American Bar Association
35th Annual Forum on Franchising

MANAGING THE FRANCHISE RELATIONSHIP THROUGH FRANCHISEE RECEIVERSHIP AND BANKRUPTCY

Carolyn J. Johnsen
Jennings Strouss & Salmon
Phoenix, Arizona
Steven Goldman
Marriott International, Inc.
Washington, D.C.
Glenn D. Moses
Genovese, Joblove & Battista
Miami, Florida

October 3 – 5, 2012
Los Angeles, CA

©2012 American Bar Association
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. DEBT STRUCTURE</td>
<td>1</td>
</tr>
<tr>
<td>A. Traditional Senior Debt</td>
<td>1</td>
</tr>
<tr>
<td>B. CMBS Lending</td>
<td>4</td>
</tr>
<tr>
<td>II. WORKOUTS AND FORECLOSURE</td>
<td>4</td>
</tr>
<tr>
<td>A. Behind the Scenes of the Default Dance</td>
<td>4</td>
</tr>
<tr>
<td>B. Workout Negotiations</td>
<td>5</td>
</tr>
<tr>
<td>1. Discussions</td>
<td>5</td>
</tr>
<tr>
<td>2. Non-Binding</td>
<td>5</td>
</tr>
<tr>
<td>3. Not Admissible</td>
<td>5</td>
</tr>
<tr>
<td>4. Termination</td>
<td>5</td>
</tr>
<tr>
<td>5. Standstill; Forbearance</td>
<td>6</td>
</tr>
<tr>
<td>6. Communication with Third Parties</td>
<td>6</td>
</tr>
<tr>
<td>III. RECEIVERSHIPS</td>
<td>6</td>
</tr>
<tr>
<td>A. Receivership Options</td>
<td>7</td>
</tr>
<tr>
<td>IV. THE UNAVOIDABLE BANKRUPTCY FILING</td>
<td>8</td>
</tr>
<tr>
<td>A. Chapter and Verse</td>
<td>8</td>
</tr>
<tr>
<td>1. Management Wishes and Prayers — &quot;TRUISM&quot; &quot;If You Find Yourself in a Hole, the First Thing to do is Stop Digging&quot;</td>
<td>8</td>
</tr>
<tr>
<td>a. Legal Duties and Obligations</td>
<td>8</td>
</tr>
<tr>
<td>b. The Cost to Participate — &quot;TRUISM&quot; &quot;There is No 'Bank' in Bankruptcy&quot;</td>
<td>10</td>
</tr>
<tr>
<td>c. The Time Drain — &quot;TRUISM&quot; &quot;Life is in a Fishbowl&quot;</td>
<td>11</td>
</tr>
<tr>
<td>d. Liquidation Versus Reorganization — &quot;TRUISM&quot; &quot;You Can't Reorganize a Company That Sells 8-Track Music Tapes&quot;</td>
<td>11</td>
</tr>
<tr>
<td>e. Payments Required in Bankruptcy — &quot;TRUISM&quot; &quot;There is No Free Parking&quot;</td>
<td>12</td>
</tr>
<tr>
<td>2. Effect of Filing — &quot;TRUISM&quot; &quot;Bankruptcy Court is a Court of Equity — Know Thy Judge&quot;</td>
<td>14</td>
</tr>
<tr>
<td>a. Commencement of the Case</td>
<td>14</td>
</tr>
<tr>
<td>b. The Automatic Stay</td>
<td>14</td>
</tr>
<tr>
<td>c. Business Operations — &quot;TRUISM&quot; &quot;The filing does not eliminate management's brains&quot;</td>
<td>15</td>
</tr>
<tr>
<td>B. Emergency, Necessity, and Immediacy</td>
<td>16</td>
</tr>
<tr>
<td>1. The Franchisor's Analysis</td>
<td>16</td>
</tr>
<tr>
<td>2. Impact on an Existing Receivership</td>
<td>17</td>
</tr>
<tr>
<td>3. Cash Collateral</td>
<td>18</td>
</tr>
<tr>
<td>4. DIP Financing</td>
<td>18</td>
</tr>
<tr>
<td>5. Other Motions in the First-Day Package</td>
<td>19</td>
</tr>
<tr>
<td>a. Pre-petition Wages and Other Employee Benefits</td>
<td>19</td>
</tr>
</tbody>
</table>
b. Utilities.................................................................................19  
c. Continuation of Cash Management Systems ..................20  
d. Honoring Coupon and Gift Certificate Obligations .......20  
e. Payment of Pre-petition Creditors ..................................20  
f. Reclamation.........................................................................20  
g. Approval of Professionals .................................................21  

V. THE FRANCHISE AGREEMENT .................................................21

A. Considerations Regarding the Status of the Franchise Agreement ....21
   1. Business Decision as well as a Legal One in Terms of the 
      Franchisor’s Desired Continuation with the Agreement ..........21
   2. Valid Termination Pre-Petition ........................................21

B. Executory Contracts in General ...........................................22
   1. What is an Executory Contract? .......................................22
   2. Debtor’s Options ................................................................22
      a. Assumption ..................................................................22
      b. Assumption and assignment .........................................23
      c. Ability to Override Anti-Assignment Provisions (but 
         see below discussion of Franchisor’s Veto Power) .........23
      d. Rejection ....................................................................24

C. The Franchisor’s Veto Power: Specific Considerations Regarding 
   Assumption or Assignment of the Franchise Agreement ........24
   1. The Debtor Cannot Assign its Franchise Agreement to a 
      Third Party without the Franchisor’s Consent ..................24
   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? ..............26
      a. The Hypothetical Test: The Franchisor May Veto 
         Assumption of the Franchise Agreement 
         Irrespective of the Debtor’s Intention to Assign ..........26
      b. The Actual Test: Assumption Prohibited Under 
         Section 365(c)(1) only if there is an Actual 
         Proposed Assignment ..............................................27
   3. Ipso Facto Termination Clauses .......................................28

VI. SALE OF ASSETS IN CHAPTER 11 PROCEEDINGS ..........................28

A. Sales in Bankruptcy are Generally Free and Clear of Liens, 
   Claims and Interests ...........................................................29

B. Other Benefits of Chapter 11 Sales .........................................29
   1. Purchasers Have the Ability to “Cherry Pick” Favorable 
      Contracts and Leases ...................................................29
   2. Ability to Bind Dissenting Shareholders ...........................30
   3. Protection Against Fraudulent Conveyance and Successor 
      Liability Claims ............................................................30
   4. Protection Against Risk of Rejection of Sale Contract in a 
      Subsequent Bankruptcy .................................................31

C. 363 Sales v. Plan Sales ........................................................31

D. 363 Sales in General ..........................................................31

E. The 363 Sale Process ..........................................................32
1. First Stage: Approval of Stalking Horse Agreement, Break-up Fee, Bid Procedures and Protections ........................................... 32
2. Second Stage of the 363 Sale: Auction and Bankruptcy Court Approval .................................................................................. 33
F. Acquisition Through a Plan of Reorganization .................................................. 34

VII. INTERACTION WITH OTHER PARTIES—*TRUISM* "Strange Bed-Fellows" ........................................................................................................ 34
A. The Lender ................................................................................................. 35
B. The Creditor's Committee ........................................................................... 35
C. Equity Interests .......................................................................................... 36

VIII. PLAN OF REORGANIZATION .................................................................... 36
A. Formulating and Filing the Plan of Reorganization—*TRUISM* "Reprise: There is No Free Parking" ......................................................... 36
1. Exclusivity .................................................................................................. 36
2. Plan Contents .............................................................................................. 37
   a. Classification .......................................................................................... 37
   b. Treatment of Creditors ........................................................................... 38
   c. Implementation of the Plan ..................................................................... 38
   d. Executory Contracts ............................................................................... 38
3. Plan Confirmation ........................................................................................ 39
4. Inability to Confirm ..................................................................................... 40
B. The Issues for Franchisors and Franchisees—*TRUISM* "Success Means Getting From A to B* ........................................................................ 40

IX. CONCLUSION .................................................................................................. 41

Attachment A ........................................................................................................ A-1
Attachment B -- Subordination, Non Disturbance and Attornment Agreement .......... B-1
Attachment C -- Foreclosures/Receiverships -- Process and Closing Checklist .......... C-1
Attachment D -- Response Letter Prior to Hotel Receiver Order Being Entered ........ D-1
Attachment E -- Response Letter After Hotel Receiver Order Entered ..................... E-1
MANAGING THE FRANCHISE RELATIONSHIP THROUGH FRANCHISEE RECEIVERSHIP AND BANKRUPTCY

It was always the same in bankruptcy.  
Everybody wanted money and there wasn’t enough.¹

While pundits pontificate about the status of the economy and whether the “Great Recession” is over and recovery or recession is on the horizon, franchise businesses struggle through the same environment of constrained growth and lending as every other business. Franchisees in financial distress currently find that the alternatives available to restructure or refinance debt are also constrained by the downturn in real estate values and the lack of liquidity in the market. The purpose of this paper is to provide an overview of the panoply of issues and choices to be made by franchisors when they face financially troubled franchisees in the process of working through this challenging business climate.

A franchise business is much like any other business in that it that requires access to capital to develop the location as well as fund ongoing operations. Usually the franchisee does not have sufficient capital on its own and turns to a lender. Lenders provide project-related financing in many flavors: senior debt, junior debt, mezzanine financing, and construction loans.

Traditional Senior Lenders uniformly seek a first priority security position with respect to all real estate and other assets of a franchised business, including collateral assignments of all property and assets that comprise the business and a mortgage or deed of trust on the real estate. Junior debt is either subordinate to the senior debt and usually secured by some or all of the same collateral. Mezzanine debt is typically secured by a pledge of the equity of the owners as collateral.

For simplicity’s sake we will focus on franchisee default of its senior debt held by traditional lenders as well as CMBS trusts because this is usually the largest debt and this pedagogical approach allows for a discussion of foreclosures, receiverships, and bankruptcies with less focus on inter-creditor agreements and mezzanine debt secured by ownership instead of assets. This paper will follow the process of formation of senior indebtedness on a franchised business, default and workout or foreclosure and receivership, and the franchisee’s response of bankruptcy, which is the backdrop against which these workouts are negotiated and which may create a way to rewrite the borrowing terms or liquidate the business.

I. DEBT STRUCTURE

A. Traditional Senior Debt

Simply put, the senior lender will attempt to get the franchisee to pledge every asset that comprises the franchised business as collateral for the loan. Typically, the documents will provide for the assignment of all licenses with respect to the operation of the business and sometimes will specify franchises. Most franchise agreements, however, provide that the franchisee may not assign or grant a security interest in the franchise agreement and that doing so is a material breach of the franchise agreement.

¹ Present Value by Sabin Willett 2004.
On the whole, courts have agreed that a lender may not enforce rights under a contract requiring consent for assignment when such consent has not been given. As a result, it is not unusual for a lender to request that the franchisor enter into a security agreement or collateral assignment or, as is common in hotel franchising, a comfort letter. These documents establish the lender’s rights to continue the franchise relationship at the location and (i) provide for how cure will be made to the franchisor and (ii) specify who will operate the franchise business during the process of foreclosure, receivership or lender’s possession of the franchised business.

Lender concerns regarding the non-assignability of franchise agreements has led to a change in the Uniform Commercial Code (the “UCC”). UCC Section 9-408

---

2 See, e.g., 69 Am.Jur.3d Assignments 244 and 37 ALR 2d 1251. There is a debate, which seems academic but often has meaningful consequences, whether such an assignment made in spite of the prohibition renders the assignment void or voidable, and franchise statutes and other laws may speak to whether a franchisor’s right to consent is circumscribed in any way or limited by the Uniform Commercial Code as discussed below.


4 § 9-408. RESTRICTIONS ON ASSIGNMENT OF PROMISSORY NOTES, HEALTH-CARE-INSURANCE RECEIVABLES, AND CERTAIN GENERAL INTANGIBLES INEFFECTIVE.

(a) [Term restricting assignment generally ineffective.]

Except as otherwise provided in subsection (b), a term in a promissory note in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(b) [Applicability of subsection (a) to sales of certain rights to payment.]

Subsection (a) applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note.

(c) [Legal restrictions on assignment generally ineffective.]

A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(d) [Limitation on ineffectiveness under subsections (a) and (c).]

To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a
addresses the lender's concern that a franchisor might decide subsequent to
documentation of a loan, to grant a later lender a security interest in the franchise
agreement that allow that party to be first to file that security interest and thereby
become the first priority interest holder with respect to the franchise, which many lenders
consider to be one of the most important asset of the business. Section 9-408 overrides
the provision of a franchise agreement that makes a collateral assignment or grant of a
security interest in the franchise agreement a franchisee default under the franchise
agreement. Such a security interest, if first filed, is effective against all other lenders but
it does not give the lender rights as a franchisee under the franchise agreement. As a
result, savvy franchisors and lenders enter into a tri-party agreement that allows the
lender and the franchisor to discuss franchisee defaults without risking a lawsuit from the
franchisee and provides the terms under which a franchisor would allow a lender to take
possession of the franchise business and operate the franchise business.

Finally, note that it is not unusual for lenders to request a "subordination, non-
disturbance and attornment" agreement ("SDNA") from the franchisor. An SDNA is
common in situations where there is a passive owner, such as a REIT, and an operator
of the franchised business, and the lender wants to ensure continued operation and
priority for lender's payments during foreclosure and eventual disposition of the property.
In the context of a franchise with an owner-operator, however, an SNDA is usually
inconsistent with the structure of the franchise because the lender rarely will allow the
existing operations to continue with the defaulted borrower. In other words, there will not
be "non-disturbance" and the parties must agree on a new operator to continue running
the franchised business and a way to address cure of franchise agreement defaults.

