

CONTENTS

ABOUT THE EDITORS AND CONTRIBUTORS	xiii
FOREWORD	xxv
PREFACE AND ACKNOWLEDGMENTS	xxvii
CHAPTER 1 PREBANKRUPTCY CONSIDERATIONS OF THE FRANCHISEE AND FRANCHISOR	1
<i>By David M. Neff and Frances A. Smith</i>	
I. Drafting Franchise Agreements to Minimize Risks for Franchisors	2
A. Agreements Not to File Bankruptcy Are Invalid	2
B. Ipso Facto Clauses Are Generally Unenforceable	3
C. Personal Guarantees Are Effective Tools	4
D. Restrictive Covenants Protect Franchisors	5
1. Noncompetition Agreements Must Be Limited in Time, Area, and Scope to Be Enforceable	5
2. Nonsolicitation Agreements Should Be Limited in Time and Scope	7
3. Nondisclosure Agreements Are Generally Enforceable	8
E. Franchisor Should Consider Taking a Security Interest in Franchisee's Assets	10
F. Use of Trademarks Should Be Addressed in the Franchise Agreement	11
G. Franchisee Should Provide Business Interruption Insurance	11
H. Comfort Letters Can Create Issues for Franchisors	12
I. Mediation and Arbitration Clauses May Be Enforceable in Bankruptcy Cases	12
J. Forum Selection Clauses May Be Enforceable in Bankruptcy Cases	13
II. Alternatives to Bankruptcy for a Distressed Franchisee	14
A. Advantages of Nonbankruptcy Alternatives	14
B. Out-of-Court Restructuring	16
C. State Law Dissolution and Winding Up	18
D. Composition of Creditors	19
E. Assignment for the Benefit of Creditors	20
F. Receivership	21

IV CONTENTS

III. Bankruptcy Overview: Chapter 7 or Chapter 11	22
IV. The Bankruptcy Code Provides Some Exclusive Remedies	24
A. The Automatic Stay Prevents Actions Against the Debtor and Its Property	24
B. The Bankruptcy Code Allows the Debtor to Assume or Reject Executory Contracts and Leases	26
C. The Bankruptcy Code Allows Sales Free and Clear of Liens	28
D. The Bankruptcy Code Limits Releases of Nondebtor Parties	29
V. Prefiling Considerations Include Where and When to File a Bankruptcy Case	31
A. Where to File: Jurisdiction and Venue of Bankruptcy Filings Are Governed by Statute	31
1. Jurisdiction of Bankruptcy Cases Is in the District Court, Which Then Generally Refers Cases to the Bankruptcy Court	31
2. Venue of Bankruptcy Case May Be Appropriate in More Than One Jurisdiction	32
B. When to File: Several Considerations Affect Timing of a Bankruptcy Filing	35
VI. Cash Collateral	38
VII. Issues When The Franchisor May File Bankruptcy	39
VIII. Conclusion	40
CHAPTER 2 THE BANKRUPTCY FILING—INITIAL ISSUES	41
<i>By Lynette J. Gladdis and Daniel M. Eliades</i>	
I. The Bankruptcy Filing—Initial Issues	42
A. Venue	42
B. Eligibility	44
C. Choice of Chapter	45
1. Chapter 7	45
2. Chapter 13	46
3. Chapter 11	47
a. Filing of Petition and the Beginning of the Chapter 11 Case	47
b. Employee and Public Relations	48
c. First Day Motions	49
d. Duties of the Debtor-in-Possession	50
e. The Meeting of Creditors	50
f. The Creditors' Committee	51
g. Operating in Chapter 11	53
h. Permitted Payments	53
i. Prohibited Payments	54
j. The Cash Needs of Chapter 11 Debtors	54
k. Cash Collateral	56

i. The Chapter 11 Plan	58
m. Potential Appointment of a Trustee	58
n. Removal of Litigation	59
D. Determining if the Franchise Agreement Is Property of the Bankruptcy Estate	61
E. Prepetition Termination of Franchise Agreements	62
F. Critical Vendor Status of Franchisors	64
II. Exit Considerations	69

