

CREDITOR'S RIGHTS TOOLKIT

What Is a Cure Claim and What Does It Mean That the Buyer Has to Provide Adequate Assurance of Future Performance Under My Contract?

Section 365 of the Bankruptcy Code allows a debtor to assume (retain), or assume and assign, an executory contract¹ to a third party, provided that all monetary and nonmonetary defaults are cured. Section 365 of the Bankruptcy Code requires that the party to whom a debtor seeks to assign an executory contract provides adequate assurance of future performance under the contract?

Key Issues

- **CURING DEFAULTS UNDER AN EXECUTORY CONTRACT**

A cure claim represents the amount that the debtor (or often, the buyer on behalf of the debtor) must pay in order to cure monetary defaults under a contract to be able to assume and then assign a contract to a would-be assignee. Importantly, cure claims must be paid in full as a precondition to assumption (which must precede assignment) of a contract. However, it is not unusual for a buyer to attempt to negotiate a lower cure amount on the basis that if a lower cure amount cannot be agreed to, the executory contract will be rejected as part of the bankruptcy. Nondebtor counterparties are entitled to notice of the debtor's proposed cure amount. If the proposed cure amount is not correct, nondebtor counterparties must timely file an objection supported by evidence of the amount due and owing.

- **ENSURING THAT ACCRUALS ARE INCLUDED IN THE CURE CLAIM**

Nondebtor counterparties should be vigilant in ensuring that cure amounts that arise between the date that the debtor files a notice of cure amount, and the date of assumption and assignment of the contract are paid, especially if high dollar amounts become due and owing quickly under the contract. It is a best practice to make sure that the language of the order approving the assumption and assignment calls for the payment of accruals and makes clear who is paying them, the debtor or the buyer.

¹ See What Is an Executory Contract and What Will Happen to My Executory Contract in Bankruptcy? [TPL_CreditorsRightsToolkit_WhatsAnExecutoryContract.pdf](https://troutman.com/TPL_CreditorsRightsToolkit_WhatsAnExecutoryContract.pdf) (troutman.com)

- **SUFFICIENCY OF ADEQUATE ASSURANCE INFORMATION**

A party to whom the debtor seeks to assign a contract must demonstrate that it is ready, willing, and able to perform under the terms of the contract (*i.e.*, adequate assurance of further performance). Courts generally require some evidence of economic wherewithal to perform the material terms of a contract. In practice, often what is provided to nondebtor contract parties by the assignee is high level, vague, and general, or relates not to the actual assignee but rather to its corporate parent. Where the would-be assignee is a well-known, reputable company, the nondebtor contract counterparty may have less concerns with the adequate assurance information that is provided. Where concerns do exist, though, nondebtor counterparties may object to the sufficiency of the information provided and seek additional information. Moreover, if after reviewing such information, the counterparty does not believe that the assignee has the financial wherewithal to perform under the contract or is otherwise incapable of performance, a timely written objection to the assignment of the contract can be filed with the Bankruptcy Court to attempt to either prevent or condition the assignment. Absent a timely objection, courts typically are unlikely to deny a proposed assignment on adequate assurance grounds.

Takeaway

Assignments of executory contracts are typical in chapter 11 cases, especially in cases where the debtor seeks to sell substantially all of its assets to a buyer. Nondebtor counterparties are afforded key protections under the Bankruptcy Code, including payment of all amounts due and owing under the contract and adequate assurance of future performance of the contract. It is important that contract counterparties be vigilant, and consult experienced bankruptcy counsel when needed, to ensure that they reap the full benefit of such protections.