B. **CMBS Lending**

In many industries, collateralized mortgage backed securities ("CMBS") loans have
been a common source of senior debt. In a CMBS transaction, a real estate mortgage

---

rule of law, statute, or regulation described in subsection (c) would be effective under law
other than this article but is ineffective under subsection (a) or (c), the creation, attachment,
or perfection of a security interest in the promissory note, health-care-insurance receivable,
or general intangible:

1. is not enforceable against the person obligated on the promissory note or the account
debtor;

2. does not impose a duty or obligation on the person obligated on the promissory note
or the account debtor;

3. does not require the person obligated on the promissory note or the account debtor to
recognize the security interest, pay or render performance to the secured party, or accept
payment or performance from the secured party;

4. does not entitle the secured party to use or assign the debtor's rights under the
promissory note, health-care-insurance receivable, or general intangible, including any
related information or materials furnished to the debtor in the transaction giving rise to the
promissory note, health-care-insurance receivable, or general intangible;

5. does not entitle the secured party to use, assign, possess, or have access to any trade
secrets or confidential information of the person obligated on the promissory note or the
account debtor; and

6. does not entitle the secured party to enforce the security interest in the promissory
note, health-care-insurance receivable, or general intangible.

---

5 See Attachment B, Subordination, Non-Disturbance and Attornment Agreement.
investment conduit ("REMIC") holds a pool of mortgages and issues to investors securities that are in essence "passed through" certificates. The certificates represent a payment right with respect to a "tranch" of debt, with payment returns based on the risk level for that group of loans. The REMIC trust is governed primarily by a Pool and Servicing Agreement, which sets out the rules for servicing the loans and distributing cash to the holders of the securities. In many respects these holders of securities have much the same standing as holders of a bond, which means they have limited rights under the Pooling and Servicing Agreement, to which they are not parties, and they have no right as holders to become directly involved in the day-to-day administration of the loans and workouts of the loans that are pooled under the REMIC trust. What is significant in foreclosure and bankruptcy about CMBS loans is that typically they are non-recourse to the borrower, which can be the case with traditional senior debt, and instead of a lender there is a Master Servicer, which has the responsibility for the day-to-day administration of the loans. It is the master servicer that typically is the counterparty to agreements with the franchisor. Typically the master servicer may not modify loan terms but may provide temporary liquidity by advancing funds from the REMIC trust to cover certain expenses or overdue amounts.

A typical Pooling and Servicing Agreement also provides for the creation of a "Special Servicer" for loans that are placed in default. The most junior tranche of REMIC certificate holders is identified as the "controlling class" because this group alone has the right to replace a Special Servicer. The primary responsibility of the servicer is to work the loan, pursue remedies, and make protective advances to protect the collateral. Although special servicers may prefer to act slowly because of the risk of litigation, special servicers are bound to act in accordance with normally accepted servicing practices, which obligate a special servicer to avoid waste and to spend money on improvements necessary to protect the value of the collateral. This may be a very different set of motivations than a traditional lender, which usually has a "real estate owned" or REO subsidiary. Under this structure, until the REO subsidiary holds title to the property, the lender usually will not make protective advances and is swimming upstream against the lender's truism: "Your first loss is you best loss."

In summary, it is important to differentiate the motivations of traditional lenders who may or may not have a guarantee and special servicer of a CMBS loan who is dealing with a non-recourse loan but unlike a traditional lender has an obligation to expend funds to prevent waste of the asset, such as termination by the franchisor for not meeting standards or paying the franchisor, and dealing with these two types of lenders may require very different approaches by the franchisor even though the rights of the two lenders are not really different with respect to the collateral or the franchise.

II. WORKOUTS AND FORECLOSURE

A. Behind the Scenes of the Default Dance

Franchise businesses find themselves unable or unwilling to service debt for a variety of reasons ranging from plain bad luck to malleasance. Generally, franchisors and lenders find common ground quickly if franchisee malfeasance is the cause. Otherwise, what happens next tends to vary somewhat depending on the parties and the state law. The lender needs to decide whether a workout, a non-judicial foreclosure, or a judicial foreclosure is expeditious enough and provides the lender with clear title, eliminates borrower redemption risks and otherwise creates a clear risk profile. This, of
course, is influenced by the length of time a state may require for judicial foreclosure, which can vary from a couple of months to a year or two depending on the state. Of particular importance to the franchisor attempting to develop a strategy is the reality of who actually will spend money if the franchisee has not paid or has defaulted. With lenders, this is largely driven by how they are organized. Lenders traditionally approach the franchisor in the posture of a White Knight who can hire a competent operator and finally fund the franchised operations appropriately. Most lenders, however, do not allow material expenditures to cure defaults or improve the franchise business until the lender is in possession of the franchise business and the decisions have moved to the real estate owned ("REO") portion of the bank, which is the same group that ultimately will sell the franchised business. As a result, many franchisors avoid taking sides at this stage of the dispute and let the lender and franchisee know that they need to work out whatever loan relief or foreclosure is going to occur, but find a way in the meantime to keep the business operating in compliance with standards and to pay the franchisor.

B. Workout Negotiations

Often, like the father of the bride, the franchisor is the last to know that that the relationship between the franchisee and the borrower has reached the default stage (in some cases probably because many franchisors make this default a grounds for franchise agreement default). Usually the call comes from one of the parties to seek the cooperation of the franchisor more than the franchisor’s participation. In the case of the lender, often the notice of franchisee default may be prompted because the lender, especially a CMBS lender, has found that its documentation with respect to the franchise is wanting in some way (CMBS documentation, like the now infamous “no doc” loans, is notably inconsistent). And when non-recourse debt is involved, the chances are increased that the franchisee is sending “jingle mail” (handing the lender the keys to the franchised unit), and the franchisor is first hearing of the extent of the problem when it hears the jingle mail arrive.

Before beginning negotiations with either the lender or the franchisee, a franchisor should consider whether a “pre-negotiation” agreement with franchisee and/or lender is appropriate. Typically, such an agreement would include the following provisions:

1. **Discussions.** No party shall incur any liability by reason of workout discussions, and participating in the discussions shall not constitute a waiver of or estoppel with respect to any rights.

2. **Non-Binding.** All discussions will be non-binding until confirmed in writing signed by all parties.

3. **Not Admissible.** The discussions may not be used or quoted in any legal proceeding and are not admissible as evidence.

4. **Termination.** Any party may terminate the discussions at any time.

5. **Standstill; Forbearance.** The franchisee/borrower may seek some relief or temporary forbearance on current payments while the parties are holding discussions. It should be mutual and immediately terminable. The
parties may want to specify grounds for termination such as the pursuit of relief in the event of threatened or actual damage or injury to or waste of the collateral security.

6. Communication with Third Parties. All parties may request the right to communicate with third parties, e.g., loan purchasers, equity providers and additional guarantors, while the discussions are proceeding.

The franchisor must remember that the lender may be considering a number of options: workout and forbearance, a deed in lieu of foreclosure, non-judicial or judicial foreclosure. From the lender's perspective, the non-judicial approaches may be a quicker way to sell the collateral in many jurisdictions, but the non-judicial approach does not affect other encumbrances on the property such as junior deeds on liens. Also, the lender may also be considering how to handle franchisee's right of redemption of the property under state law and whether there is a deficiency action worth bringing against the franchisee or recourse against a guarantor. Finally, in a state with the "one action" rule, the lender will have to pick between suing on the note and, for instance, the guaranty absent court approval.

III. RECEIVERSHIPS

Receivers are creatures of state court, and in most proceedings relevant to this paper, are appointed to operate and protect the business that is the collateral of the lender. Receivers in some jurisdictions can also sell the property and may present an expeditious method for the lender to sell the franchised business without taking possession. Receivers, depending on the custom in the jurisdiction, may either be an individual at a company that operates the business, or may be a friend of the court. In either event, the receiver's obligation is the same: to protect the value of the assets of the lender during a foreclosure process. Lenders are generally entitled to appointment of a receiver without any showing of malfeasance.

Receivers, however, have no funds available to them other than those from operations and those provided by the lender. Although receivers are typically required to post a bond, this is a fidelity bond to prevent theft by the receiver, and does nothing to prevent a partial payment by a receiver at the winding up of the receivership if there is not enough money available to pay all the creditors. From a franchisor's perspective, if the franchise is a valuable asset, risk of operational non-performance, non-payment, or creation of franchisor liability is an intolerable risk because, unless the business is generating sufficient income to fund operations and needed improvements, the franchisor may find that, at the end of a receivership, a poor franchise may have remained in the system and increased indebtedness to the franchisor who has undergone the distraction of at least two changes in control.

Because the law of receiverships is surprisingly undeveloped, a franchisor that has not entered into an agreement with the lender that specifies what happens in a receivership may find itself in a court with a judge that is trying to balance the conflicting positions of the lender, which is entitled to a receivership to protect the lender's

---

6 Generally, non-judicial foreclosure is an exercise of the lender's power of sale in the mortgage or deed of trust; judicial foreclosure is an action in state court to foreclose on the property.

7 See Generally, 82 ALR 2d 1075

8 See Attachment C, Process and Closing Checklist.
collateral, which appears to include the franchise agreement, and of the franchisor, which is entitled to a license agreement with the person acting as franchisee with respect to the franchised business. The Lanham Act is a federal law protecting trademark owners, and it presumably preempts the state court receivership provisions. A franchisor can argue that the use of the franchisor’s trademarks and systems without a license violates the Lanham Act and gives the franchisor all of the rights against the receiver it would have against any other violator of the Lanham Act. The best approach, however, is to have in place a tri-party agreement with the lender and franchisee that requires the lender to give notice of the receivership and to cure various deficiencies and enter into an agreement directly with the franchisor. ⁹ Most lenders will honor these provisions and will incorporate them into either the initial order appointing the receiver so that it is clear that the receiver has authority to enter into that agreement and to meet the obligations of the existing agreement with the franchisor, and such an agreement puts presumptions on the franchisor’s side if the lender were to ignore the agreement. Occasionally, a lender will seek to get this receiver appointed ex-parte but with full recognition that immediately thereafter the lender and franchisor will work out the terms of an order to supplement the initial order appointing the receiver. There are occasions where lenders, particularly lenders, without any prior agreement with the franchisor, will seek an order appointing a receiver that effectively contravenes the rights of most franchisors. But this is the exception rather than the rule. ¹⁰

This is also one of those situations where lenders and special servicers often behave differently. Both typically honor their agreements with the franchisor. From the point of view of a typical lender, the assets have not yet moved into the real estate owned portion of the lenders operations and therefore it is exceedingly difficult to obtain any protective funding from the lender. Special servicers, on the other hand, have contractual obligations to make such funding. Thus, there can be advantages to dealing with a CMBS special servicer instead of a traditional lender.

A. Receivership Options

At the beginning of a receivership, a franchisor has to sort out a strategy based on the status of the relationship. Most lenders will want time to become comfortable with the cash flow and operating costs. Lenders also need to determine whether, if the business needs capital to meet standards, they are willing to commit the necessary funds. Most franchisors want to get paid any past-due amounts and have resolution of the status of the unit. The franchisor also does not want to undergo the expense of dealing with the receivership, issuance of new agreements to a receiver, a lender, and a purchaser of the business. To find the right commercial mix, there are a number of approaches that a franchisor can take depending on the facts and the time that foreclosure takes under state law:

- A short-term (90-day) receiver’s franchise to allow for a sale or lender’s commitment on foreclosure. In either case, the agreement with the receiver is for a limited duration.
- A long-term, “step in” receiver’s franchise that is designed for the lender to assume at the end of the receivership.

---

⁹ See Attachment D, Response Letter Prior to Hotel Receiver Order Being Entered.
¹⁰ See Attachment E, Response Letter After Hotel Receiver Order Entered.
These can either be for full-term, with a full deficiency list and "product improvement plan" payment of an application fee, or for the remainder of the existing agreement term, which only requires cure of deficiencies, including legal costs.

- A termination agreement if all parties cannot come to agreement.

IV. THE UNAVOIDABLE BANKRUPTCY FILING

While the actual commencement of the bankruptcy consists of preparing and filing a simple 2-page document, the ramifications should be well vetted in advance. It is best to start at the end. That is to say, the first questions to ask are: what is the debtor trying to accomplish by a bankruptcy filing; what is the exit strategy; will there be enough cash to get there; can a viable plan of reorganization that implements a viable business plan be confirmed; or is this an exercise in futility? These are the critical business decisions affecting both franchisors and franchisees. While all parties desire a "magic pill" to rectify their financial woes, a bankruptcy may or may not be the elixir. As this paper develops, the reader will be alerted to a number of "truisms" which seem to exist in every case. Most bankruptcy practitioners will agree that these basic concepts are ever-present. While not to trivialize the importance of issues, both factual and legal, these simple maxims should assist those delving into the bankruptcy realm in focusing on realistic options and decisions.

A. Chapter and Verse¹¹

1. **Management Wishes and Prayers —*TRUISM* “If You Find Yourself in a Hole, the First Thing to do is Stop Digging”¹²**

   a. **Legal Duties and Obligations**

   Along with the difficulties of managing a business in financial distress, there is an overarching issue the entity’s officers and directors must place at the forefront: corporate governance and fiduciary obligations. Under normal circumstances, officers and directors have the freedom to operate the business so long as they exercise good business judgment and act in the best interest of the corporation without self-dealing and with due care. Generally, their duty is to maximize value for the equity interests. However, a dramatic shift occurs when the corporation reaches what is known as the "zone of insolvency." The focus of officers and directors shifts to a strict duty to creditors, and they must be cautious to avoid placing the company in further financial demise or cause what has been termed a "deepening insolvency."

¹¹ The "Bankruptcy Code" or "Code" refers to 11 U.S.C. § 101 et seq. The main provisions pertaining to Chapter 7 liquidations are contained in §§ 701-728; the main provisions pertaining to Chapter 11 reorganizations are contained in §§ 1101-1146.

