A Non-Party’s Ability to Assert a Cure Claim Under 365(b)(1)(A) in New York

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Introduction

Under section 365 of title 11 of the United States Code (the “Bankruptcy Code”), “[a] trustee [or debtor], subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.”1 Before assumption, a debtor must promptly cure or provide adequate assurance that it will promptly cure any defaults that existed at the time of assumption.2 Under New York law, an intended third-party beneficiary of a contract can enforce the terms of that contract.3

This Article discusses how the Southern District of New York dealt with the issue of whether an intended third-party beneficiary to a contract can assert a cure claim under section 365(b)(1)(A). Part I analyzes the section 365(b)(1)(A) cure right and discusses the implications of, and requirements for, a debtor exercising their right to assume an executory contract or unexpired lease. Part II looks at how New York courts determine third-party beneficiary status. Part III examines the only reported decision that addresses whether an intended third-party beneficiary can bring a cure claim.

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I. Assumption of Executory Contracts and Unexpired Leases

Debtors may assume any executory contract or unexpired lease subject to the court’s approval.\textsuperscript{4} The Bankruptcy Code does not define “executory contract.” Courts, however, have interpreted it to “mean[] a contract that neither party has finished performing.”\textsuperscript{5} When determining whether a contract is executory, courts focus on whether the failure to perform obligations under the contract would constitute a material breach.\textsuperscript{6}

A debtor may only assume an executory contract or unexpired lease when the debtor first “(1) cures or provides adequate assurance that it will promptly cure the default; (2) compensates or provides adequate assurance of prompt future compensation for actual pecuniary loss resulting from the default; and (3) provides adequate assurance of future performance under the contract or lease.”\textsuperscript{7} Section 365 of the Bankruptcy Code “allows a debtor to ‘continue in a beneficial contract provided, however, that the other party is made whole at the time of the debtor’s assumption of said contract.’”\textsuperscript{8} Additionally, in general “indivisible contractual arrangements must be assumed or rejected in whole.”\textsuperscript{9} This means that a debtor may not “cherry pick” the parts of an integrated contract it wishes to assume while rejecting the rest.\textsuperscript{10}

The non-debtor party to a contract must raise cure claims in a timely fashion after receiving notice that the debtor intends to assume its executory contract or unexpired lease.\textsuperscript{11}

\textsuperscript{9} A & F Enterprises, Inc. II v. IHOP Franchising LLC (In re A & F Enterprises, Inc. II), 742 F.3d 763, 767 (7th Cir. 2014).
\textsuperscript{10} In re Riodizio, Inc., 204 B.R. 417, 420 (Bankr. S.D.N.Y. 1997).
\textsuperscript{11} ReGen Capital 1, Inc. v. Halperin (In re U.S. Wireless Data, Inc.), 547 F.3d 484, 495 (2d Cir. 2008).
Failure to raise claims in a timely manner will result in the forfeiture of the right to raise these claims. Cure claims seek to repair the debtor-creditor relationship to pre-default status and bring the contract back into conformity with its terms.

If a debtor has satisfied the section 365 requirements, a court will generally approve the debtor’s motion to assume an executory contract or unexpired lease if it can be demonstrated that the debtor used sound business judgment in its decision. Additionally, a debtor can “assign certain contracts if the contract is assumed in accordance with § 365 and the assignee provides adequate assurance of future performance.”

II. Third-Party Beneficiary Status as Defined by New York Law

As a rule, “the terms of a contract may be enforced only by contracting parties or intended third-party beneficiaries of the contract.” In New York, the Restatement (2d) of Contracts § 302 is the accepted guideline for determining whether a third-party can enforce a contract. An intended third-party beneficiary only has standing to enforce promises under the contract which were made for its benefit. However, some courts have held that an intended third-party beneficiary “has the same rights as the contracting parties.”

Further, under New York law, the party asserting that it is an intended third-party beneficiary “has the burden of demonstrating that he has an enforceable right.” Additionally, said party must demonstrate their enforceable right by establishing “(1) the existence of a valid...
and binding contract between other parties, (2) that the contract was intended for his benefit and (3) that the benefit to him is sufficiently immediate, rather than incidental, to indicate . . . a duty to compensate him if the benefit is lost.”

The intent to benefit test has been troublesome to apply and has become a “prolific source of judicial and academic discussion.” However, the New York Court of Appeals has stated that intent to benefit the third-party is sufficiently shown “when the third party is the only one who could recover for the breach of contract or when it is otherwise clear from the language of the contract that there was ‘an intent to permit enforcement by the third party.”