CHAPTER 3 THE AUTOMATIC STAY 71

By Marcus A. Banks, Joel Buckberg, and David S. Catuogno

I. The Automatic Stay—Generally	71
A. Effect and Impact of the Stay	71
1. The Basics	71
2. Notable Exceptions to the Automatic Stay	73
3. Franchise Law and the Automatic Stay	75
B. Timing and Duration of the Automatic Stay	76
II. Obtaining Relief from the Automatic Stay	78
A. “Cause” for Stay Relief in Franchise Settings under 11 U.S.C. § 362 (d)(1)	78
1. Adequate Protection	79
2. Specific “Cause” Applicable to Franchising	80
a. Failure to Perform Financial Obligations	80
b. Lack of Insurance	80
c. Postpetition Quality Defaults	80
d. Nonassignability of a Franchise Agreement	81
(1) Applicable Nonbankruptcy Law	81
(2) Hypothetical Test	81
(3) Personal Contracts and Intellectual Property Licenses	82
(4) The Lanham Act’s Specific Application to Licensing Contracts	82
B. “Cause” for Stay Relief in Franchise Settings under 11 U.S.C. § 362 (d)(2)	83
III. Procedural Aspects of Obtaining Stay Relief	84
A. Motion Practice—Contested Matters	84
B. Movant’s Burden of Proof	86
C. Evidentiary Issues	86
D. Appeal Issues	87
IV. Violations of the Automatic Stay	88
A. Violations Generally	88
B. Automatic Stay Violations in Franchise Bankruptcy Cases	89

C. Potential Damages for Willful Violation of the Automatic Stay	90
1. Actual Damages	91
2. Punitive Damages	91
D. Defensive Strategies	92
CHAPTER 4 CASH COLLATERAL	95
<i>By Sharon Z. Weiss, Craig K. Schuenemann, and Aaron Kaufman</i>	
I. Overview of 11 U.S.C. § 363(a)	96
A. What Is Cash Collateral?	96
B. Initial Cash Collateral Review	98
1. Parties with an Interest in Cash Collateral	98
2. Postbankruptcy DIP Financing as an Alternative to Cash Collateral	99
3. Special Circumstances in Franchising Cases	100
C. Terms of Use—A Fluid Concept	101
II. Preliminary Considerations	102
A. Motivation of the Parties	102
1. Secured Lender	102
2. Franchisors	103
3. Franchisees	103
4. Suppliers	104
5. Debtor	104
6. Committees	104
7. U.S. Trustee	105
B. Security Documents and Agreements	106
1. Loan Documents and Collateral	106
2. Inter-Creditor Agreements and the Relationship of the Parties	106
III. Use of Cash Collateral and Procedural Issues	107
A. Consent	107
1. The Basic Options	107
2. Prepetition Consent to Use Cash Collateral	107
3. Implied vs. Express Consent	108
B. Contested Cash Collateral Motions	108
1. Impact of a Contested Motion	108
2. Ongoing Requirements	109
3. Benefit of the Estate	110
C. Timing	110
IV. Special Considerations	110
A. Special Considerations in General	110
1. How Special Considerations Arise	110
2. Concessions Regarding Amount, Status, or Validity of a Creditor’s Claim	111
3. Release of a Creditor from Liability	111

4. Waiver of Surcharge	111
5. Expedited Hearings and Trustee Appointment	112
6. Plan Approval Requirements	112
B. Court Approval of Special Considerations	112
1. Limits to Special Consideration	112
2. Jurisdictional Considerations and Checklists	113
C. Cash Collateral in Chapter 11, Chapter 13, and Follow-On Chapter 7 Cases	114
1. Chapter 11 Cases	114
2. Chapter 13 Cases	115
3. Chapter 7 Cases	115
V. Adequate Protection	116
A. Requirements of Adequate Protection	116
B. Forms of Adequate Protection	117
1. General Categories of Adequate Protection	117
2. Section 361 Requirements	117
3. Innovative Options	117
4. The Indubitable Equivalent	117
5. Preservation Adequate Protection	118
C. Valuation	119
D. Failure of Adequate Protection	119
E. Nonresidential Real Property and Personal Property Leases	119
F. The Burden of Proof	120
VI. Relationship to the Section 362 Automatic Stay	120
A. General Automatic Stay Considerations	120
B. Adequate Protection Is Mandatory Regarding the Automatic Stay	121
C. Timing of Adequate Protection	121
D. Relief from Stay	121
 CHAPTER 5 ASSUMPTION, REJECTION, AND ASSIGNMENT OF FRANCHISE AGREEMENTS IN BANKRUPTCY	 123
<i>By John R. Gotaskie, Jr. and Glenn D. Moses</i>	
I. Executory Contracts: Assumption, Rejection, and Assignment	123
A. Executory Contracts Defined	123
B. Timing	124
C. Commercial Real Estate Leases	125
D. Valid Termination Prepetition	127
E. Assumption Issues	127
F. Cure	128
1. Cure of Economic Defaults	128
2. Cure of Noneconomic Defaults	129
3. Cure of Actual Pecuniary Loss	129