¹² Will Rogers.
Officers and directors owe three duties to the corporation: 1) to be obedient, i.e. act within the powers granted by the corporate documents;\textsuperscript{13} 2) to be diligent, i.e. act in good faith and with the care an ordinary prudent person would use;\textsuperscript{14} and 3) to be loyal, i.e. to avoid conflicts of interest and act with candor in the context of corporate transactions.\textsuperscript{15} And, for the most part, an officer or director is usually not liable for mistakes of honest business judgment when the director acts in good faith-- the so-called business judgment rule.\textsuperscript{16}

When the corporation is solvent, the directors have a fiduciary relationship to the corporation and its shareholders. Typically, this relationship does not extend to creditors absent fraud or the like.\textsuperscript{17} However, when the corporation is insolvent, the directors are deemed to be trustees for the corporation and its creditors. Thus, as the corporation becomes insolvent or is on the brink of insolvency, the duties of the officers and directors shift from maximizing benefits for the shareholders to preserving the corporate assets as a trust fund for creditors. This fiduciary relationship arises when the corporation enters the zone of insolvency or becomes insolvent in fact.\textsuperscript{18} This becomes important as management must act in such a way to protect creditors.

In recent years, management duties have been scrutinized intensely in the bankruptcy arena as creditors struggle for recovery from any source in the wake of liquidating no-asset companies. A theory has evolved in which officers and directors may be sued for acting fraudulently or even negligently in prolonging the life of the company and increasing its debt and exposure to creditors. This cause of action is what is referred to as the tort of deepening insolvency.\textsuperscript{19} It is a developing area; some courts have refuted it, and others have expanded it to include accountants, investment brokers, lawyers, and even lenders.\textsuperscript{20} What is important is that management is aware of its duties and responsibilities, since the possible consequences become critical as a financially troubled company moves into the zone of insolvency and constantly must weigh its alternatives. For example, should a franchisor continue with expansion and the sale of new franchises, or allow the transfer of existing franchises? Should a franchisor or a franchisee enter into new or extended financing arrangements that leverage the company further? Decisions should be made carefully and reasoned and management should be realistic as to their assessment of filing a bankruptcy proceeding.

Finally, upon the filing, a bankruptcy “estate” is created. In a Chapter 11 proceeding as described below, the entity becomes a “debtor-in-possession” (“DIP”). At this point, the principals of the company and its counsel owe a fiduciary duty to the

\textsuperscript{13} Wilshire Oil Co. of Tex. v. Riffe, 409 F.2d 1277 (10th Cir. 1969).
\textsuperscript{14} See e.g., Scott Sys., Inc. v. Scott, 996 P.2d 775 (Colo. App. 2000).
\textsuperscript{15} Herald Co. v. Seawell, 472 F.2d 1081 (10th Cir. 1972).
\textsuperscript{16} See e.g., Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
estate, which means they must act in the best interest of creditors and parties in interest. This issue often arises in small or closely held entities in which the principals rely on the business for their livelihood and have often contributed considerable monies and guaranteed the debt. These individuals must put their personal interests aside and act strictly for the benefit of the DIP. Their actions are often challenged as a matter of “good faith” when it comes time to develop and confirm a plan of reorganization.

b. **The Cost to Participate—“TRUISM” “There is No ‘Bank’ in Bankruptcy”**

Ironically, despite the financial dilemma creating the need to file a bankruptcy, the potential debtor must anticipate a huge cost to file and maintain the case. The filing fee for a Chapter 11 is $1,046 and that probably is the smallest check the company will write in connection with the proceedings. The professional fees are the largest concern. The bankruptcy process of initiating the case and complying with the Bankruptcy Code requirements such as filing detailed asset and liability schedules, closing and opening bank accounts or other cash management systems, filing necessary motions to continue operations are all expensive. Moreover, these matters occur within the first days of the case. Depending on the size of the case, the overall strategy, and the reaction of the other parties, the case will probably take a minimum of a year and more likely longer depending on these factors. Creditor challenges to various issues in the case can increase fees exponentially. Unlike a single lawsuit, bankruptcy cases often involve a myriad of mini-trials and the company and its lawyers find themselves in bankruptcy court on a regular basis. In fact, in larger cases, courts often will set aside specific days to handle multiple matters.

In many cases, particularly small ones or those involving single-assets, attorneys for the debtor have a risk of not being paid once the case is filed. This is generally because a lender claims an interest in the debtor’s receivables as its “cash collateral” and will prevent its use for the payment of professional fees. Thus, most attorneys will require a significant retainer prior to the filing of the case.

Other professionals may include financial advisors or certified restructuring officers (“CROs”) who may have been hired by the company prior to the filing. As the case progresses, there may be a need to hire experts to prepare reports and testify about valuation of assets or the appropriate interest rate for a restructured loan. In larger cases in which a committee of unsecured creditors (“Committee”) is appointed, the Committee’s counsel and its other professionals must be paid by the debtor as well. All professionals must be paid in full upon confirmation of a plan of reorganization (see below section VIII), unless they agree otherwise.

Chapter 11 cases are monitored by the United States Trustee’s Office (“UST”), an arm of the Department of Justice. The debtor is required to meet with the UST shortly after the case is filed and provide extensive documents regarding assets, insurance, bank accounts, tax returns and financials. The debtor is also required to file Monthly Operating Reports that include information about income and expenses. Based on monthly disbursements, the debtor is required to pay quarterly fees. These fees can be significant depending on the debtor’s expenditures and they continue even after plan confirmation until the case is actually closed.

---

c. **The Time Drain—“TRUISM* “Life is in a Fishbowl”**

Bankruptcy can be an absorbing affair for management.Appearances at hearings and meetings with creditors draw principals away from their immediate task of running the business. The bankruptcy entitles creditors and parties in interest access to all of the company’s books and records and company personnel may spend enormous amounts of time compiling documents to fulfill such requests.\(^{22}\) All in all, bankruptcy is about full and forthright disclosure.\(^{23}\) Thus, the bankruptcy subjects the company to “life in a fishbowl.”

d. **Liquidation Versus Reorganization—“TRUISM** “You Can’t Reorganize a Company That Sells 8-Track Music Tapes”

A business entity is eligible for essentially two types of bankruptcy proceedings identified by specific sections in the Bankruptcy Code as a Chapter 7 or a Chapter 11.\(^{24}\) A Chapter 7 is a straight liquidation that can be filed by a business entity or an individual. All assets become property of the bankruptcy estate. A trustee is immediately appointed randomly from a panel of individuals who have met the Bankruptcy Code qualifications to serve in that capacity. The trustee takes control of the debtor’s assets, sells them and distributes the proceeds to creditors. The trustee can operate the debtor’s business during the liquidation process. Trustees have full access to the debtor’s books and records.

Chapter 11 is typically a reorganization case and can be filed by an individual or an entity. As in a Chapter 7, all assets become property of the estate, but in a Chapter 11, there is no trustee and the debtor remains in possession of the assets. In fact, the debtor is referred to as the “debtor-in-possession” or “DIP.” Businesses typically continue to operate in a Chapter 11 with the goal of restructuring debt or otherwise re-ordering their financial or corporate structure. Although generally referred to as a reorganization, a DIP can liquidate its assets in a Chapter 11 proceeding and may want to do so believing that it can achieve a higher value than could a Chapter 7 trustee.\(^{25}\)

In certain circumstances, and upon motion by a party in interest, the bankruptcy court may appoint a Chapter 11 trustee to take control of the debtor’s assets, if there is a showing of “cause,” mainly that the DIP has committed gross mismanagement, fraud or.

---

\(^{22}\) Bankruptcy Rule 2004 provides that on motion of any party, the court may order the examination of any entity. See Fed. R. Bankr. P. 2004. The scope of the examination is limited to the “acts, conduct, or property or to the liabilities and financial condition of the debtor . . . .” See id. at 2004(b). However, this section is read extremely broadly and is often characterized as entitling the movant to a “fishing expedition.” It is a two-edged sword in that the debtor is equally entitled to seek information from third parties. One exception to the breadth of the rule pertains to trade secrets or confidential research, development or commercial information. Bankruptcy Code § 107 provides a means for the court to protect an entity from having to divulge such information. Nevertheless, a motion seeking this type of relief must meet a heavy burden. See e.g., In re FiberMark, Inc., 330 B.R. 480, 504 (Bankr. D. Vt. 2005); In re Food Mgmt. Group, LLC, 359 B.R. 543, 561 (S.D. N.Y. 2007).

\(^{23}\) Rome v. Braunstein, 19 F.3d 54 (1st Cir. 1994).

\(^{24}\) Other Chapters providing bankruptcy relief include the following: Chapter 13 is a reorganization case for individual wage earners with a maximum of roughly $360,000 in unsecured debt and secured debt of about $1,000,000. Chapter 9 can only be filed by a municipality and Chapter 12 can only be filed by a family farmer.

\(^{25}\) For the most part, the use of the term “trustee” in the Code is synonymous with the term “debtor-in-possession.” See 11 U.S.C. §§ 1107 and 1108.
some other such egregious activity, or is unable properly to conduct its affairs within the confines of the Bankruptcy Code and its various requirements. It is an extraordinary remedy. A party may also seek the appointment of an examiner to investigate the debtor’s conduct, financial condition, assets, or business operations. This may provide a middle ground in allowing the company to retain control while giving parties a comfort level that an independent party is exploring any questionable transactions or conduct.

A Chapter 11 entity or a Chapter 11 individual who conducts business activities other than pure real estate operations may be designated as a “small business” debtor if their liquidated debt is $2 million or less. Although there are certain reporting requirements, a small business debtor has the advantage of moving the case toward confirmation more quickly and economically.

Choosing whether to file a Chapter 7 or 11 depends on a realistic view of the current financial condition of the company and its prospects for the future.

e. Payments Required in Bankruptcy--“TRUISM” “There is No Free Parking”

One of the key initial benefits of the bankruptcy filing is that generally, the debtor is relieved of any current obligation to pay pre-petition creditors. Their repayment is treated in an eventual plan of reorganization. But, that is not the case with post-petition debt. The debtor will be required to pay substantially all claims that arise after the bankruptcy filing. The Bankruptcy Code grants a first priority among unsecured claims to claims for “the actual, necessary costs and expenses of preserving the estate.” This group includes post-petition obligations to vendors, employees, professionals, and taxing authorities. Post-petition claims entitled to first priority treatment are referred to as administrative claims. The debtor’s Monthly Operating Reports filed with the court must reflect all payments and include an aging report. The UST and creditors have the opportunity easily to monitor the debtor’s business from this standpoint. Failure to pay

27 But see e.g., In re Bibo, 76 F.3d 256 (9th Cir. 1996) (court can appoint a trustee sua sponte).
28 11 U.S.C. § 1104(c). The grounds include that the appointment is in the best interest of creditors. An examiner may be appointed automatically if the debtor’s fixed, liquidated unsecured debts, other than for goods, services, or taxes or owing to an insider, exceed $5,000,000.
29 See 11 U.S.C. § 101(51D); 11 U.S.C. § 1129(e) (in small business cases, generally a court shall confirm a plan not later than 45 days after plan is filed); In re Roots Rents, Inc., 420 B.R. 28 (Bankr. D. Idaho 2009).
30 Nearly all cases are filed voluntarily by the debtor. In certain circumstances, however, a case can be commenced by an “involuntary petition” filed by a group of creditors. This petition must be filed by three creditors to which the debtor owes unsecured, liquidated, non-contingent debt, and those creditors must allege that the debtor is generally unable to pay its debts as they come due. If the debtor has fewer than 12 creditors, the petition can be filed by a single creditor. The debtor has the right to dispute the involuntary petition on grounds such as that it is regularly paying its debt or that the petitioning creditors are ineligible to participate in the petition (e.g., because their debts are not liquidated or are contingent). Or, the debtor may consent that the bankruptcy case should go forward. For example, if the involuntary petition was filed under Chapter 7, the debtor may agree, but only if the case proceeds under a Chapter 11.
31 See All Trac Transp., Inc. v. Transp. Alliance Bank (In re All Trac Transp., Inc.), 306 B.R. 859, 876 (Bankr. N.D. Tex. 2004) (“Outside of a Chapter 11 plan of reorganization confirmed by the bankruptcy court, the Bankruptcy Code does not provide for the pre-plan payment of pre-petition unsecured debt.”); see also Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987) (“The Bankruptcy Code does not permit a distribution to unsecured creditors in a Chapter 11 proceeding except under and pursuant to a plan of reorganization that has been properly presented and approved.”).
administrative expenses, with the possible exception of professionals, could result in the appointment of a trustee or conversion of the case to a Chapter 7.

In many cases, the debtor has been unable to pay current rent for leased commercial property. This period of non-payment is short-lived in bankruptcy. First, the debtor must pay rent post-petition. The rent is an administrative claim, but courts tend to view the payment of rent as having more urgency. Second, if the debtor wants to continue the lease, it must assume it (a form of affirmation) within 120 days of the bankruptcy filing or it will be deemed rejected and the landlord can take necessary steps to take back its property. The court may extend the deadline for 90 days upon a showing of "cause" and thereafter, only with the consent of the lessor. If the debtor assumes the lease, it will have to pay the accumulated arrearages. These deadlines are critical in that the debtor will have to make immediate decisions with respect to its leases and determine whether payment of arrearages is possible. This is more problematic for debtors with multiple leases. If a lease is rejected, the landlord has an unsecured claim for rent but it is capped. On the other hand, if the lease is assumed and the debtor is eventually unable to pay its rent obligations, all of the rent due becomes an administrative claim. This is another important consideration.

