

Alert

Bankruptcy Claims Trading: Seventh Circuit Clarifies that Acquired Rights May Include a “Cure” Claim but Recovery is Still Not Guaranteed

March 1, 2011

On Feb. 18, 2011, the Seventh Circuit Court of Appeals (the “Circuit Court”) held that (i) an assignment of unsecured contract claims from AT&T to ReGen Capital I, Inc. (“ReGen”) was broad enough to include right to receive “cure” payments in the event the debtor, UAL Corporation (“United”), assumed the underlying executory contracts, but (ii) ReGen could not successfully assert a “cure” claim because United had not assumed the executory contracts, even though United’s confirmed plan of reorganization included them on a list of assumed contracts. *ReGen Capital I, Inc. v. UAL Corp. (In re UAL Corp.)*, ___ F.3d ___, 2011 WL 559702 (7th Cir. Feb. 18, 2011). This decision is important for bankruptcy claims investors because it both clarifies the scope of assignable rights in a claims trade and also serves as a reminder to claims investors to vigilantly analyze the terms of a debtor’s plan of reorganization to protect their recovery rights. Additionally, the decision’s broader implication is to require purchasers of claims arising from an executory contract to take affirmative steps to ensure that their seller’s actions or failure to act do not result in the rejection of the underlying executory contract.

Assumption and Rejection of Executory Contracts under the Bankruptcy Code

Although not defined in the Bankruptcy Code, executory contracts generally are those contracts where both parties have an obligation to perform beyond the mere payment of money. Examples of these types of contracts include those arising from utility service contracts, trade vendors’ supply contracts, software and information technology servicing contracts and marketing and distributions agreements, to name but a few. Section 365 of the Bankruptcy Code allows a debtor to assume or reject its executory contracts at any time before the confirmation of a plan of reorganization. Assumption of an executory contract allows a debtor to compel the non-debtor counterparty to continue the pre-bankruptcy contractual relationship, even if the debtor had defaulted on the contract. However, to assume an executory contract, a debtor must “cure” the default, which in many cases results in the debtor paying all outstanding amounts in full. A claims investor may therefore recover 100 percent on a claim arising from an executory contract because it could potentially recover on both (i) the pre-petition amounts due under the contract, *pari passu* with other unsecured claims, and (ii) an additional cure claim if the debtor assumes the contract.

Facts and Background

Post-confirmation, ReGen filed a timely cure claim for the remaining unpaid amount of the claims it had acquired from AT&T because United’s confirmed plan of reorganization included the AT&T executory contracts on a schedule entitled “Assumed Executory Contracts and Unexpired Leases.” As a result ReGen believed that the assumption was a “done deal” and it was entitled to payment in full of all cure amounts. United objected to ReGen’s cure claim asserting that ReGen had only acquired general unsecured claims from AT&T and was not entitled to receive a cure payment. United also filed a notice that it intended to reject the AT&T contracts. *UAL Corp.*, 2011 WL 559702 at *2-3.

The Circuit Court's Decision

The Circuit Court rejected both the bankruptcy court's and the district court's decisions and held that ReGen had acquired the right to assert a cure claim under the assignment agreement. The lower courts had held that the assignment of a claim does not include a cure claim because the cure claim arises out of the contract with the debtor and not out of the claim. *Id.* at *4. The Circuit Court first explained that the relevant language in the assignment agreement defining "Claim" was broad enough to cover cure claims. *Id.* Specifically, the assignment agreement provided that ReGen had acquired "any action, claims, lawsuits, or rights of any nature whatsoever, whether against a debtor or any other party, arising out of or in connection with the Claim." *Id.* The Circuit Court then stated that a cure claim is connected to ReGen's general unsecured claim because "it stems from the same transaction giving rise to a single right of payment." *Id.* Importantly, the Circuit Court stated that the claims' assignment had separated the right to assert any cure claim from the continuing rights and obligations under the executory contracts between United and AT&T. *Id.* at *5.

Unfortunately for ReGen, the Circuit Court's inquiry did not end with finding that the scope of the claims' assignment agreement included a right to assert a cure claim. *Id.* at *6. The Circuit Court also held that United had effectively rejected the underlying contracts even though the plan listed the contracts in a schedule of contracts to be assumed. *Id.* The Circuit Court reasoned that while the bankruptcy court's confirmation of the plan of reorganization constituted approval for United to assume the listed executory contracts, plan confirmation did not result in United automatically assuming all contracts listed in the schedule. *Id.* at *9. Instead, United had reserved its rights in the confirmed plan to reject any executory contract up to fifteen days after (i) the date on which the parties agreed on the cure amount, or (ii) the bankruptcy court issued a final order that established the cure amount. *Id.* at *6. As neither of these events had occurred with respect to the AT&T executory contracts, United retained its right to reject. *Id.* at *8.

Practical Implications

UAL Corp. has three practical implications for claims investors seeking to recover on a cure claim:

- Confirm that the assignment agreement is broad enough to encompass all rights they intend to acquire.
- Vigilantly analyze and monitor the executory contract assumption process.
- Structure a deal that aligns investor's and seller's incentives after the assignment of claim is settled.

Structuring the post-settlement incentives is crucial because the settlement of an assignment of a claim separates the right to a cure claim from the seller's post-bankruptcy rights and obligation on the underlying contract. As a result, the seller, as the non-debtor party to the contract, will have less to gain from an assumption of the contract, because it will no longer receive the cure payment. Claims investors should therefore ensure that the claim assignment agreement requires the seller to take any necessary steps to cause the debtor to assume the contract. If the seller's actions, or failure to act, lead to the rejection of the executory contract or the debtor fails to cure, such as when the seller enters into a new or modified agreement with the debtor for the same goods or services, the agreement should provide investors with adequate recourse to the seller. While in those circumstances, claims investors may arguably find some comfort in their ability to seek recourse against a seller under a number of market standard representations and warranties, claims investors should consider protecting their interest with more specific provisions in the claim assignment agreement. For instance, the agreement may include express covenants that restrict a seller's ability to continue their business relationship with the debtor, absent either the debtor's assumption and cure payment or the seller compensating the claims investor for the lost cure claim recovery. Alternatively, claims investors may want to negotiate a partial hold-back of the purchase price to be paid upon the debtor's assumption of the contract aligning the seller's and claims investors' incentives to have the debtor assume the contracts.

Authored by [David J. Karp](#) and Erik Schneider.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

New York

Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
+1 212.756.2000
+1 212.593.5955 fax

www.srz.com

Washington, DC

Schulte Roth & Zabel LLP
1152 Fifteenth Street, NW, Suite 850
Washington, DC 20005
+1 202.729.7470
+1 202.730.4520 fax

London

Schulte Roth & Zabel International LLP
Heathcoat House, 20 Savile Row
London W1S 3PR
+44 (0) 20 7081 8000
+44 (0) 20 7081 8010 fax

U.S. Treasury Circular 230 Notice: Any U.S. federal tax advice included in this communication was not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal tax penalties.

This information has been prepared by Schulte Roth & Zabel LLP ("SRZ") for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with SRZ. Electronic mail or other communications with SRZ cannot be guaranteed to be confidential and will not (without SRZ agreement) create an attorney-client relationship with SRZ. Parties seeking advice should consult with legal counsel familiar with their particular circumstances. The contents of these materials may constitute attorney advertising under the regulations of various jurisdictions.