viii CONTENTS

G. Adequate Assurances	130
H. Assignment Issues	130
I. Rejection	131
1. Rejection by Franchisee	132
2. Rejection by Franchisor	133
II. Special Considerations of Franchisee Chapter 11 Proceedings	135
A. Trademark Rights under Federal Law	135
B. The Franchisor's Veto Power Regarding Assumption or Assignment of the Franchise Agreement	136
1. The Debtor Cannot Assign Its Franchise Agreement to a Third Party without the Franchisor's Consent	136
2. May the Franchisor Block the Debtor/Franchisee's Assumption (and Use) of Its Franchise Agreement, Even if There Is No Intent to Assign It to a Third Party?	138
a. The Hypothetical Test: The Franchisor May Veto Assumption of the Franchise Agreement Irrespective of the Debtor's Intention to Assign	138
b. The Actual Test: Assumption Prohibited under Section 365(c)(1) Only if There Is an Actual Proposed Assignment	141

CHAPTER 6 INTELLECTUAL PROPERTY ISSUES 145

By John Vernon, Christina Stephenson, and David Gurnick

I. Basics of Intellectual Property Law in Relation to Bankruptcy	145
A. What Is Intellectual Property	145
B. Trademark Basics	146
C. Trade Secret Basics	149
D. Copyrights	151
E. Patents	152
F. Other Intangible or Intellectual Property	154
II. Nature of the Relationship as It Relates to Intellectual Property	154
III. Effects on Intellectual Property When Franchisee Files for Bankruptcy Protection	155
IV. Effects on the Intellectual Property When a Franchisor Files for Bankruptcy Protection	157

CHAPTER 7 CLAIMS AND CLAIMS LITIGATION 159

By Eric C. Peterson and Ryan Hardy

I. The Proof Of Claim	160
A. The Claim Form	160
B. Required Attachments	160
C. Execution and Filing of Claims	161

D. Amendments to Claims	161
E. Informal Proof of Claim	161
F. Legal Effect of Allowance and Disallowance of Claims	162
1. Bases for Objection	162
2. Claim Objection Procedure	163
3. Deadlines and Burdens	163
4. Finality	164
5. Process	164
II. Effects of Filing a Proof of Claim	164
A. Evidentiary Effect	164
B. Submission to Jurisdiction	165
III. Types of Claims	166
A. General Unsecured Claims	166
1. Note on Liquidated Damages	166
B. Priority Claims	167
C. Administrative Claims	167
1. Administrative Claims Generally	167
2. Application for Allowance Procedure	168
D. Secured Claims	168
1. General Treatment of Perfected Secured Claims	168
2. Unperfected Secured Claims	169
3. A Note on Earmarking	170
E. Reclamation Claims	170
1. General Background and Rules Governing Reclamation Claims	170
2. Procedure for Asserting Reclamation Claims	171
F. Claims Arising from Executory Contracts and Assumption or Rejection of the Same	171
G. PACA Claims	172
IV. Note Regarding Treatment of Claims Under Confirmed Plans	173
A. Chapter 11 Plans	173
B. Chapter 13 Plans	173

CHAPTER 8 BANKRUPTCY SALES 175

By Jason B. Binford and Matthew Gruenberg

I. Bankruptcy Sales—The Legal Underpinnings	176
A. Bankruptcy Code Section 363(b)—Sales Outside the Ordinary Course of Business	176
B. Procedural Requirements for a Sale—The Bankruptcy Rules	177
C. Legal Standard for Approval of a Sale	179
1. Legal Standard in General	179
2. Good Business Reasons for a Sale and “Sub Rosa” Plans	180
3. Sales Free and Clear—Bankruptcy Code Section 363(f)	182

