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Executory Contracts: How Prompt Is "Prompt?"

Written by:
Risa Lynn Wolf-Smith
Holland & Hart LLP; Denver
rwolf@hollandhart.com

Wendy Chung Rossiter
Qwest Communications Corp.; Denver
wendy.rossiter@qwest.com

While bankruptcy practitioners know that the language of §365 requires "prompt" cure before an executory contract may be assumed, most do not realize that the cases vary widely in determining promptness.

Risa Lynn Wolf-Smith

One can, of course, find authority for the principle that "prompt cure" requires "immediate" payment or payment within a relatively short period of time, but more often than not, what satisfies the requirements of §365(b)(1)(A) depends on the facts and circumstances of each case. An examination of the range of possibilities presented by the caselaw provides guidance for those of us who must fashion appropriate cure arrangements.

Caselaw on Prompt Cure

Section 365(b)(1) provides:

> (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
>
> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.

11 U.S.C. §365(b)(1).

The terms "promptly cure" and "adequate assurance" of such prompt cure for purposes of §§365(b)(1)(A) and (B) are not defined. Instead, their meanings have been developed in caselaw.

The general rule is that the cure of monetary defaults under 11 U.S.C. §365 must be made at or near the time the contract is assumed.[1] Decisions concerning the promptness of cure under §365, however, have varied, as courts have determined the issue based on the unique facts of each case.[2] While a given court may pronounce its own rule of "promptness," others may just as easily contradict that rule. For example, the court in *General Motors Acceptance Corp. v. Lawrence*, 11 B.R. 44, 45 (Bankr. N.D. Ga. 1981), announced: "It seems unlikely that a period in excess of one year would be considered by this court to be a prompt cure of a default under §365(b)(1)(A)." In contrast, the court in *In re Mako Inc.*, 102 B.R. 818, 821 (Bankr. E.D. Okla. 1988), stated: "Under the appropriate set of facts, a period of time in excess of a year could be prompt."

Factors considered by courts in determining whether the "prompt cure" requirement of §365 is satisfied include (1) the debtor's past financial performance, (2) any inequitable acts by the non-debtor party, (3) harm or prejudice suffered by the non-debtor party resulting from past defaults and (4) the term of the contract or lease.

For example, in one case, the debtor's proposal to pay the balance owing over two years was determined to be "prompt" where the lease had approximately 22 years remaining in its term. *In re Valley View Shopping Center*, 256 B.R. 10 (Bankr. D. Kan. 2001). In a unique decision that allowed a three-year cure period, the court focused on the fact that the non-debtor party had acted inequitably by compelling the debtor to pay a surcharge of $0.50 per case to reduce its pre-petition arrearage by approximately $50,000 by the time assumption was proposed. *In re Coors of North Mississippi Inc.*, 27 Bankr. 918 (Bankr. N.D. Miss. 1983).[3] The court also noted that the cure period represented "a comparatively short period of time as it relate[d] to the prospective longevity of successful business operation[s]" contemplated by the proposed cure. *Id.* at 922.[4]

In another case, the court based its decision requiring immediate payment on the harm already suffered by the non-defaulting party to a real estate contract. *Bokes Bros. Farms Inc.*, 1994 Bankr. LEXIS 2386, at *6 (Bankr. N.D. Iowa 1994). In doing so, the court held that the seller had "already been forced to wait almost a year and a half without receiving contract payments" and that the seller was reliant "on the contract payments as a main source of income for her day-to-day needs." *Id.*

Adequate Assurance

Adequate assurance of the debtor's ability to make future payments is often determined by its financial stability. *See In re Health Science Prod. Inc.*, 191 B.R. 895, 909 (Bankr. N.D. Ala. 1995) (holding that the debtor's "ability to make current payments, along with

1 *See, e.g., In re Fisha Indus. Inc.*, 9 B.R. 834, 835 (D. Nev. 1981) (granting debtor 60 days to assume or reject contract involving lease of bakery equipment if it paid the monetary default immediately upon assumption and all lease payments were paid promptly during such period); *Cole v. Kramer Suburban Car Wash Enter. Inc.*, 1992 W.L. 62144 (D. Md. 1992) (proposal to cure arrearage over seven-month period did not constitute prompt cure); *In re Bronx-Westchester Mack Corp*, 4 B.R. 730, 734-35 (Bankr. S.D.N.Y. 1980) (monetary defaults under distributor agreements were to be paid immediately or debtor was to provide adequate assurance in the form of cash or collateral that was nonspeculative, positive and sufficiently substantial).