A court will typically find an intended third-party beneficiary exists when the third-party beneficiary has a right to performance under the contract, and the “circumstances indicate that the promisee intends to give the third party the benefit of the promised performance.” Additionally, “[w]here performance is to be rendered directly to a third party under the terms of an agreement, that party must be considered an intended beneficiary.” Furthermore, a third-party is an intended third-party beneficiary of a contract where the contract expressly includes a right for the party to enforce the terms of the contract. In *Kassover*, shareholders, who were expressly given the right to enforce the terms of a merger agreement, were held to be intended third-party beneficiaries of the contract.

Courts have consistently held that “where the contract in issue makes clear that a third party will be retained to assist in the performance by the promisee that such third parties are not

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22 Seaver v. Ransom, 120 N.E. 639, 640 (N.Y. 1918).
27 Id.
intended beneficiaries of the main contract.”\textsuperscript{28} Moreover, when the third party is not the only one who could recover for breach of contract, and there is no explicit language within the contract showing an intent to permit a third party to enforce the contract, New York courts will routinely conclude that the benefit bestowed upon the third-party is merely incidental.\textsuperscript{29} In \textit{Dormitory Auth.}, the court swiftly concluded that the third party was merely an incidental third-party beneficiary because one of the contracting parties also brought a breach of contract claim, and the “contract [did] not expressly name the City as an intended third-party beneficiary nor authorize the City to enforce any obligations thereunder . . . .”\textsuperscript{30} Lastly, contractual language must show that the contract was for the benefit of the third-party, not merely intended to benefit a third-party, to create an intended third-party beneficiary.\textsuperscript{31}

\section*{III. Third-Party Beneficiaries and the Section 365(b)(1)(A) Cure Right}

In \textit{In re George Washington Bridge Bus Station Dev. Venture LLC}, the United States District Court for the Southern District of New York (the “Court”) addressed the issue of whether an intended third-party beneficiary can assert a cure claim under section 365(b)(1)(A).\textsuperscript{32} Although the Court concluded the party asserting the cure right was not, in fact, an intended third-party beneficiary to the lease, the Court still opined on whether an intended third-party beneficiary can bring such a claim.\textsuperscript{33}

\textsuperscript{28} Artwear, Inc. v. Hughes, 615 N.Y.S.2d 689, 693 (App. Div. 1st Dept. 1994) (articulating that “it is well settled that the subcontractor or supplier of a general contractor on a construction project is not invested with third-party beneficiary status”).


\textsuperscript{30} Id. (voicing that this scenario is analogous to the Restatement’s illustration of an incidental third-party beneficiary).


\textsuperscript{33} Id. at *16–17.
The Court first commented that, in general, only the non-debtor party to an assumed executory contract can bring a cure claim.\textsuperscript{34} In addressing who could assert a cure claim, the Court looked to the language of section 365.\textsuperscript{35} The Court observed that while section 365(b)(1)(A) does not contain an express limitation on who may bring such a claim, section 365(b)(1)(B) limits relief to the non-debtor party to an executory contract.\textsuperscript{36} The Court stated that for the approach of section 365 to be consistent, section 365(b)(1)(A) “must implicitly contain the same limitation.”\textsuperscript{37} The party asserting intended third-party beneficiary status cited two cases “that supposedly undermine[d] the general proposition that only the non-debtor party to an executory contract may bring a cure claim.”\textsuperscript{38} However, the Court quickly distinguished these cases as cases that involved “a cure claim on an unexpired lease brought by a former landlord who had, as a condition of assigning the lease to the new landlord, retained the contractual right to bring a cure claim for unpaid rent.”\textsuperscript{39} The Court remarked that these cases were not analogous as the party arguing intended third-party beneficiary status here was never a party to the ground lease and never had a contractual right to bring a cure claim thereunder.\textsuperscript{40}

Conclusion

Debtors often assert their right to reject or assume an executory contract or unexpired lease upon default. Before doing so, a debtor must promptly cure, or provide adequate assurance that it will promptly cure, any defaults which existed at the time of assumption. Customarily, if the non-debtor to that contract asserts a timely cure claim, the debtor will be obligated to cure their defaults and bring the contract back in compliance with its terms. Although intended third-

\textsuperscript{34} Id. at *15.
\textsuperscript{35} Id. at *14.
\textsuperscript{36} Id. at *17.
\textsuperscript{37} Id. at *17–18.
\textsuperscript{38} Id. at *19.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
party beneficiaries often have the right to enforce the terms of a contract, it is less clear whether
a court would ever allow them to assert a cure claim. It is clear, however, that a general
contractor who is not an intended third-party beneficiary of a ground lease has no right to assert a
cure claim under section 365(b)(1)(A).