EXECUTORY CONTRACTS IN BANKRUPTCY

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When a company files for bankruptcy, one of the things it gets to do is to decide which contracts it wants to keep and which it wants to get rid of. Keeping a contract is called “assumption” and getting rid of a contract is called “rejection.” There are slightly different rules for leases of commercial property.

What the Bankruptcy Code tries to do is to strike a balance between the debtor’s (the company in bankruptcy) interest in having “breathing space” to figure out what it is going to do and those on the other side of the contract in getting paid. As a general rule, the debtor is given until the end of the case (confirmation of the plan) to decide what it is going to do. If it decides it is going to “assume” a contract, one of the things it has to do is to cure any arrearages, or show how the arrearages will be cured.

If you entered into a contract with a company now in bankruptcy, this does not mean that you should sit back and do nothing. The following are things you should keep in mind.

1. Fast Track Cases. While the debtor has until the end of the case to decide whether it will assume or reject its contracts, it is becoming more common for the plan to be filed either when the case is filed, or within the first few weeks of the filing. For example, before the bankruptcy, the company may have entered into an agreement to sell to a third party. Then, when the case is filed, it is on a fast track. One of the early filings with is a list of the contracts to be assumed and rejected. One of the other things that will happen is the debtor will list what it believes to be the cure amount.

It is important to look at what the debtor says is the cure amount. If you disagree, there will be a process of indicate what you think is owed. If there is a disagreement, the parties will attempt to resolve it. if they cannot, there will be a hearing and the court will decide.

I was involved in a case last year where my client had over 300 contracts with the debtors. You can imagine how long it took to calculate the amount of the arrearages.

1. Motion to Compel Assumption or Rejection. The second thing to keep in mind is that the playing field is not completely level. While the debtor gets time to decide whether it is going to assume or reject, the non-debtor has to comply. Amounts owed to the non-debtor are called “administrative expense claims” and should be paid on under the terms of the contract. If you are the non-debtor and you feel you are being taken advantage of, you can file a motion asking the court to have the debtor decide whether it will assume or reject the contract. What happens here is the court tells the debtor that it has to make the decision as to whether it is going to assume or reject prior to the end of the case. What happens most of the time is the debtor will say to the court that it will comply with the terms of the contract pending its determination of whether it will assume or reject. That is a pretty good result, because you are getting the benefit of the bargain during the case.
2. Commercial Leases. There is a different standard for commercial leases. In that situation, the debtor has 210 days from the beginning of the case to decide whether to assume the lease. If the debtor fails to assume the lease within that time, it is automatically deemed rejected. The 210 day time limit can only be extended with the agreement of the landlord.

The other thing is that the debtor has to comply with the terms of the lease after the first two months of the case.

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