties of cooperation alone do not render the Policies executory. The debtor has no obligations to assume. The failure of either Transit to cooperate with Ace in the underlying liability litigation involving one claimant or Ace’s failure to pay a single claim is limited to the sole claim involved and does not constitute a material breach of the Policies in toto.

However, payment of the underlying premiums is an essential obligation under the Policies. Transit’s failure to pay the premiums due under the Policies would be a material breach and would excuse Ace’s performance under the Policies. The parties negotiated for the premiums Transit paid to get coverage. Unless and until Transit pays these negotiated for premiums, Ace should be excused from performance. The fact that the bill for the premiums was due before this case was filed is irrelevant when the Policies had not expired by the petition date and Transit relies on the coverage to fund its proposed plan of reorganization.

Indeed, all courts that have addressed this issue, except one, has held that the only basis for holding that an insurance policy is executory is if the insured had a continuing obligation to make premium payments under the policy. In re Firearms Import and Export Corp., 131 B.R. 1009 (Bankr. S.D. Fla. 1991); In re Sudbury, Inc., 153 B.R. 776 (Bankr. N.D. Ohio 1993); Contra

In re Texscan Corp., 976 F.2d 1269 (9th Cir. 1992)(An additional statutory provision under Arizona state law rendered the issue of whether an insurance policy is executory if the insured has a continuing obligation to make premium payments under the policy inapplicable in the case.) Therefore, applying the Countryman test, the Policies were executory on the petition date because both parties had material obligations to perform. Transit had an obligation to pay premiums to Ace. Ace had the obligation to provide coverage.

Similarly, applying the functional test, one can hardly visualize a case in which the debtor and its estate would not benefit from assuming an executory insurance policy, curing any defaults in premium payment, and maintaining insurance coverage. Perhaps, in some circumstances, a debtor may have few outstanding claims and exorbitant premium costs so that assumption of the executory insurance agreement does not make sense. However, in this case, Transit and its estate clearly benefit from the payment of the outstanding premiums, totaling \$766,420, in exchange for payment of claims estimated at several million dollars. Even if the claims are settled for a much lesser sum, the avoidance of future litigation costs and risks alone justify the payment of the remaining premium. The Policies were executory on the petition date under the functional test adopted by the Eleventh Circuit Court of Appeals.

Therefore, the Court holds that the obligation to make premium payments under an insurance policy that had not expired on the petition date renders the policy executory under §365. The Policies were not expired on the petition date and, although, they expired only three days later, Transit cannot expect to receive its end of the bargain under the Policies, without paying the premiums due. Transit continues to owe to Ace the last monthly premium installment payment, as well as a small amount for a retrospective premium adjustment. Continuation of coverage under the Policies is essential for confirmation of Transit's plan. Therefore, Transit must assume the Policies under §365 in order to confirm the plan, and the Court sustains Ace's Objection.

As part of the assumption, Transit must cure its \$766,420 default within a reasonable period of time. The Court initially will request the parties to confer on a reasonable cure period. If the parties cannot agree on the terms for assuming the Policies the Court will rule on the remaining issues. Further, because the Court finds the Policies executory, the Court needs not rule on the remaining issues raised in Ace's objection.

DONE and ORDERED at Orlando, Florida, this 25th day of November, 2002.

/s/ Karen S. Jennemann

Karen S. Jennemann
United States Bankruptcy Judge

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