The debtor has some respite with respect to its equipment leases. The debtor is not required to pay equipment lessors during the first sixty (60) days of the case to have time to evaluate whether it wants to retain the equipment or return it to the lessors. After that time period, however, the payments must be made, and the lessor can seek payment if it can show that use of the equipment was an actual, necessary cost of preserving the estate. The Bankruptcy Code does not create a presumption that a debtor benefits from equipment simply because the equipment is in its possession. Note, however, not all leases are "true leases," but rather may be disguised financing transactions. For example, a so-called lease that requires a dollar buy-out at the end of the term is probably a secured transaction and the "lessor" is a secured creditor. The debtor may still have to make adequate protection payments to compensate for a decline in the value of the equipment, but these payments may be less than the lease payments.

With respect to other contracts, the debtor is not required to assume or reject them prior to confirmation. Nevertheless, it must make payments to parties to ongoing contracts to the extent that the debtor continues to accept the benefits of a contract. This includes payments pursuant to a franchise agreement. Note that contracts for

---

33 See 11 U.S.C. § 365(d)(3); see also, In re Goody's Family Clothing, Inc., 610 F.3d 812, 817-18 (3d Cir. 2010); Bural Farms v. Roehrich, (In re Burival), 613 F.3d 810, 813 (8th Cir. 2010); Adolphia Bus. Solutions, Inc. v. Abnos, 482 F.3d 602, 606 (2d Cir. 2007).
39 The terms "actual" and "necessary" are to be construed narrowly and encompass only those expenses that actually benefit the estate and its creditors. See State of Texas v. Lowe (In re H.L.S. Energy Co., Inc.), 151 F.3d 434, 437 (5th Cir. 1998); NL Indus., Inc. v. GHR Energy Corp., 940 F.2d 957, 966 (5th Cir. 1991); In re Old Carco LLC, 424 B.R. 633, 642 (Bankr. S.D. N.Y. 2010); Nat'l Union Fire Ins. Co. v. VP Bldgs., Inc., 606 F.3d 835, 838 (6th Cir. 2010).
financial accommodation, (i.e. loan agreements, promissory notes) are not subject to assumption or rejection. But, the debtor often is required to make partial payments to secured lenders during a case to protect adequately the secured creditor's interest in its collateral.

2. **Effect of Filing—“TRUISM”**  
   **“Bankruptcy Court is a Court of Equity—Know Thy Judge”**

Bankruptcy courts are Federal Courts and bankruptcy judges are "Article I" judges appointed by the Circuit Court of Appeals for 14-year terms. Procedure is governed by the Bankruptcy Code (the "Code") and the Federal Rules of Bankruptcy Procedure that mirror the Federal Rules of Procedure. Trials in bankruptcy court are conducted as they would be in Federal Court. There is, however, somewhat of a tacit understanding that bankruptcy courts are courts of equity, and bankruptcy judges will often rule from that standpoint. This factor can make the outcome rather unpredictable at times during the course of the case. The point is to understand the dynamics of what the judge is conveying in a particular instance. Again, unlike a single litigation event, the case is ongoing and ever changing and requires strategic responses to court rulings and decisions.

The Code itself "giveth and taketh" away. It innately contains many balances. For example, while the filing benefits the debtor by preventing actions by creditors to recover their collateral, demand past-due payments, or in some cases, suspend services, creditors are entitled to certain and "adequate" protections including payments to prevent a decline in value of their collateral. Again, the point is to understand the dynamics of the Code so as to establish a strategic position from either perspective. For example, while the Code may permit a creditor to demand payments, an extreme position may create a financial situation that hinders the debtor from being able to pay vendors and otherwise continue operations. It may be a hollow victory, whereas a more reasoned approach may provide for ultimate payment to all creditors.

a. **Commencement of the Case**

The case is commenced by filing a petition, which effectuates the creation of the bankruptcy estate. All assets owned by the debtor at the time of filing are considered property of that estate.\(^{42}\) Everything occurring prior to the filing is designated as "pre-petition" and everything after is referred to as "post-petition." This is an important distinction in that the debtor is instantly restricted from paying pre-petition debt including payroll and trade vendors and from utilizing cash proceeds ("cash collateral") from the business if subject to a lender lien. The debtor must close its pre-petition bank accounts and start a new set of financial records beginning on the date of filing.

b. **The Automatic Stay**

Immediately upon the filing of the case, an injunction known as the "automatic stay" goes into effect.\(^{43}\) The automatic stay prevents creditors from proceeding with any action against the debtor such as a foreclosure, collections (including letters and phone

---

\(^{41}\) Attributed to Neil Batson, Alston and Bird.  
\(^{42}\) For individual debtors, property of the estate also includes post-petition wages and property acquired post-petition. 11 U.S.C. § 1115.  
calls), perfection of a lien, set-off, lawsuits, and contract terminations (including notices of termination). The policy behind the automatic stay is that the debtor should be entitled to some “breathing room” while assets are marshaled or the debtor is developing a reorganization plan. Creditors who violate the automatic stay by proceeding against the interests of the debtor may be subject to monetary sanctions or other penalties.

Certain actions are not subject to the automatic stay, such as some governmental proceedings and tax audits and assessments. Additionally, for the most part, the automatic stay does not prevent actions against third parties not in bankruptcy. Thus, for example, a lender can pursue a guarantor who has not filed bankruptcy even though the entity principally obligated on the debt has filed. Debtors often will petition the court to enter an injunction staying any proceedings against the principals of the entity during the pendency of the bankruptcy.\textsuperscript{44} The arguments are typically that the principals are distracted by extraneous litigation when their efforts are necessary to operate the debtor’s business and that the principals may be contributing funds toward the eventual reorganization of the entity. In most cases, if an injunction is entered, it dissolves at confirmation of the plan or other resolution of the case.\textsuperscript{45} In addition, the automatic stay does not prevent collection on a letter of credit or the attachment of a mechanics’ lien.

A creditor whose action is stayed may file a motion asking the bankruptcy court to lift the stay to allow it to proceed with its remedies. Various grounds must be shown. For example, a creditor seeking to foreclose on real property may be able to obtain relief from the stay by showing the property does not have equity or that it is declining in value and no payments are being made, or that the property is not necessary to the debtor’s reorganization.\textsuperscript{46}

So-called “single asset” cases are treated somewhat differently. In cases in which the debtor’s sole asset is real property, other than residential property with fewer than four units, the debtor is required to file a plan of reorganization within 90 days of filing or make payments to its secured creditors.\textsuperscript{47} Otherwise, the stay may be lifted.

c. **Business Operations-"TRUISM* "The filing does not eliminate management’s brains”**

For the most part, day-to-day business operations continue as usual. Typical management decisions must be made, supplies must be ordered, and services must be rendered. Business decisions should go forward as usual; business objectives should be established and followed. The business solution is always the best one, and management should focus on the end goal to emerge from bankruptcy with a reorganized structure.

The caveats are these: Unlike restrictions preventing payment of pre-petition debt, a debtor must pay its post-petition payables or may be subject to a conversion to a

\textsuperscript{44} Known as a §105 injunction that is based on the section of the Bankruptcy Code giving the court broad power to issue orders for the benefit of the parties and control the case. \textit{In re Regatta Bay, LLC}, 406 B.R. 875 (Bankr. D. Ariz. 2009).
Chapter 7 or the appointment of a trustee. A lender with an interest in cash collateral may restrict its use and limit expenditures to a well-defined budget. Many transactions such as sales or leases outside the ordinary course of business require court approval. Payment to principals considered to be insiders will be scrutinized and salaries may be reduced. While there can be enormous benefits to filing, namely restructuring debt while the business and/or the economy recovers, there is a certain relinquishment of autonomy.

B. Emergency, Necessity, and Immediacy

Once the case is filed, it seems that every issue is an emergency, is critically necessary to the debtor’s success, and requires immediate relief from the bankruptcy court. As noted above, the debtor would be stymied in its continued operations, unless it obtains court approval to pay certain creditors, namely employees and use the cash proceeds generated by the business. Thus, the debtor typically files a series of what are known as “first-day motions” to obtain permission to continue operations with the least amount of disruption.

First-day motions are heard by the court on an expedited basis, usually one or two days after the filing. The debtor will attempt to provide notice at least to its lenders, its twenty largest unsecured creditors, specific affected parties such as utility companies and the UST for the district where the case is filed. But, practically speaking, there is often little or no time for creditors or interested parties to respond. Many times a franchisor does not receive immediate notice because the debtor is current on payments and has not listed it as a creditor.

The UST will usually appear at the first-day hearing and essentially represent the interests of creditors until they have a chance to appear and be heard or until a committee of creditors is formed. Evidence is often presented by a declaration of the principal of the entity. Because of the emergency nature of the relief sought, the bankruptcy court will usually only grant the motions on an interim basis and give creditors additional time to object. Nevertheless, the debtor has had the advantage of presenting its case to the court and setting the tenor it wishes to follow. On all of these issues, a prudent debtor will meet with representatives of the UST’s office prior to the case filing to resolve any potential problems as well as outline the parameters of the case.

1. The Franchisor’s Analysis

From the franchisor’s perspective, two points are important. First, is quick action; cases vary with respect to how much advance notice of the bankruptcy the franchisor may have. As soon as it has notice, the franchisor needs to take immediate action internally to notify personnel that the automatic stay is in effect and all collection-related, termination-related actions must cease. All documents, e-mails, and correspondence relating to the debtor should be preserved.

The franchisor should take immediate steps to become involved in the bankruptcy process, even if no more than obtaining notice. The decision to hire outside counsel should be made immediately. Courts vary from jurisdiction to jurisdiction as to

48 See infra, Section VII B.

4127158v1(99999.1)
their requirements for having local counsel be associated or whether in-house or out-of-town counsel can appear pro hac vice. It is often a wise choice to hire local counsel who is familiar with the nuances of local procedures and practices (see Section A2 above Know Thy Judge). In any event, a “notice of appearance” should be filed in the case immediately. All bankruptcy courts have electronic filing, and in fact, most will not allow paper filing. The court’s website will typically give instructions on how to file electronically. Filing the notice will trigger e-mail notice of all filings in the case.

The second point is analysis. In some respects the franchisor must make a similar analysis to that made by the debtor in deciding to file. Is this a viable reorganization? Are previous monthly defaults an indication that cash is going to be a problem without an immediate infusion of capital? What position is the lender taking?

The easiest way to analyze the situation quickly is to engage in conversation with debtor’s counsel and counsel for the lender.

What should permeate all decision making is the recognition that the bankruptcy court is a court of equity with broad injunctive powers. A franchisor could damage its case by being too aggressive at the beginning of the case and offending that sense of balance.

Prior to a bankruptcy filing, a franchisor may be posed with the decision of accepting payments which may be considered “preferential.” A payment to an unsecured creditor made ninety days prior to the case may be recovered by the bankruptcy estate if it was made out of the ordinary course of business while the debtor was insolvent and which allows the creditor to receive more than it would receive in a liquidation of the debtor. For the most part, practitioners will advise that the franchisor accept the payments despite the fact they may be later subject to disgorgement. The case may change in one form or fashion and the payment may never be attacked or can be negotiated down.

Finally, a franchisor may be asked to serve on the Unsecured Creditors’ Committee (see Section VIIIB below). This may seem appealing at first since the Committee often has a great deal of sway in the case. However, it can present a number of conflicts for a franchisor. The franchisor will need to be able to be flexible and may need to side with the debtor or the lender or with unsecured creditors and that position cannot be known at the first of the case. It is probably advisable to decline the invitation.

2. Impact on an Existing Receivership

Most debtors will choose to file before a receiver is appointed to avoid the cost of litigating or even participating in the receivership hearing, but nothing prevents a debtor from filing after the appointment. Bankruptcy Code § 543 requires a custodian such as a receiver to turnover property to the debtor after the commencement of the case. Still, many lenders will file an expedited motion with the court to leave the receiver in place. This is the equivalent in many respects of appointing a trustee and thus, there must be a showing of “cause” for this relief. From practical experience, courts often give deference to the lender in this regard, and the burden seems somewhat relaxed. In any event, a franchisor should be cognizant of such a motion (which again, probably will be filed on an expedited basis) and determine whether it wants to take a position.
3. **Cash Collateral**

As explained previously, once the case is filed, the debtor is restricted from spending cash collateral unless the lender consents or the court permits such use after notice and a hearing. In the absence of an agreement with the lender, the debtor must file a motion seeking authority to use cash collateral. Typically, the debtor will include a budget and will describe its means by which it intends to “adequately protect” the lender. This is essentially compensation for a decline in the value of the collateral. Courts are reticent to deny the use of cash collateral, which would effectively shut down the debtor’s operation. Instead, they usually will grant at least on an interim basis, the authority for the debtor to pay necessary expenses in the ordinary course so that business can continue uninterrupted.

From a practical standpoint it is rare in a large case that the debtor and its lender will not have reached some agreement as to the use of cash collateral by the time the case actually files. In most instances, however, in exchange for granting use, the lender has extracted a number of concessions from the debtor such as an agreement that the lender’s liens are valid and perfected that the debtor cannot seek a surcharge,49 that the debtor’s payment to professionals are capped, and that avoidance actions are subject to the lender’s lien.50 This stipulation between lender and debtor requires court approval in that the debtor is giving up many of its rights, and this could have a detrimental effect on other creditors. From a franchisor’s perspective, it is important to make sure franchise payments are addressed in the cash collateral budget.

Even if the cash collateral hearing (or other first-day motion for that matter) is not particularly critical for the franchisor, it may provide a good opportunity to appear as a player in the proceedings and educated the judge as the franchisor’s position. The franchisor certainly holds a key interest, albeit it perhaps a neutral one, and that fact may carry significant weight with the judge.

4. **DIP Financing**

In many instances, the debtor will have obtained financing for its continued operations and specifically to fund the cost of the bankruptcy. The lender will likely insist that the financing be implemented post-petition, which requires court approval. The benefit to the lender is that it may have the opportunity to obtain additional collateral or validate its pre-petition liens, all of which is “blessed” by the court. If these actions were taken pre-petition, the risk is that they would be set aside in a subsequent bankruptcy filing.

