

The Meaning of “Prompt and Adequate”

RISA LYNN WOLF-SMITH AND ERIN L. CONNOR*

While bankruptcy practitioners know that the language of § 365 requires a “prompt” cure of all defaults before an executory contract may be assumed, most may not realize that the meaning of the term “prompt” varies widely under applicable case law. Whether your goal is to extend or abbreviate a cure period, you are likely to find authority to support your position.

Section 365(b)(1) provides:¹

(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.

Although Section 365 seems straightforward at first blush, the Bankruptcy Code does not define the terms “prompt” or “adequate assurance” anywhere. Instead, their meanings have been developed in case law. What

* Risa Wolf-Smith is the head of Holland & Hart’s bankruptcy practice and has extensive experience in bankruptcy proceedings of all sizes, with particular emphasis on Chapter 11 reorganizations. Ms. Wolf-Smith can be reached at Holland & Hart at 303-295-8011 or via e-mail at rwolf@hollandhart.com. Erin Connor is an associate at Holland & Hart specializing in corporate business transactions and bankruptcy. Ms. Connor can be reached at 303-295-8374 or via e-mail at econnor@hollandhart.com.

satisfies the requirements of §365(b)(1)(A) depends on the facts and circumstances of each case.²

Prompt Cure

The general rule is that the cure of monetary defaults under § 365 must be made at or near the time the contract is assumed.³ Even so, decisions concerning the promptness of cure under § 365 have varied, as courts have determined the issue based on the unique facts of each case.⁴ 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*⁵ 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).”⁶ In contrast, the court in *In re Mako, Inc.*⁷ stated: “Under the appropriate set of facts, a period of time in excess of a year could be prompt.”

A review of the case law demonstrates, however, that the first proposition, while not a bright line rule, is proving to be true. Few holdings have permitted cure periods of greater than one year. Factors considered by courts in determining whether the “prompt cure” requirement of § 365 might be attenuated 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. In a unique decision, one court allowed a three-year cure period.⁸ The *Coors* 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. 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.⁹

Like the *Coors* decision, other decisions have focused on the remaining term of the executory contract. In *In re Valley View Shopping Center*,¹⁰ the Kansas bankruptcy court granted the debtor’s proposal to pay the balance owing over two years where the lease had approximately 22 years remaining in its term. In contrast, when the proposed cure period coincides with the remaining term of the contract, courts have rejected the proposed cure period.¹¹

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.¹² 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.”

Adequate Assurance

Adequate assurance of the debtor’s ability to make future payments is often determined by a debtor’s financial stability.¹³ 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.¹⁴ For example, in *Matter of World Skating Center, Inc.*,¹⁵ 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.¹⁶

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.¹⁷

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.¹⁸ 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.¹⁹

Conclusion

Because the meaning of “prompt” and “adequate”, for purposes of § 365, is not strictly mandated by the Bankruptcy Code, practitioners are likely to find case law that supports their position when a cure proposal is being considered. The cases provide insight into cure proposals likely to be approved and the factors to be considered.

RESEARCH REFERENCES:

Norton Bankr. L. & Prac. 2d §§ 39:29, 39:45; Bankr. Serv., L Ed §§ 21:347, 21:349.

West’s Key Number Digest, Bankruptcy ☞ 3114

NOTES

1. 11 U.S.C. § 365(b)(1).
2. See, e.g., *In re Embers 86th Street, Inc.*, 184 B.R. 892, 900 (Bankr. S.D. N.Y. 1995).
3. See, e.g., *In re Fisha Industries*, 9 B.R. 834, 835 (Bankr. 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 Enterprises, Inc.*, 1992 WL 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, 734-735, 6 Bankr. Ct. Dec. (CRR) 581, Bankr. L. Rep. (CCH) ¶ 67493 (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). *In re Lafayette Radio Electronics Corp.*, 9 B.R. 993, 4 Collier Bankr. Cas. 2d (MB) 220 (Bankr. E.D. N.Y. 1981) (immediate payment was "prompt").
4. *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.").
5. *General Motors Acceptance Corp. v. Lawrence*, 11 B.R. 44, 45, 7 Bankr. Ct. Dec. (CRR) 928 (Bankr. N.D. Ga. 1981).
6. See, e.g., *In re Gold Standard at Penn, Inc.*, 75 B.R. 669 (Bankr. E.D. Pa. 1987); *In re Berkshire Chemical Haulers, Inc.*, 20 B.R. 454, 9 Bankr. Ct. Dec. (CRR) 230, 6 Collier Bankr. Cas. 2d (MB) 843 (Bankr. D. Mass. 1982).
7. *In re Mako, Inc.*, 102 B.R. 818, 821 (Bankr. E.D. Okla. 1988).
8. *In re Coors of North Mississippi, Inc.*, 27 B.R. 918, Bankr. L. Rep. (CCH) ¶ 69414 (Bankr. N.D. Miss. 1983). 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).
9. *In re Coors of North Mississippi, Inc.*, 27 B.R. 918, 922, Bankr. L. Rep. (CCH) ¶ 69414 (Bankr. N.D. Miss. 1983).
10. *In re Valley View Shopping Center, L.P.*, 260 B.R. 10 (Bankr. D. Kan. 2001).
11. *In re R/P Intern. Technologies, Inc.*, 57 B.R. 869, 872-873, 14 Bankr. Ct. Dec. (CRR) 106 (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 Chemical Haulers, Inc.*, 20 B.R. 454, 458, 9 Bankr. Ct. Dec. (CRR) 230, 6 Collier Bankr. Cas. 2d (MB) 843 (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).
12. *In re Bockes Brothers Farms, Inc.*, 1994 WL 912213 (N.D. Iowa 1994).
13. See *In re Health Science Products, Inc.*, 191 B.R. 895, 909 (Bankr. N.D. Ala. 1995) (holding that the debtor's "ability to make current payments, along with the debtor's projected financial stability, provides adequate assurance of future performance under the contract").
14. *In re Bronx-Westchester Mack Corp.*, 4 B.R. 730, 734-735, 6 Bankr. Ct. Dec. (CRR) 581, Bankr. L. Rep. (CCH) ¶ 67493 (Bankr. S.D. N.Y. 1980).
15. *Matter of World Skating Center, Inc.*, 100 B.R. 147 (Bankr. D. Conn. 1989).
16. See, also, *In re Skylark Travel, Inc.*, 120 B.R. 352 (Bankr. S.D. N.Y. 1990).
17. *In re Embers 86th Street, Inc.*, 184 B.R. 892, 900-901 (Bankr. S.D. N.Y. 1995); *In re Travelot Co.*, 286 B.R. 447, 462 (Bankr. S.D. Ga. 2002) (court noted that it possessed broad pow-

ers to require “timely and substantial guaranties of cure and future performance in the context of any order on the assumption of a contract”).

18. In re Embers 86th Street, Inc., 184 B.R. 892, 902 (Bankr. S.D. N.Y. 1995)

19. In re JLS Shamus, Inc., 179 B.R. 294, 296-297 (Bankr. M.D. Fla. 1995).