II. The Mechanics of a Bankruptcy Sale	183
A. In General	183
B. Marketing of Assets	184
C. Auctions	185
1. Bidding Procedures	185
2. Stalking Horse Bidders and Related Protections	186
3. Credit Bidding	187
D. Sale Orders and Bankruptcy Code Section 363(m)	188
III. Franchisor/Franchisee Bankruptcy Sale Issues	189
A. Nondebtor's Role in the 363 Sale of a Franchise Agreement	189
B. Debtor's Role in the 363 Sale of a Franchise Agreement	194
IV. Conclusion	195
CHAPTER 9 PLAN CONFIRMATION	197
<i>By Jan S. Gilbert and Craig R. Tractenberg</i>	
I. The Disclosure Statement	197
A. Contents of a Disclosure Statement	197
B. Objections to a Disclosure Statement	199
C. Small Business Cases and Conditional Approval	199
II. Confirmation	200
A. Confirmation of a Plan	201
B. Elements of the Plan of Reorganization	201
C. Plan Distribution Alternatives	201
1. A Fixed Fund or Formula Plan	201
2. A Fixed Dividend	202
3. A Combination Plan	202
D. Plan Funding	202
E. Confirmation Requirements	202
F. "Cramdown" Confirmation Where an Impaired Class Fails to Approve the Plan	203
G. Issuance of Securities and Real Estate Interests	204
H. Effect of Confirmation	204
I. Modification of a Plan	205
J. Postconfirmation Events	205
K. Case Study on Disclosure and Confirmation—The Reorganization Issues of a Franchisee	205
CHAPTER 10 CHAPTER 7 BANKRUPTCY AND LIQUIDATION ISSUES	209
<i>By Michael Conway and Michelle Shriro</i>	
I. General Principles of a Chapter 7 Bankruptcy—Disclosure	209
A. Chapter 7 Process and Procedure	211
1. The Automatic Stay	212
2. Chapter 7 Trustee	212

3. Schedules and Statement of Financial Affairs	215
4. Section 341 Creditors' Meeting	215
B. Benefits of a Chapter 7 Bankruptcy for a Company—Why Would a Company Want to File a Chapter 7 Bankruptcy?	216
1. Advantages of the Corporate Chapter 7 Bankruptcy	217
2. Disadvantages of the Corporate Chapter 7 Bankruptcy	217
C. Liquidating Outside of Bankruptcy	219
D. Chapter 7 Bankruptcy Filings for Individuals	220
1. Advantage of Filing a Chapter 7 Bankruptcy for an Individual	220
2. Disadvantage of Filing a Chapter 7 Bankruptcy for an Individual	220
3. Exemptions for the Individual Debtor	220
II. Creditor Remedies	221
A. Monetary Relief—Filing Claims in the Case and Seeking a Nondischargeable Judgment	222
1. Rejection Damage Claims	223
2. Priority and Secured Claims	224
3. Nondischargeable Debts	225
B. Nonmonetary Relief—Relief from Stay and Injunctive Relief	225
1. Relief from Stay	225
2. Injunctive Relief	227
3. Obtaining Documents or Other Information—Rule 2004	230
III. Chapter 7 Trustee Responsibilities	230
A. Claims Objection and Allowance Process	230
B. Avoidance Actions	230
C. Assumption or Rejection of Contracts	231
IV. Conclusion	232

**CHAPTER 11 INDIVIDUAL REORGANIZATION BANKRUPTCIES:
CHAPTER 13 AND CHAPTER 11** 233

By Nicole S. Zellweger and Rakhee V. Patel

I. The Parties	234
A. Debtor	234
1. Self-Employed Chapter 13 Debtor	236
2. Small Business Chapter 11 Debtor	236
B. Trustee	237
C. Creditors	238
II. The Debtor's Pleadings	239
A. Petition	240
B. Schedules	240
C. Plan	240
D. Confirmation Order	241
E. Discharge	241

III. Key Bankruptcy Concepts	241
A. Property of the Estate	241
B. The Automatic Stay and the Codebtor Stay	243
C. Operating in Bankruptcy	244
D. Meeting of Creditors	245
E. Proofs of Claims and Pre- and Postpetition Debt	245
1. Prepetition	246
2. Postpetition	247
F. The Plan Process	248
1. Chapter 13	248
2. Chapter 11	249
G. Executory Contracts: Assumption, Assignment, or Rejection of Franchise Agreements, Leases, and IP Licenses?	251
H. The Bankruptcy Discharge	257
IV. Additional Bases for Challenging and/or Objecting to the Debtor's Case	258
A. Challenging the Debtor's Filing on the Basis of Debt Limitations	258
B. Challenging the Debtor's Filing on the Basis of the Value of Assets and/or Bad Faith	259
V. Adversary Proceedings in Bankruptcy Court	261
VI. Dealing with Guaranty Liability in a Bankruptcy Filing	262
A. Types of Guaranties	262
B. Guarantor's Bankruptcy Case	263
C. Collateral	263
1. Surrender	263
2. Acceptance	264
3. Cramdown	264
D. Unsecured Debt under a Personal Guaranty	265
VII. Conclusion	266
TABLE OF CASES	267
INDEX	281