In exchange for providing the financing, the lender will require a number of agreements from the debtor much as described above in the section on cash collateral, i.e. liens are valid, use of funds is limited and so forth. DIP financing requires court

---

49 Bankruptcy Code § 506(c) provides that the debtor may recover from property securing an allowed secured claim, the necessary costs and expenses of preserving or disposing of such property to the extent it benefits the holder of the claim. This is referred to as “surcharging the collateral.” See Compton Impressions, Ltd. v. Queen City Bank, N.A. (In re Compton Impressions, Ltd.), 217 F.3d 1256, 1260 (9th Cir. 2000).

50 The debtor (or a third party if approved by the court) can seek on behalf of the estate to recover preferential or fraudulent transfers made by the debtor prior to the commencement of the case. These are referred to as “avoidance actions” and are codified in Bankruptcy Code §§ 544, 547, 548 and 549.
approval. If the court approves the financing at the first-day hearing, even if only on an interim basis, it will typically allow the lender to provide funding and will grant it security and other protections for the amount actually loaned.

5. Other Motions in the First-Day Package

Creditors will receive a number of motions in the “first-day package,” many of which may not be particularly critical to a franchisor. However, the typical motions are outlined below to give an overview of what will probably be presented to the court.

a. Pre-petition Wages and Other Employee Benefits

Since the debtor is restricted from paying pre-petition debts, employees become creditors for the amount of wages and other benefits which remain due at the time of filing. It is essentially a timing issue in that even on the day payroll is paid, employees have accrued time for the subsequent pay period. Despite the technical requirement that these pre-petition creditors should not be paid, courts recognize the extreme hardship this cause to employees who simply cannot afford to miss a paycheck. There is no provision in the Bankruptcy Code that allows these payments, but it is justified on the basis that ultimately, in a plan or a liquidation wages would be entitled to a priority claim up to $10,000, which would be paid before general unsecured creditors.

The goal is to maintain as much as possible the status quo as it pertains to employees to maintain ongoing operations. Clearly, an exodus of employees or a decline in morale would have a detrimental impact on the business and possible reorganization.

b. Utilities

A utility cannot discontinue service on the basis of the commencement of a bankruptcy case or a past due debt; however, it may do so unless the debtor, within 20 days of the filing furnishes adequate assurance of payment. This may be in the form of a cash deposit, letter of credit, certificate of deposit, surety bond, prepayment, or mutually agreed security. A utility may offset against pre-petition charges any security deposit it has at the time of the bankruptcy filing. The debtor’s first-day motion is often a request for the court to establish procedures to address the issue of providing adequate assurances. Requiring large deposits may pose a significant cash drain at the beginning of the case. Negotiations may entail increased payments over time or a mechanism for default if certain threshold payments are not made.

Bankruptcy Code § 364 provides the mechanism for financing. The debtor may obtain unsecured credit in the ordinary course of business without court approval or outside the ordinary course with approval, and the lender then has an administrative claim against the estate. If the debtor cannot obtain credit in this manner, it may seek credit which is entitled to priority over all administrative expenses, secured by a lien on collateral not already subject to a lien, or secured by a junior lien on collateral subject to a lien. The debtor may also seek a so-called “priming lien” to secure new financing. The lien may be equal to or senior to existing liens so long as those creditors’ positions are adequately protected.


The term “utility” is not defined in the Bankruptcy Code. See In re Erving Indus., Inc., 432 B.R. 354, 363 (Bankr. D. Mass. 2010) (noting the term ordinarily refers to a “business organization performing a public service and subject to special governmental regulations”) (citing One Stop Realtor Place, Inc. v. Allegiance Telecom, Inc. (In re One Stop Realtor Place, Inc.), 268 B.R. 430, 436 (Bankr. E.D. Pa. 2001)).

c. **Continuation of Cash Management Systems**

The UST Guidelines require that the debtor close all of its bank accounts and open new ones with the designation “Debtor-in-possession.” The required accounts include general, payroll, and tax accounts. In the case of a large franchisor with multiple accounts and an intricate system of deposits and payments, one can imagine the havoc if this requirement was enforced. Thus, the debtor will seek as part of its first-day motions the ability to maintain its cash systems in place. The UST may require certain controls and reporting. Again, the goal is to maintain the transition into bankruptcy as seamlessly as possible.

d. **Honoring Coupon and Gift Certificate Obligations**

From a technical standpoint, a customer who holds a coupon or gift certificate for the debtor’s merchandise is a general unsecured creditor because the debtor is indebted to the customer. Certainly, a failure to honor these obligations would have a devastating affect on customer relations. The debtor will seek authority to honor coupons and gift certificates to avoid these negative consequences.

e. **Payment of Pre-petition Creditors**

After the filing, trade vendors are not required to continue doing business with the debtor (unless pursuant to an actual contract) and may suspend service or supply based on the fact they are owed pre-petition payment. If these vendors can be characterized as “critical,” that is, the absence of which would severely hinder the debtor’s business, the debtor may request the court to allow payment of their pre-petition debt. This kind of relief is highly scrutinized because the debtor is seeking payment of some unsecured creditors and not others.\(^{55}\) The debtor must show it cannot otherwise obtain the service or product from another vendor and that its business would suffer extreme damage.

f. **Reclamation**

To the extent that a party has sold goods in the ordinary course of its business to the debtor pre-bankruptcy, it may have rights to reclaim the goods if the debtor received the goods while insolvent and the reclaiming creditor makes a written demand for reclamation.\(^{56}\) The reclaiming creditor will be entitled to an administrative expense claim and so for purposes of first-day motions, the debtor will typically ask that such a claim be granted in lieu of returning the goods.

\(^{55}\) See *In re KMart Corp.*, 359 F.3d 866 (7th Cir. 2004); see also, *In re Coserv, L.L.C.*, 273 B.R. 487, 493 (Bankr. N.D. Tex. 2002); *In re Comer Home Care, Inc.*, 438 B.R. 122, 127 (Bankr. W.D. Ken. 2010). The critical vendor motion is rooted in the doctrine of necessity, but more recently has been used to balance the interests between debtors and reclaiming creditors. See *In re Comer Home Care, Inc.*, 438 B.R. at 126-27 (“vendors would not be able to ask for special treatment and debtors would not be bullied or manipulated by overreaching creditors”).

\(^{56}\) 11 U.S.C. § 546(c). In addition, reclaiming creditors will be entitled to an administrative claim under 11 U.S.C. § 503(b)(9) even if written notice was not given and this may obviate the need to include reclamation issues as part of the first-day motions. See *In re Dana Corp.*, 367 B.R. 409, 415 (Bankr. S.D. N.Y. 2007).
g. **Approval of Professionals**

All of the debtor's professionals must be approved by the court and these applications are usually presented as part of the first-day motions. Included are attorneys, financial consultants, appraisers, and investment bankers. Professionals must seek court approval of all fees and costs. The initial approval of professionals is often on an interim basis to allow creditors to review their employment applications and disclosures of conflicts and compensation. The Bankruptcy Code permits fee applications every 120 days; however courts generally will allow professionals in a large case to seek interim compensation on a monthly basis.\(^{57}\)

V. **THE FRANCHISE AGREEMENT**

A. **Considerations Regarding the Status of the Franchise Agreement**

1. **Business Decision as well as a Legal One in Terms of the Franchisor's Desired Continuation with the Agreement**

As discussed herein, the franchisor will have specific powers and tools at its disposal to leverage favorable result in the bankruptcy proceeding. The franchisor, however, will need to carefully utilize these tools in order to achieve a business resolution. In almost all circumstances, the franchisor will have the legal ability to withhold consent to the sale and assignment of the franchise agreement to a third party. In several jurisdictions, the franchisor will also have the ability to prevent the franchisee from continuing to reorganize around the franchise agreement, irrespective of whether there is a contemplated assignment to a third party.

In these circumstances, the franchisor essentially as "veto power" over several aspects of a debtor's bankruptcy case. An aggressive use of this power can result in the failure of the reorganization, the possible creation of "dark" location(s) where the franchisee previously operated, and the minimization of any recoupment of monetary losses the franchisor may have sustained as a result of the franchisee's breaches. Therefore, the franchisor must always consider the business ramifications of the legal actions it may choose to take in the bankruptcy case.

2. **Valid Termination Pre-Petition**

The question of whether the franchise agreement has terminated (either before the bankruptcy or by its own terms thereafter) is crucial because the answer determines whether the debtor has power to assume and/or assign the agreement (subject to the limitations discussed herein), and also whether the debtor can continue to operate under the agreement pending a decision to assume or reject.

If a franchise agreement is set to expire by its own terms, but before the expiration date the franchisee files a bankruptcy petition, the automatic stay has no effect: at the end of the contract term the agreement will terminate. Courts have held that "[t]he automatic stay does not toll the mere running of time under a contract, and thus it does not prevent automatic termination of the contract."\(^{58}\)

---


If, however, the franchise agreement is not simply expiring, but rather is set to terminate if the franchisee does not cure defaults by a certain date, an intervening bankruptcy petition (and the automatic stay that comes along with it) will operate to freeze the parties' rights as of the moment of filing and prevent the termination of the agreement.\footnote{In re Tudor Motor Lodge Assocs., L.P., 102 B.R. 936, 951 (Bankr. D. N.J. 1989).} If the franchise agreement had already terminated as of the petition date (due to the franchisee's failure to cure defaults by a date certain or otherwise), however, it cannot be revived.\footnote{City Auto, Inc. v. Exxon Co., 567 F. Supp. 567, 569 (E.D. Va. 1992).}

Because a violation of the automatic stay can subject the offender to sanctions, a franchisor who believes that the franchise agreement validly terminated pre-petition should nevertheless seek such a determination from the bankruptcy court (even in relatively clear-cut cases). If the debtor continues to operate under the franchise agreement after what the franchisor believes was a pre-petition termination, it will nevertheless be necessary to seek relief from the automatic to take the necessary action to prohibit such use.

B. Executory Contracts in General

1. What is an Executory Contract?

Section 365(a) of the Bankruptcy Code states that "the trustee, subject to the court's approval, may assume or reject any 'executory contract' or unexpired lease of the debtor." However, the Bankruptcy Code does not define "executory contract." In determining whether a contract is executory, courts typically consider whether "the obligation of both the bankrupt and the other party [under] the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."\footnote{See Vern Countryman, Executory Contracts in Bankruptcy: Part I, 57 Minn. Law Review 439, 460 (1973).} In other words, an executory contract is one that has substantial performance remaining on both sides. As set forth herein, almost every franchise agreement, with the related license to use the franchisor's intellectual property, will be considered an executory contract.

2. Debtor's Options:

a. Assumption

The debtor may assume an executory contract and retain the benefits of the contract. However, as set forth above, if the contract has been effectively terminated prior to the bankruptcy filing, the debtor cannot revive the contract. A terminated contract is no longer executory.\footnote{Norton Bankruptcy Law and Practice 3d §46:17} 

If the debtor is in default under the executory contract, it may not assume the contract unless it does the following:

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default...
(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from default; and

(C) provides adequate assurance of future performance under such contract or lease.\textsuperscript{63}

Thus, the debtor is permitted to keep those executory contracts that will be most beneficial to its reorganization, in the case of a chapter 11 filing, or that can be sold/assigned to generate value for distributions to creditors, in the case of either a Chapter 7 or Chapter 11 filing.

Notably, in assuming a contract, the debtor must assume the agreement in its entirety. The debtor is not permitted to assume beneficial portions of a contract while rejecting less satisfactory parts.\textsuperscript{64} However, where a single contract is comprised of two or more severable agreements, the debtor may be able to accept some and reject others.\textsuperscript{65}

A debtor's decision to assume an executory contract must be carefully made. If a contract is not assumed but is rejected, the damages resulting from the rejection or breach constitute prepetition unsecured claims against the estate. However, if a debtor assumes an executory contract and then defaults, the claim is a postpetition claim generally entitled to payment in full.\textsuperscript{66}

b. Assumption and assignment

Not only may a debtor choose to assume or reject an executory contract, but in some instances the debtor is also permitted to assign the executory contract to a third party regardless of whether the agreement prohibits assignment.

To assign a contract, the debtor must first assume the contract in accordance with all the provisions of Section 365 as set forth above, and also provide adequate assurance of future performance by the assignee, irrespective of whether the debtor has defaulted.\textsuperscript{67}

c. Ability to Override Anti-Assignment Provisions (but see below discussion of Franchisor's Veto Power)

Provisions in an executory contract or unexpired lease which prohibit, restrict or condition a debtor's ability to assign are rendered unenforceable by section 365(f)(1) of the Bankruptcy Code. Section 365(f)(1) generally covers express anti-assignment provisions, and states that "notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions

\textsuperscript{63} 11 U.S.C. § 365(b)(1).
\textsuperscript{64} \textit{In re Camptown, Ltd.}, 96 B.R. 352, 355 (Bankr. M.D. Fla.); \textit{In re Cutters, Inc.}, 104 B.R. 886, 888 (Bankr. M.D. Tenn. 1989).
\textsuperscript{65} \textit{Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.}, 83 F3d 735 (5th Cir. 1996).
\textsuperscript{67} 11 U.S.C. §§ 365(b) and (f).
the assignment of such contract or lease, the trustee may assign such contract or lease... This ability to override contractual provisions is a powerful tool to enhance the value of a debtor's assets.

