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## Following Sale And Assignment Notices

*Law360, New York (February 19, 2009)* -- No matter how you measure it, bankruptcy filings are surging. According to BankruptcyData.com, the number of filings among publicly traded companies increased 74 percent in 2008.

The value of these bankruptcy filings grew from \$70.5 billion in assets in 2007 to \$1.16 trillion in assets in 2008 — a significant jump even if the massive bankruptcies of Lehman Brothers and Washington Mutual are excluded.

In addition, forecasters predict that junk bond defaults will rise from 4 percent in 2008 to 13 percent in 2009.

In these increasingly difficult economic times, most experts expect the number and value of bankruptcy filings to continue increasing at an accelerating rate.

As bankruptcy filings escalate, sales of assets pursuant to Section 363 of the Bankruptcy Code will likely become more common. Section 363 sales have long been the primary tool of Chapter 7 trustees, but the practice has taken longer to catch on in the Chapter 11 context.

Section 363 sales have distinct advantages for the debtor and purchaser. For example, officers and directors of the debtor greatly reduce their potential for liability, and the purchaser can acquire the assets of the debtor free and clear of most liens with limited exposure to fraudulent transfer laws.

Typically, the buyer in a Section 363 sale will also want the benefit of the debtor's beneficial contracts, and, as a result, the seller in a Section 363 sale usually will combine the sale motion with a motion under Section 365 of the Bankruptcy Code to assume and assign certain of the seller's leases and executory contracts.

These motions can be good news for the non-debtor parties to these contracts, since, as discussed in more detail below, the debtor or buyer must promptly cure the debtor's pre-bankruptcy defaults and provide adequate assurance of future performance.

However, a sale motion under Section 363 and an assumption and assignment motion under Section 365 carry certain risks to the non-debtor party. One of these risks is illustrated in a recent opinion of the Second Circuit.

The case of *In re: U.S. Wireless Data Inc.* confirmed that parties which have contracted with now-bankrupt companies must diligently monitor the bankruptcy proceeding and adhere to sale and assignment notices establishing bar dates for filing cure claims. 547 F.3d 484 (2nd Cir. 2008).

### **In re: U.S. Wireless Data Inc.**

Last October, in the *U.S. Wireless* case, the Second Circuit held that a creditor that misses a cure claim bar date cannot thereafter re-characterize its cure claim and file it instead as a general unsecured claim.

In that case, prior to the debtor filing for bankruptcy, AT&T had provided the debtor with telecommunications services pursuant to a contract. Concurrent with filing its Chapter 11 petition, the debtor filed a motion under Section 363 of the Bankruptcy Code to sell all of its assets.

In connection with the proposed asset sale, the debtor moved to assume certain executory contracts in accordance with Section 365 of the Bankruptcy Code.

Attached to the debtor's motion was a schedule of contracts proposed for assumption by the debtor. The debtor proposed to assume the contract with AT&T and the schedule indicated a "cure cost" of approximately \$11,000 for curing defaults under the contract.

Upon approving the auction and bidding procedures for the debtor's proposed Section 363 sale, the bankruptcy court set a deadline, or bar date, for filing cure claims related to the scheduled contracts.

A notice of sale and assignment was served by mail upon all non-debtor parties to the scheduled contracts, including AT&T, advising them that a bar date had been set for assertion of any cure costs contrary to the amounts set forth in the contract schedule.

AT&T missed the cure claims bar date. Thereafter, but before the bar date for filing general unsecured claims, AT&T submitted a general unsecured claim of over \$70,000 for unpaid amounts under the contract with the debtor.

AT&T claimed that the bankruptcy court failed to provide clear notice of what claims were to be submitted prior to the bar date. AT&T further maintained that its cure claim converted to a general unsecured claim after the cure claims bar date had passed.

The bankruptcy court rejected AT&T's arguments. The court held that the notice was properly served and that such notice unequivocally stated that all non-debtor parties that failed to object by the cure claims bar date would be limited to the cure amounts set forth in the contract schedule.

The court further held that AT&T could not re-characterize its cure claim as a general unsecured claim.

### **Sale and Assignment Notices**

As Section 363 sales become more common, non-debtor parties would be well-advised to familiarize themselves with such sales in order to avoid AT&T's fate.

In structuring a Section 363 sale, debtors are permitted by Section 365 to assume and assign executory contracts. Subject to court approval, the Bankruptcy Code allows the debtor to assume those contracts which are beneficial to the debtor and reject those which are not. Upon assumption of the contract, the debtor may assign it to the purchaser of the debtor's assets.

However, if the debtor is in default under the contract, the debtor is allowed to assume the contract only after it cures the default. The debtor proposes to the court the amount required to cure the default under the contract.

As made clear by the U.S. Wireless case, the non-debtor party is bound by the cure amount proposed by the debtor unless it objects and files a cure claim before the cure claim bar date.

In most cases, non-debtor parties are entitled to at least 20 days' notice by mail of bar dates set by the bankruptcy court. Courts generally require that a bar date be prominently announced and include an explanation of the significance of the bar date.

However, in connection with a Section 363 sale of assets, the cure claims bar date will often be included in the general notice of sale and assignment or in a court order establishing the auction procedures for the Section 363 sale.

This notice or order will bind all non-debtor parties who fail to object to either the assumption and assignment of contracts or the proposed cure amount before the bar date.

Therefore, each notice and order (especially notices of sale and assignment and orders establishing the auction procedures for a Section 363 sale) should be carefully read by non-debtor parties or their counsel.

Parties that miss the cure claim bar date set forth in such notices or orders are bound by the cure amount proposed by the debtor and cannot thereafter recharacterize their cure claim and file it as a general unsecured claim.

## **Trap for the Unwary**

The one-two punch of the economic slowdown and the credit crisis is likely to cause a substantial increase in the number of Section 363 sales in the near future.

The economic slowdown will push many companies into bankruptcy, while the credit crisis will limit access to debtor-in-possession financing thereby forcing debtors to use bankruptcy as a venue to sell their assets rather than reorganize.

As the number of bankruptcies and Section 363 sales increases, non-debtor parties that have contracted with the debtor must carefully monitor the bankruptcy proceeding.

Under the recent Second Circuit ruling in *In re U.S. Wireless*, non-debtor parties must file cure claims before the cure claim bar date rather than rely on the general unsecured claims bar date.

Furthermore, non-debtor parties who receive notice of the cure claims bar date may be charged with understanding the implications of missing such bar date.

Only by closely monitoring the bankruptcy proceeding and adhering to each bar date (whether for cure claims, general unsecured claims or otherwise) will non-debtor parties weather the impending spike in bankruptcy filings.

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