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R E L A T I O N S

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Assumption of Breached Contract

The federal bankruptcy statute permits a Chapter 11 debtor to assume or reject an "executory" contract between the debtor and another entity. An executory contract is one where both parties still have unperformed obligations under the contract.

A Delaware bankruptcy judge was recently asked to determine whether a Chapter 11 debtor could assume a contract which the debtor had breached prior to commencing its bankruptcy case. The pre-bankruptcy breach excused the other party from any obligation to perform. Thus, at the start of the bankruptcy case, both parties did not have unperformed obligations.

The court decided that the contract was nonetheless executory, because the statute requires a debtor to cure defaults in order to assume a contract. The judge reasoned that this requirement only makes sense if a contract on which a debtor has defaulted is still executory and can be assumed.

In re Kemeta, LLC, 470 B.R. 304 (Bankr. D. Del. 2012).

Late-Filed Tax Return Insufficient

Bankruptcy law permits a debtor to discharge unpaid income taxes where the return was last due more than three years prior to the bankruptcy filing, provided certain other conditions are also met. Tax incurred in a year for which no return was ever filed will not be discharged. In 2005, Congress amended the statute to include the following definition: “[T]he term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements).”

A federal appeals court in New Orleans recently decided that filing a return after the due date does not satisfy the applicable filing requirements. Such a late filed return is not a "return", and the situation is the same as if no return was ever filed. The tax could not be discharged.

McCoy v. Mississippi State Tax Commission (In re McCoy), 666 F.3d 924 (5th Cir. 2012).

Preference Defense

Under the federal bankruptcy statute, a Chapter 7 trustee may recover payments made to creditors by the debtor within 90 days prior to the commencement of the bankruptcy case. These recoverable payments to creditors are referred to as "preferences".

A Delaware bankruptcy judge ruled that where the debtor obtained permission from the court to assume an executory contract during its Chapter 11 case, a subsequent Chapter 7 trustee cannot recover payments made to the creditor under that contract prior to the initial bankruptcy filing. Assumption of the contract required the debtor to cure all defaults, including any unpaid invoices owed to the creditor. Thus, even if the debtor had not made the payment within the 90 days prior to the bankruptcy, the debtor would have been required to make the payment later when the contract was assumed. The payment did not enable the creditor to receive anything more than it would have received in the bankruptcy case.

Guiliano v. Almond Investment Co. (In re Carolina Fluid Handling Intermediate Holding Corp.), 467 B.R. 743 (Bankr. D. Del. 2012).

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