An express exception to this general rule negating anti-assignment provisions is found in section 365(c)(1), which provides that a trustee or debtor may not assume or assign a contract if “applicable law” (i.e., non-bankruptcy law) prohibits its assignment. Thus, regardless of whether a contract expressly prohibits assignment, a trustee or debtor may not assume or assign the contract if, for example, it is a license to use certain intellectual property or another type of contract that cannot be freely assigned outside of bankruptcy. This issue is discussed in detail in the section below dealing with the Franchisor’s veto powers.

d. Rejection

If a debtor determines a contract is more burdensome than beneficial, it may choose to reject that contract rather than assume it. Rejection does not terminate the contract, but rather constitutes a breach of the agreement. This is an important distinction where a third party has an interest in a lease, such as a lender with a leasehold mortgage covering a leasehold interest. Otherwise, if the rejection also terminated the lease, then the lender’s interest in the lease would also terminate, resulting in a forfeiture of the lender’s interest.

Upon rejection, the counter-party to the rejected contract has a pre-petition claim against the debtor’s estate for breach of contract damages. The claim is deemed to have accrued pre-petition even though the rejection actually occurred following the bankruptcy filing.

C. The Franchisor’s Veto Power: Specific Considerations Regarding Assumption or Assignment of the Franchise Agreement

1. The Debtor Cannot Assign it’s Franchise Agreement to a Third Party without the Franchisor’s Consent

As set forth above, the Bankruptcy Code allows a debtor to assume, or assume and assign, an executory contract if it cures all defaults under such contract and provides adequate assurance of future performance thereunder. A debtor is generally

---

69 The 2005 amendments to the Bankruptcy Code narrowed a debtor's ability to override certain anti-assignment provisions. The amended version of section 365(b)(1)(A) provides that a default relating to a debtor's nonmonetary obligations under an unexpired lease of real property must be cured "by performance at and after the time of assumption in accordance with such lease." Thus, while section 365(b)(1)(A) does not prevent a debtor from assuming and assigning a commercial real estate lease under which the debtor previously breached its nonmonetary obligations, it does require that a default arising from a failure to operate in accordance with the terms of the lease must be cured at the time of the assumption, and that any assignee abide by such nonmonetary obligations thereafter. Under this amendment, a debtor desiring to assume and/or assign a commercial real estate lease with respect to which it had defaulted under a "go dark" provision should be prepared to turn the lights back on as a condition to assumption and/or assignment. See 3 Collier on Bankruptcy ¶ 365.05[3][C](15TH Ed. 2008).
71 11 U.S.C. § 365(g).
72 Cont'l Airlines v. O'Neill (In re Cont'l Airlines), 981 F.2d 1450 (5th Cir. 1993); 11 U.S.C. § 502(g).
granted these rights notwithstanding contractual provisions which restrict the assignment of such agreement.\textsuperscript{73}

Nevertheless, the Bankruptcy Code restricts a debtor's right to assign a contract to a third party if applicable law would bar its non-consensual assignment outside of bankruptcy. Specifically, Section 365(c)(1) of the Bankruptcy Code provides, in relevant part:

The trustee \textit{may not assume or assign} any executory contract . . . of the debtor, whether or not such contract . . . prohibits or restricts assignment of rights or delegation of duties, if −

(1) (A) applicable law excuses a party, other than the debtor, to such contract . . . from accepting performance from or rendering performance to an entity other than the debtor . . . ; and

(2) such party does not consent to such assumption or assignment.\textsuperscript{74}

"Applicable law" which excuses the non-debtor party under the agreement (i.e., the franchisor) from accepting performance from or rendering performance to a entity other than the debtor (i.e., the debtor's assignee) has been uniformly held to include the laws governing intellectual property, such as trademark\textsuperscript{75} (including the Lanham Trademark Act\textsuperscript{76}), copyright,\textsuperscript{77} patent,\textsuperscript{78} and certain other laws.\textsuperscript{79}

The cornerstone of all franchise agreements is the franchisor's grant of a revocable license to use certain of its intellectual property and other proprietary information, such as a combination of trademarks, service marks, trade names, copyrights and/or trade secrets. Thus, since a franchisor can prevent the unauthorized use of its trademarks or other intellectual property under applicable law, the restriction on assignment under section 365(c)(1) will apply to franchise agreements.

\textsuperscript{73} 11 U.S.C. § 365(f)(1).
\textsuperscript{74} 11 U.S.C. § 365(c)(1).
\textsuperscript{76} 15 U.S.C. § 1051 \textit{et seq.} The Lanham Act defines a "trademark" as "any word, name, symbol or device, or any combination thereof . . . used by a person . . . to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown." 15 U.S.C. § 1127. The Lanham Act affords many protections to the owner of a trademark. For example, a party can be held liable for infringing a trademark when it "without the consent of the registrant . . . use[s] in commerce any reproduction . . . of a registered mark in connection with the sale . . . of any goods." 15 U.S.C. § 1114. Also, a party can be held liable for civil damages if he "uses in commerce any . . . word . . . symbol . . . which . . . is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services or commercial activities by another person." 15 U.S.C. § 1125.
\textsuperscript{77} \textit{In re Sunterra Corp.}, 361 F. 3d 257 (4th Cir. 2004).
\textsuperscript{78} \textit{In re Catapult Entm't, Inc.}, 165 F.3d 747 (9th Cir. 1999).
\textsuperscript{79} \textit{In re St. James Cable Partners, L.P.}, 27 F.3d 534 (11th Cir. 1994) (Right of municipality to use state law to prohibit the assignment of a contract held to be "applicable law"); \textit{In re W. Elecs., Inc.}, 852 F.2d 79 (3d Cir. 1988) (Government's right to consent to assignment of governmental contract under the Anti-Assignment Act held to be "applicable law").
Therefore, a debtor/franchisee will not be able to assign or otherwise transfer its franchise agreement to a third party without the franchisor's express consent.

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?**

Section 365(c)(1) is clear that a contract may not be assigned if "applicable law" would bar its assignment to a third party outside of bankruptcy.

However, there is disagreement among some circuit courts of appeal as to whether section 365(c) applies to the assumption of a contract even if the debtor has not yet decided to, or never will, assign the contract. Thus, reading the words "may not assume or assign" in the disjunctive (i.e., the act of assumption is separate from the act of assignment), section 365(c) can be read to bar the assumption of a franchise agreement because applicable law bars the non-consensual assignment of the agreement. The dual interpretations of section 365(c) have resulted in the formation of two different approaches: the hypothetical test and the actual test.

a. **The Hypothetical Test: The Franchisor May Veto Assumption of the Franchise Agreement Irrespective of the Debtor's Intention to Assign**

Courts that apply the hypothetical test base their decisions on a plain reading of the literal language of Section 365(c)(1), and preclude a debtor from assuming an intellectual property license where the debtor is prohibited under intellectual property law from assigning the license agreement to a hypothetical third party, whether or not the debtor actually intends to assign the agreement to a third party following its assumption.  

Applying the hypothetical test, or the disjunctive test, the court will ask: If a debtor would be precluded from hypothetically assigning an agreement under applicable law, then it is also precluded from assuming such agreement in its bankruptcy case.

To date, the Third, Fourth, Ninth, and Eleventh Circuit Courts of Appeal have adopted the hypothetical test with respect to license agreements or other executory contracts.  

These cases provide significant protection to a franchisor (or a licensor of intellectual property) that desires to retain complete control over the identity of its franchisees, including whether the franchisee should be permitted to continue to use the franchisor's intellectual property once it has become a debtor in a Chapter 11 case. If

---

80 Section 365(c)(1) is written in the disjunctive: a debtor "may not assume or assign" a contract if non-bankruptcy law precludes its assignment without consent of the other party.

81 *In re Sunterra Corp.*, 361 F. 3d at 257; *In re Catapult Entmt', Inc.*, 165 F.3d at 747; *In re St. James Cable Partners, L.P.*, 27 F.3d at 534; *In re W. Elecs., Inc.*, 852 F.2d at 79. See also *In re Wellington Vision, Inc.*, 364 B.R. 129 (Bankr. S.D. Fla. 2007); *In re N.C.P. Marketing Group, Inc.*, 337 B.R. at 230.
the franchise agreement is essential to the reorganization of the debtor, the franchisor in these circumstances essentially have veto rights over the Chapter 11 case.\textsuperscript{82}

On the other hand, the hypothetical test has been subject of criticism. The draconian reality of the hypothetical test is that even when the debtor indicates no interest in assigning the agreement, assumption is prohibited if assignment is prohibited. While those courts construe the literal language of the Bankruptcy Code, such decisions seemingly jeopardize a debtor's ability to successfully reorganize without the express consent of the franchisor or the owner of the intellectual property rights at issue.\textsuperscript{83}

b. The Actual Test: Assumption Prohibited Under Section 365(c)(1) only if there is an Actual Proposed Assignment

The actual test provides that if the debtor has no intent to assign the executory contract to a third party, then it can be assumed so long as it meets the other traditional requirements of Section 365 (i.e., defaults are cured and adequate assurance of future performance is provided). Under this approach, the courts will make "a case-by-case inquiry into whether the non-debtor party . . . actually was being 'forced to accept performance under its executory contract from someone other than the debtor party with whom it originally contracted.'\textsuperscript{84} These courts read the disjunctive "or" in section 365(c)(1) as the word "and".\textsuperscript{85} The actual test requires that the debtor actually proposes an assignment before the courts will preclude an assumption in the first instance under in section 365(c)(1).

The actual test has been adopted by only the First and Fifth Circuit Courts of Appeal.\textsuperscript{86} However, a substantial number of lower courts have applied the actual test.

\textsuperscript{82} In fact, a licensor of intellectual property can prevent the debtor/licensee's assumption of the agreement in these jurisdictions - even if the licensor consented to the assignment of the agreement pre-petition. For example, in Sunterra, even though the licensee was permitted pursuant to the terms of the subject software license agreement to assign the license agreement to a successor in interest that acquires substantially all of the licensee's assets, the licensee was precluded from assuming the license agreement pursuant to Section 365(c)(1). The Fourth Circuit reasoned that the consent to assignment did not operate to render the license agreement assumable because the consent made no reference to assumption of the agreement under Section 365. Sunterra Corp., 361 F. 3d at 270-271. Accordingly, in a case in the Fourth Circuit involving application of Section 365(c)(1), even where a license agreement is freely assignable by the licensee in accordance with its terms, the license agreement cannot be assumed by the debtor if the agreement does not include language that expressly authorizes the licensee to assume the agreement under Section 365.

\textsuperscript{83} For example, the Supreme Court stated in denying the petition for certiorari in N.C.P. Marketing: "The hypothetical test is not, however, without its detractors. One arguable criticism of the hypothetical approach is that it purchases fidelity to the Bankruptcy Code's text by sacrificing sound bankruptcy policy. For one thing, the hypothetical test may prevent debtors-in-possession from continuing to exercise their rights under nonassignable contracts, such as patent and copyright licenses. Without these contracts, some debtors-in-possession may be unable to effect the successful reorganization that Chapter 11 was designed to promote. For another thing, the hypothetical test provides a windfall to nondebtor parties to valuable executory contracts: If the debtor is outside of bankruptcy, then the nondebtor does not have the option to renege on its agreement; but if the debtor seeks bankruptcy protection, then the nondebtor obtains the power to reassign - and resell at the prevailing, potentially higher market rate - the rights it sold to the debtor." 129 S.Ct. at 1577.

\textsuperscript{84} Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493 (1st Cir. 1997).
\textsuperscript{85} Id.
\textsuperscript{86} Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608 (1st Cir. 1995); Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d at 493. The Fifth Circuit adopted the "actual test" for purposes of construing Code section 365(e)(2)(A)'s exception to the prohibition against enforcement of ipso facto clauses. Bonneville
outside of the hypothetical test circuits.\textsuperscript{87}

Of course, the actual test is not without criticism. It may be argued that the actual test aligns Section 365(c) with sound bankruptcy policy only at the cost of departing from at least one interpretation of the plain text of the law.\textsuperscript{88}

3. **Ipso Facto Termination Clauses**

Section 365(e) invalidates bankruptcy "ipso facto" default clauses (clauses which trigger a default or contractual modification upon the insolvency or bankruptcy of the debtor). Thus, subject to the exceptions set forth in Section 365(e)(2), a clause in an agreement which provides for the termination, default or modification of a franchisee’s rights upon the filing of bankruptcy case would be unenforceable in the franchisee’s bankruptcy proceeding.

An exception to this rule is contained in Section 365(e)(2)(A)(i), which provides that the prohibition on *ipso facto* clauses in Section 365(e)(1) does not apply to an executory contract as to which applicable law excuses the non-debtor party from accepting performance from or rendering performance to a third party. This is the same exception that applies under Section 365(c) to exclude certain types of executory contracts from assignment and, possibly, assumption under Bankruptcy Code Section 365. Thus, if a license agreement cannot be assumed or assigned by a debtor licensee pursuant to Section 365(c)(1) on the basis that applicable law excuses the non-debtor party from accepting performance from or rendering performance to the debtor, an *ipso facto* termination clause in such license agreement is not rendered unenforceable by Section 365(e)(1) and should be enforceable by the non-debtor party, subject to the provisions of Section 362 that may automatically stay the enforcement of such termination clause until relief from the automatic stay is obtained from the bankruptcy court.

VI. **SALE OF ASSETS IN CHAPTER 11 PROCEEDINGS**

Generally, the sale of company’s assets or business in bankruptcy is accomplished in two ways: (1) through a sale by motion – typically in connection with a

---

\textsuperscript{87} *Power Admin. v. Mirant Corp. (In re Mirant Corp.),* 440 F.3d 238, 248–249 (5th Cir. 2006) (rejecting the hypothetical approach to Code section 365(c)(1) and holding that “*ipso facto*” clauses are saved and remain enforceable under Code section 365(c)(1) if the non-debtor party is excused from accepting performance from a trustee or assignee). Although the Section 365(e)(2) language at issue in Mirant differs in certain respects from the relevant language of Section 365(c)(1), the reasoning of the Fifth Circuit in Mirant suggests that the result would be the same under Section 365(c)(1).