2 *In re Tama Beef Packing Inc.*, 277 B.R. 407, 411 (Bankr. N.D. Iowa 2002) ("Various courts have held that prompt can mean anywhere between two weeks to five years, depending on the circumstances of a particular case."); *In re Embers 86th Street Inc.*, 184 B.R. 892, 900 (Bankr. S.D.N.Y. 1995) ("Whether a cure is 'prompt' for purposes of §365(b)(1)(A) depends on the facts and circumstances of each case.").

3 This decision has been criticized by commentators as "a significant departure from the majority rule and [one that] represents the dangers inherent in equitable attempts to rewrite contractual provisions to suit some abstract notion of fairness." Epling, Richard, "Contractual Cure in Bankruptcy," 61 Am. Bankr. L. J. 71, 76-77 (1987) (published by the National Conference of Bankruptcy Judges).

4 *Compare In re R/P Int'l. Tech. Inc.*, 57 B.R. 869, 872-73 (Bankr. S.D. Ohio 1985) (debtor's proposal to cure $156,000 in rent arrearage over 60 months was not "prompt" because it was virtually co-extensive with the remaining term of the lease), with *In re Berkshire Chem. Haulers Inc.*, 20 Bankr. 454, 458 (Bankr. D. Mass. 1982) (rejecting debtor's proposal to cure arrearage over an 18-month period because lease had only 18 months left to run).

the debtor's projected financial stability, provides adequate assurance of future performance under the contract"). Adequate assurance requires a foundation that is non-speculative, positive and sufficiently substantial so as to assure the non-debtor party that it will receive the amount of the default. *In re Bronx Westchester Mack Corp.*, 4 B.R. 730 734-35 (Bankr. S.D.N.Y. 1980). For example, in *In the Matter of Old World Skating Center Inc.*, 100 B.R. 147 (Bankr. D. Conn. 1989), the proposed cure of an arrearage over a three-year period was not approved where the record would not support a finding that the debtor's promise would constitute adequate assurance. *See, also, In re Skylark Travel Inc.*, 120 B.R. 352 (Bankr. S.D.N.Y. 1990).

While adequate assurance does not require a guaranty of future performance, there must be a firm commitment by the debtor to cure the default and a reasonably demonstrable capability that it can do so. *In re Embers*, 184 B.R. at 900-01. *But, see In re Travelot Co.*, 286 B.R. 447, 462 (S.D. Ga. 2002) (court noted that it possessed broad powers to require "timely and substantial guaranties of cure and future performance in the context of any order on the assumption of a contract.").

Factors considered by courts in determining whether a debtor has provided adequate assurance of its ability to cure a default include (1) evidence of profitability, (2) a plan to earmark money exclusively to cure the default and (3) the willingness and ability of the debtor or its proposed assignee to fund cure payments. *Id*. at 902. For example, where a debtor had been frequently in default and its sales records had shown prolonged periods of declining sales before a brief period of increased sales, the court did not allow it to assume certain real estate, equipment and licensing agreements, though the debtor had no realistic basis for achieving rehabilitation without assumption of those contracts. *JLS Shamus*, 179 B.R. 294, 296-97 (Bankr. M.D. Fla. 1995).

Conclusion

While it is difficult to glean any bright-line rules from the cases interpreting the term "prompt" for purposes of §365, the existing authority provides insight into how to create a workable cure proposal. On the flip side, there is abundant authority for those who wish to argue that a proposed cure is not acceptable. ■

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