

DOWJONES | Daily Bankruptcy Review**Viewpoint: Contract Counterparties Facing Sales Must Be Vigilant**

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January 08, 2013

Bankruptcy cases are often used as a vehicle to sell a debtor's business as a going concern under Section 363 of the Bankruptcy Code. A contemplated § 363 sale dramatically shifts the dynamics of the case. The decision to assume or reject contracts and leases connected to the business being sold is moved from the debtor to the purchaser in the § 363 sale. The non-debtor party to the contract (the contract counterparty) is swept into the sale process and must immediately ascertain whether its contract is proposed to be assumed or rejected, the cure amount, the procedure for confirming the cure amount, and when cure payments will be made.

In the flurry of activity, contract counterparties may overlook or inadvertently relinquish to savvy debtors and purchasers the protections that the Bankruptcy Code provides. This article shares experiential wisdom to help contract counterparties avoid falling prey to creative tactics that debtors, purchasers and their advisors have employed.

The Bankruptcy Code contains important protections for contract counterparties. Section 365(b)(1) requires cure (or adequate assurance of prompt cure) of all monetary defaults under an executory contract or unexpired lease. Section 365(d)(3) requires a debtor to make timely post-petition payments under a nonresidential real estate lease until the lease is assumed or rejected, and § 365(d)(5) requires timely post-petition payments on personal property leases after the 60th day of the bankruptcy case. Additionally, amounts incurred post-petition under a contract that is beneficial to the operation of the debtor's business are entitled to elevated priority of payment as actual and necessary administrative expenses under § 503(b)(1)(A).

A § 363 sale motion usually includes or is accompanied by a motion to assume executory contracts and unexpired leases (the "assumption motion") that lists the executory contracts and unexpired leases that the debtor tentatively seeks to assume and assign to the purchaser (the "list"). Most contract counterparties are thrilled to see their contracts on the list, thinking that their inclusion means that all monetary defaults will be cured and that they will soon be dealing with a financially stable purchaser (rather than the debtor.) Some view their place on this original list as a prize in their pocket and are lured into dangerous complacency.

Section 363 sale motions have been used to squeeze monetary concessions from contract counterparties. One scheme, the "bait and switch," goes something like this: After listing the executory contract, the debtor advises the contract counterparty that it is "strapped" for cash and needs deferral or forbearance on post-petition payments until the sale closes, but assures that the purchaser will have to pay full cure amount when the contract is assumed as part of the § 363 sale. Some contract counterparties acquiesce, fearing that if they demand post-petition, pre-assumption payment, the debtor will kick them off the list. Others agree because they erroneously perceive their inclusion on the list as a fait accompli.

Then comes the switch. Shortly before the sale closing, the debtor files an amended list that moves targeted contracts and leases to the dreaded list of agreement being rejected (the "rejected list"). The debtor announces that the purchaser has "changed its mind" now that it has "better information" regarding the cure claims asserted by contract counterparties. The contract counterparty is told it can win readmission to the list if it will waive or reduce its cure claim. Protests of the contract counterparty that it has already yielded by giving valuable consideration (i.e., deferral or forbearance of post-petition payments) will likely be ignored.

What can be done? Contract counterparties must be vigilant in response to each § 363 sale and assumption motion and should watch for any changes to the list affecting their particular executory contract or unexpired lease. They must be alert to the timing and procedures governing contract assumption and rejection, including the process for determination of cure amounts. Increasingly, debtors list cure amounts at \$0 and require contract counterparties to object and establish the correct cure amount on an expedited basis. Bankruptcy courts typically approve (and thus condone) these burden-shifting tactics and tight timeframes, probably reasoning that a going-concern sale and job preservation are more important than protecting the rights of contract counterparties. If the contract counterparty enjoys a strong position (especially if the contract is essential to business operations and hard to replace) then, even if the assumption motion accurately states the cure amount, the contract counterparty should consider filing a response to remind everyone that the Bankruptcy Code requires the debtor to make timely post-petition, pre-assumption payments. That response will give the contract counterparty leverage to negotiate with the debtor—who is probably anxious to resolve all objections to the sale and the assumption motion.

If the contract counterparty is reluctant to file a response to the assumption motion or to seek post-petition pre-assumption payment (for fear of getting thrown off the list), then any forbearance or deferral of post-petition payments should be memorialized in a written stipulation that is filed with the court, which confirms that concessions are being given to the debtor in express reliance on the assumption motion and inclusion on the list. That way, if the debtor moves the contract to the rejected list, the contract counterparty can cite the stipulation in support of a request for an administrative claim for post-petition, pre-rejection amounts owed.

Even these measures cannot guarantee a particular result. But if taken timely, they can help preserve the Bankruptcy Code's protections for contract counterparties.

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