\textsuperscript{88} *In re Footstar, Inc.*, 323 B.R. 566, 569 (Bankr. S.D.N.Y. 2005).

Another variation of the actual test has developed over the past few years, which focuses on the use of the term “trustee” in section 365(c). In the case of *In re Footstar*, 323 B.R. 566 (Bankr. S.D.N.Y 2005), the court, unlike other courts that have addressed this issue, applied the plain meaning rule of statutory construction in reaching its conclusion that the “actual test” applies under Section 365(c)(1). The court based its conclusion on the finding that the term “trustee”, when used in Section 365(c)(1), could not logically mean the “debtor in possession”. *Id.* at 572. The court reasoned that because the Bankruptcy Code does not state that the words “trustee” are to be construed to mean ‘debtor’ or ‘debtor in possession,” it makes sense to prevent the trustee from assuming or assigning a contract, but not the party that originally entered into the contract with the nondebtor. *Id.* Thus, “where the debtor in possession seeks to assume, [section] 365(c)(1) does not prohibit assumption of the contract by the debtor in possession and cannot operate to allow the non-debtor party to the executory contract to compel the Debtor to reject the contract.” *Id.* While the rationale is different, the *Footstar* line of cases seems to play out the same as the actual test so long as no trustee has been appointed.
court approved auction - pursuant to Section 363 of the bankruptcy code (a "363 Sale") or (2) by through a plan of reorganization (a "Plan"). An auction conducted under a 363 Sale is generally an expeditious process used to acquire assets that are rapidly losing value. In contrast, buying a business through a Plan is a more deliberate and time-consuming process including the development of a plan of reorganization, soliciting votes on the plan and confirming the plan pursuant to a court order.

Chapter 11 sales - whether through a 363 Sale or a Plan - are highly attractive for a number of reasons, including the following:

A. **Sales in Bankruptcy are Generally Free and Clear of Liens, Claims and Interests**

Perhaps the most significant benefit provided by a 363 Sale or sale under a Plan is that the purchaser can generally acquire the company's assets free and clear of substantially all interests and claims. In particular, Section 363(f) of the Bankruptcy Code provides that assets may be sold free and clear of the interests and claims of third parties if one of the following five conditions is met:

1. applicable non-bankruptcy law permits a sale of the assets free and clear of such interests;
2. the interest holder consents;
3. the interest is a lien and the price for the property is greater than the aggregate value of all liens on such property;
4. the interest is in a bona fide dispute; or
5. the holder of the interest could be compelled to accept a money satisfaction in a legal or an equitable proceeding.

B. **Other Benefits of Chapter 11 Sales**

1. **Purchasers Have the Ability to "Cherry Pick" Favorable Contracts and Leases**

A purchaser is generally given the flexibility to choose desirable assets, including the company's executory contracts and unexpired leases (even if those contracts and leases were breached or the subject of litigation prior to the bankruptcy). Subject to the limitations discussed herein, Section 365 of the Bankruptcy Code allows a debtor to assume most contracts and leases, so long as all defaults are cured and the purchaser can provide "adequate assurance of future performance" under the contracts at issue. Alternatively, a purchaser may leave behind the company's undesirable contracts and leases which would be rejected by the debtor. Therefore, prospective purchasers can, to a significant extent, buy a debtor's business free of the obligations that had hindered

---

89 While the language of section 363 states that the assets are sold free and clear of "interests," many bankruptcy courts embrace an expansive interpretation of section 363(f) and find that such a sale can be free and clear of "claims" (i.e., successor liability) as well. See In re Trans World Airlines, Inc., 2001 WL 1820325 at *6 (Bankr. D. Del. 2001) (successor liability claims are "interests" within the meaning of Section 363(f)) aff'd 322 F.3d 283 (3d Cir. 2003); In re Lekie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996).
the company's financial performance or that are otherwise redundant assets. However, the power of a debtor to reject an unfavorable contract creates strong leverage with which to compel a counterparty to renegotiate.

2. **Ability to Bind Dissenting Shareholders**

In many instances, companies in financial distress are not able to obtain the necessary backing of their shareholders. Outside of bankruptcy, many corporate charters require majority shareholder approval before substantially all the assets of a company may be sold. The Bankruptcy Code overrides such provisions, allowing selling companies to overcome significant shareholder resistance to a sale. Bankruptcy thus makes some transactions possible when companies might otherwise lack shareholder consensus.

3. **Protection Against Fraudulent Conveyance and Successor Liability Claims**

Outside of bankruptcy, a buyer of a distressed business faces a risk if the seller closes and thereafter files a bankruptcy petition (or is the subject of an involuntary bankruptcy filing). If the seller was insolvent at the time of the sale, or became insolvent as a result of the transfer, the transaction could be subject to avoidance if the consideration paid was for less than reasonably equivalent value. The Bankruptcy Code provides a two year “look back” period for such transactions, and most states have fraudulent transfer statutes which generally provide for four year reach back periods. In bankruptcy, a representative of the bankruptcy estate (typically a trustee) can generally invoke all of the avoidance rights a creditor would have under state law (thus enhancing the look back period by two years).

For this reason, purchasers of assets from a distressed company frequently insist that the company commence a bankruptcy proceeding and consummate the transaction through bankruptcy court approval. This will insulate the purchaser from a subsequent contention that the purchaser underpaid.

Moreover, a non-judicially approved asset sale may subject a buyer to successor liability claims as being a “mere continuation” of the seller, especially where the buyer continues in the same line of business as the seller. A carefully worded bankruptcy court order approving a 363 Sale or Plan can substantially mitigate these risks and provide both the buyer and seller with significant protection against such claims.

---

92 There remains, however, the risk of successor liability claims in certain circumstances. Generally, section 363(f) of the Bankruptcy Code authorizes the sale of a debtor's property “free and clear of any interest in such property of an entity other than the estate . . . .” While the phrase “any interest in such property” is not defined by the Bankruptcy Code, the recent trend is to interpret this language broadly, so that assets can be sold free and clear of successor liability claims. See In re Chyster, LLC, 405 B.R. 84 (Bankr. S.D.N.Y 2009) (sale free of property damage and personal injury claims). But see Schwinn Cycling and Fitness, Inc. v. Benonis, 210 B.R. 747 (Bankr. N.D. Ill. 1997) (allowing successor liability for product liability claims) and Volvo White Corp. v. Chambersburg Beverage, Inc., 75 B.R. 944 (Bankr. N.D. Ohio 1987) (allowing successor liability for tort claimants). Accordingly, purchasers should always ensure that there is specific language in their sale orders stating that they are absolved of any successor liability claims.
4. **Protection Against Risk of Rejection of Sale Contract in a Subsequent Bankruptcy**

Similarly, a non-bankruptcy sale agreement can be rejected in a subsequent bankruptcy proceeding. If a bankruptcy is filed prior to closing, the purchase agreement can be deemed an executory contract subject to assumption or rejection. If rejected, the selling company will have no obligation to perform under the agreement, and the purchaser will have an unsecured prepetition claim for the damages it may have incurred from the loss of the transaction. Bankruptcy Court approval of a sale transaction will insulate the buyer from these risks.

C. **363 Sales v. Plan Sales**

The traditional method for buying and selling assets in bankruptcy is through the confirmation of a Chapter 11 plan of reorganization. Plan confirmation, however, is a complex (and often expensive) process that generally requires a significant amount of time. Even when a plan is not contested, parties need time to build consensus and adhere to the procedural formalities surrounding plan presentation and voting. If a plan is not consensual, parties will require additional time to address objections and renegotiate terms if necessary.

By contrast, a 363 Sale is designed to be expeditious. Although the marketing process and auction required before an asset of a bankrupt estate may be sold pursuant to Section 363 (discussed below) may involve some delay, the process generally will permit assets to be sold in a manner that permits buyers to acquire the assets without substantial plan related delay unrelated to the purchase. In many instances, a sale can be accomplished within thirty to forty five days from the filing of the initial sale/bid procedure motion.

Completing a sale quickly is especially important for a debtor holding assets which may decline in value if not disposed of expeditiously. In addition, a 363 Sale may attract more bidders because the uncertainty and high costs commonly associated with a sale through a Plan are not present. In particular, if the sale of assets is meant to be effectuated through a plan, it is possible that the creditors will vote to reject the plan and therefore the sale might not be approved. With a 363 Sale, creditors and shareholders are not entitled to vote on the transaction (although they will have the opportunity to object to the sale).

D. **363 Sales in General**

Asset sales that are within the ordinary course of business do not require bankruptcy court approval. Transactions that occur on a day-to-day or other routine basis, such as a retailer's sale of inventory to customers, will be considered to be in the ordinary course of business. On the other hand, the sale of a significant portion of a debtor's assets, or an otherwise large or unusual transaction, will be a sale outside the ordinary course of business requiring notice to interested parties and bankruptcy court approval under Section 363(b)(1) of the Bankruptcy Code.

---

93 In re Chicago Hudson, LLC, 345 BR 887 (Bankr. N.D. Ill 2006).
363 Sales permit debtors to sell their assets outside of the plan confirmation process, thus potentially disenfranchising stakeholders. As a result, bankruptcy courts will require a sound business purpose for the use of this process and a demonstration that a sale outside of the plan confirmation process is justified.94 The most common justifications for a 363 Sale are that the value of the assets involved will rapidly deteriorate or that the seller needs the cash from the sale to continue its remaining businesses and avoid a liquidation, which, in either case, will lead to a lower recovery for creditors.95

In addition to a sound business justification for a sale, a debtor also must demonstrate that it provided adequate and reasonable notice of the sale, that the price it obtained for the assets is "fair and reasonable," and that the parties acted in good faith.96 Thus, a proposed sale may be disapproved if the court finds that the debtor did not conduct a robust sale process.97

E. The 363 Sale Process

Buying assets out of a bankruptcy cannot be done quietly. As such, 363 Sales routinely occur through a public auction process, and typically occur in two stages. The first stage involves the debtor approving bidding and sale procedures as well as obtaining approval to proceed with a sale to a stalking horse and other bid protections. The second stage consists of the auction itself, as well as a hearing to approve the results of the auction.

To meet the requirements of section 363, courts generally require that a debtor conduct a public auction process under which all parties in interest, including all creditors, receive adequate notice of the auction and the applicable deadlines and procedures.

1. First Stage: Approval of Stalking Horse Agreement, Break-up Fee, Bid Procedures and Protections

Before making a bid in an asset sale or an acquisition, a potential purchaser must spend substantial time and resources conducting due diligence and negotiating a contract. Since a 363 Sale is subject to higher/better offers, the purchaser runs the risk of being outbid.

94 See In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) (stating that a bankruptcy judge must consider all the salient factors of the proceeding to determine if a sound business purpose exists, including "the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value"); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999).
95 In re Trans World Airlines, Inc., et al., No. 01-00056, 2001 WL 1820326, at *4 (Bankr. D. Del. 2001). In exercising its discretion in considering major sales of assets, the bankruptcy court should consider all salient factors, such as the value of the assets to be sold in relation to the estate as a whole, the effect that disposing of the assets would have on the ability to confirm a plan of reorganization and whether the value of the assets is increasing or decreasing. Id.
97 In re Exeveis, Inc., 380 B.R. 741, 744-746 (Bankr. D. Del. 2008) (motion sell assets denied where the debtor failed to present evidence of efforts to market assets to parties other than the proposed insider-purchaser).
A stalking horse offer is an initial bid by the debtor to test the market in advance of an auction. The intent is to maximize the value of the assets and to create a “bidding floor” for the auction process. In connection with entering into a stalking horse offer, the debtor can offer bidding protections such as a breakup fee to the best bidder before the auction. These incentives enhance the value of the offering for the bidder which might lead to a better offer before the auction begins. This higher offer becomes the starting point in which any other prospective buyers bid against and generally results in a benefit to the estate when competing bids are submitted.

A common, and often attractive, bid protection offered to a stalking horse is a “break-up fee”. Generally, the debtor seller agrees to provide the stalking horse with a break-up fee of a specified dollar amount or a percentage of the sale price (generally ranging between 1% and 3%) if the stalking horse’s bid attracts better offers and the debtor in fact consummates a sale to a higher bidder. The break-up fee is typically paid out of the sale proceeds. The amount of a break-up fee creates an initial bidding increment: a seller will not accept a bid lower than the sum of a stalking horse’s offer plus the break-up fee.

The first stage also entails the debtor obtaining bankruptcy court approval of other bidding procedures and protections, including: establishing a minimum “overbid” price; establishing a deadline to submit qualified bids; requiring the terms and conditions of competing bids to be the same as, or substantially similar to, those contained in the stalking horse’s purchase agreement; establishing bidding in minimal increments; requiring that the bidder who submitted next to highest bid to agree to remain bound by its bid until the winning bidder closes; and establishing the date of the auction and the hearing to approve the sale to the highest and best bidder.

2. Second Stage of the 363 Sale: Auction and Bankruptcy Court Approval

The sale process then goes forward in accordance with the court approved sale procedures. The auction is then conducted pursuant to the sale procedures. This sometimes occurs in the bankruptcy court, but is more typically done at the offices of the seller’s law firm. At the conclusion of the bidding, the seller and its advisors, together with the creditors’ committee and its advisors (if one has been appointed), will analyze the bids and will declare which bid is highest and best.

Once the winning offer is selected, the parties will appear in court on the scheduled hearing (usually the day or two after the auction) to approve the sale to the highest and best bidder. The objective of the auction process is to obtain the “highest and best” offer for the assets, thus maximizing the proceeds to the estate and, indirectly, the seller’s creditors. Note that “highest and best” does not necessarily mean the highest price but also includes non-monetary considerations such as certainty and

---

98 See e.g., In re Adelphia Comm’n Corp., 336 B.R. at 639 (approving 2.5% break-up fee on a $17.6 billion bid); In re APP Plus, Inc., 223 B.R. 870, 876 (Bankr. E.D.N.Y. 1998) (approving 1.25% break-up fee on $20 million bid); In re CXM, Inc., 307 B.R. 94, 97 (Bankr. N.D. Ill. 2004) (break-up fee of 3.2%, inclusive of expenses, on $6,254 million bid); In re Fortunoff Fine Jewelry and Silverware, LLC, No. 08-10353 (JMP), 2008 WL 618986, *47 (Bankr. S.D.N.Y. Feb. 15, 2008) (2.8% break-up fee, plus reimbursement of expenses up to additional 1.25%, on $80 million bid); In re Women First Healthcare, Inc., 332 B.R. 115, 118 (Bankr. D. Del. 2005) (2.9% break-up fee, plus reimbursement of expenses up to additional 1.9%, on $1.75 million bid).

99 See In re Food Barn Stores, Inc., 107 F.3d 558 (8th Cir. 1997); In re Abbots Dairies of PA, Inc., 788 F.2d 143, 149 (3d Cir. 1986).
speed of closing. As set forth above, the bankruptcy court will generally approve the sale if there is a sound business reason which supports the sale, interested parties and creditors were provided with adequate and reasonable notice, the sale price is fair and reasonable, and the purchaser acted in good faith.

F. Acquisition Through a Plan of Reorganization

For situations in which a 363 Sale is not undertaken, a restructuring or acquisition can be affected through a plan of reorganization. The acquisition of a company or its assets through a Plan requires an understanding of an elaborate system of rules, timetables and requirements imposed by the Bankruptcy Code and the Bankruptcy Rules. Section 1123(a)(5)(D) of the Bankruptcy Code authorizes the "transfer of all or part of the property of the estate" pursuant to a plan of reorganization. Although a purchase pursuant to a Plan may be more time-consuming, expensive and complicated than a 363 Sale, parties often proceed with this process for a number of reasons.

If transfer taxes are a significant economic concern, then the parties should consider an acquisition through a Plan. Asset sales made pursuant to a plan of reorganization are exempt from state and local transfer taxes under section 1146(a) of the Bankruptcy Code. While courts previously had split over the issue, the Supreme Court ruled in 2008 that the 1146(a) exemption is not applicable to 363 Sales not made in pursuant to a plan of reorganization.

In addition, if a 363 Sale is not possible due to an inability to meet the standard or of the purchaser does not want to be used as a stalking horse, then a sale can be done through a plan process.

As with 363 Sales, the buyer of the debtor's business pursuant to a Plan can be free and clear of claims and interests. Section 1141(c) of the Bankruptcy Code provides that "after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor."

VII. INTERACTION WITH OTHER PARTIES—*TRUISM* “Strange Bed-Fellows”

The very fact that bankruptcy is not a static process gives rise to a multiple of negotiations and deal-making between and among the various parties and constituents. During the case, alliances may change and one-time adversaries may become allies. The debtor may find it necessary to align itself with one set of creditors to ensure confirmation of the Plan. The Committee or the lender may find itself on the outside of the momentum leading to confirmation. The important point for franchisees and franchisors is to know the dynamics of who is sitting at the table.

---

100 See e.g., In re Gulf States Steel Inc., 285 B.R. 497 (Bankr. N.D. Ala. 2002) (trustee has discretion in determining which bid is the "highest and best" and may consider factors other than the dollar amount); In re Bakalis, 220 B.R. 525 (Bankr. E.D.N.Y. 1998).
102 11 U.S.C. § 1146(a) provides: The issuance, transfer or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp or similar tax.
A. The Lender

As discussed above in Section I, it is important to recognize who the lender is to gain insight into how decisions might be made in the bankruptcy. What position for example will the lender take with respect to continued payments to the franchisor, allocations for repairs and updates, continued operations by the debtor and whether the lender will simply embark on a campaign to take over the property. Again, the question becomes whether contact with or siding with the lender is prudent and the benefit of a comfort letter.

B. The Creditor’s Committee

The Bankruptcy Code provides for the appointment of an official committee to represent the interests of unsecured creditors in Chapter 11 cases. The Bankruptcy Code also permits the establishment of additional creditors’ committees or a committee of equity security holders to ensure that these constituents are adequately represented in the bankruptcy case.

In a Chapter 11 case, the largest unsecured creditors are given the opportunity to form a creditors’ committee. The United States Trustee will solicit and select committee members from the debtor’s list of its twenty largest unsecured creditors. Ordinarily, the committee will consist of either five or seven of the largest unsecured creditors.

A creditors’ committee often plays an important role in a Chapter 11 case, including (a) consulting with the trustee or the debtor-in-possession concerning the administration of the case; (b) investigating the conduct and financial affairs of the debtor; (c) investigating the operation of the debtor’s business, and determining the desirability of continued operations; (d) participating in the formulation of a plan of reorganization and making recommendations concerning the plan; and (e) requesting the appointment of a trustee or examiner if circumstances warrant such an appointment.

Depending on the case, participation in a creditors’ committee can be time consuming. Some committees meet once a week during the early days of a case and thereafter when the debtor or the committee is formulating a reorganization plan. Since different creditors may have very different views, discussions can be lengthy. Committee members have a fiduciary duty to act in the interests of unsecured creditors.

On the other hand, members of the committee typically have much more information regarding the debtor’s operations than other creditors. Committee members often are required to sign confidentiality agreements with the debtor so that they can see

105 11 U.S.C. § 1102. The Bankruptcy Code also provides for the appointment of creditors’ committees in chapter 7 cases (11 U.S.C. § 705), but they are rarely appointed since a disinterested chapter 7 trustee exists to act in the interests of creditors. Conversely, a chapter 11 debtor seeking to reorganize is primarily interested in saving its business, regardless of the effect on unsecured creditors.

106 Even if a franchisor does not hold a large unsecured claim at the time of the filing, the franchisor may be able to convince the U.S. Trustee that the creditor’s relationship is so critical to the debtor’s future operations that it should be a member of the committee. However, the franchisor (or the U.S. Trustee) may decide that it does not share the same interests as other unsecured creditors and would have a conflict in serving on the committee. This is particularly true if the debtor and/or the franchisor expect the franchise agreement to be assumed (which would require the full payment of any pre or post-petition claims).

nonpublic information. In addition, the committee can influence the direction of the Chapter 11 case. If the committee strongly opposes certain provisions of a plan or other actions taken by the debtor during its case, the court will listen to these objections more seriously than if they are raised by a single creditor.

C. Equity Interests

In many small cases, the owners of the company have a personal stake in that they often have contributed or loaned money to the enterprise and guaranteed a substantial portion of its debt. As indicated previously, the principals of the company who are making decisions on behalf of the entity owe a fiduciary obligation to the estate and its creditors. They must not be advocating their own position to the detriment of the estate. One the other hand, it is difficult to ignore their position and their interests should be reconciled as part of negotiations.

VIII. PLAN OF REORGANIZATION

The ultimate product of all of the strategies and negotiations is the plan of reorganization ("Plan"). The "reorganization" description may be a misnomer in that many plans may provide for a full or partial liquidation, sale of assets, or a complete change of equity structure. In any event, the Plan is the "contract" with creditors that is blessed by the Court and establishes how the company will go forward. For the franchisor, the plan and its confirmation will dictate the future of the business. If the plan is not confirmed, the property may revert to the lender and the franchisor must contend with a new owner.

A. Formulating and Filing the Plan of Reorganization—"TRUISM: Reprise: There is No Free Parking"

1. Exclusivity

Within the first 120 days after the case is commenced, the DIP has the exclusive right to file a Plan, a period of time known as "exclusivity." Creditors or other parties-in-interest may file a Plan if the DIP has not filed one in this timeframe, or if the debtor has not been able to obtain acceptances of the Plan within 180 days after the case is commenced. The debtor or other party-in-interest may seek an extension or a reduction of time for these two deadlines for "cause." However, the 120-day period may not be extended beyond 18 months after the case is commenced and the 180-day period may not be extended beyond 20 months. The debtor typically requests an extension if the case is large and/or complicated and additional time is required to formulate a Plan or negotiate with creditors. A party may request that Exclusivity be reduced or even terminated based on factors such as the debtor's poor performance and doubtful prospects. If it prevails, the party would have the ability to file its own Plan that may provide for better treatment of its claims than those proposed or contemplated by the debtor. Demonstrating "cause" in either case is not an easy task and requires the

---

108 Bankruptcy Code § 327 governs the appointment of counsel for the debtor. Essentially to be employed, counsel must not represent an interest adverse to the estate and must be "disinterested." Because the interests of the debtor and its principals may be conflicting, in most instances, separate counsel is required.
presentation of evidence.\textsuperscript{109} Some courts actually prefer that there be competing Plans so that creditors have alternatives.\textsuperscript{110}

The filing requirements for a Plan in a single-asset case are different. In those cases, the debtor must file a Plan within 90-days of the commencement of the case or must commence payments to the secured creditor.\textsuperscript{111}

Along with the Plan, the Plan proponent whether it is the Debtor or anther party must file a Disclosure Statement that describes the Plan in detail. The Disclosure Statement must contain a history of the debtor; the factors leading to bankruptcy; the major events in the bankruptcy proceeding; a description of all the creditors and the amount of the claims they are asserting and will usually contain financial projections and valuations to support the proposed restructure and payment plan.\textsuperscript{112} A hearing on the Disclosure Statement will be held to determine whether it contains sufficient information to allow creditors to vote on the Plan. Once the Disclosure Statement is approved by the court, the court will set a hearing date for determining whether the Plan can be confirmed and will permit any party to solicit creditors to vote in favor of or against the Plan.

The Plan, Disclosure Statement, and a ballot must be sent to creditors at least 25 days prior to the date set for confirmation.\textsuperscript{113} In small business cases, the hearing on the Disclosure Statement may be combined with the hearing on Plan confirmation, which results in a more streamlined process.\textsuperscript{114}

2. **Plan Contents**

   a. **Classification**

The Plan will place each creditor into a separate classification based on the nature of the creditor’s claim against the debtor.\textsuperscript{115} For the most part, each secured creditor is placed in a separate class because they each claim an interest in a distinct piece of collateral. Unsecured creditors are generally placed in the same class; however, if an unsecured creditor’s claim can be characterized differently from other


\textsuperscript{110} See Bank of Am. Nat’l Trust & Sav. Assoc. v. 203 N. LaSalle St. P’ship, 526 U.S. 434, 108 S.Ct. 626 (1999) where the Supreme Court found that competing plans was one way to satisfy the "absolute priority rule" codified in section 1129 (b)(2)(B)(ii) of the Code. Simplistically, this section requires that to confirm a plan, equity holders may not retain their interests unless unsecured creditors are paid in full. To satisfy this section, equity holders may provide "new value" to the debtor. However, the opportunity to provide such new value must be exposed to the market and this may be by way of a competing plan.

\textsuperscript{111} 11 U.S.C.§ 362(d)(3).


\textsuperscript{113} FED. R. BANKR. P. 2002.

\textsuperscript{114} 11 U.S.C. § 1125(f)(3)(C); While this section does not provide for combined hearings in other cases, at least one case has permitted this approach. Bankruptcy Code § 105 permits the court to set the hearing on approval of the disclosure statement combined with the hearing on plan confirmation. See In re Gulf Coast Oil Corp., 404 B.R. 407, 425 (Bankr. S.D. Tex. 2009). Or the Court may simply reduce the time for obtaining votes and set a confirmation hearing earlier.

\textsuperscript{115} 11 U.S.C. § 1122(a) "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class. The Code does not expressly state whether a plan must classify similar claims together, but the section mandates that dissimilar claims cannot be placed into the same class. See In re Loop 76, LLC, 442 B.R. 713, 716 (Bankr. D. Ariz. 2010).
unsecured claims, it may be separately classified. Examples may include a claim that is in dispute or that is guaranteed by a third party. The Plan must state whether each class is impaired or unimpaired. To be unimpaired, the holders of claims in the class must receive treatment in accordance with their pre-petition contracts or be paid in full on the Effective Date. If the Plan proposes to vary the terms of payment, the class is impaired. Unimpaired classes are not entitled to vote on the Plan and are deemed to have accepted it.

b. Treatment of Creditors

The Plan can propose payment to creditors in any number of ways. In general, secured creditors have the right to retain their liens and receive a stream of cash payments with a present value equal to the value of the secured creditor’s collateral on the filing date, or to otherwise realize the indubitable equivalent of their claims. Essentially then, secured creditors have the highest priority claims to the extent of the value of their collateral. Unsecured creditors must receive as much as they would receive if the debtor’s assets were liquidated in a Chapter 7. In many cases, the secured lender has a lien on all assets, and in liquidation, there would be no recovery for unsecured creditors. Thus, payment may be minimal or in some instances, unsecured creditors are given “hope certificates” if the company profits reach certain thresholds. One caveat is that equity holders cannot retain their interests in the company unless unsecured creditors are paid in full. This is known as the “absolute priority rule.” There is an exception to the rule if “new value” is contributed to the entity.

c. Implementation of the Plan

The Plan will describe how the debtor or Plan proponent intends to pay (or not pay) creditors as the case may be. The proposals for treatment contained in the Plan that then become the contract with creditors may be implemented by any number of means or a combination of them, such as continued as-is operations with methods for increased profitability, operations without burdensome contracts, the sale of all or a portion of the company’s assets, the infusion of capital, or the merger with another entity. The Plan will provide for an “Effective Date,” the date by which the Plan is effectuated and enforceable. The terms of the Plan may require that it be delayed pending the occurrence of certain events such as securing new financing.

d. Executory Contracts

The Plan must state whether the Plan proponent will assume or reject each of its

---

116 See e.g., In re Johnston, 21 F.3d 323 (9th Cir. 1994); In re Loop 76, LLC, 442 B.R. at 714.
117 11 U.S.C § 1123.
118 The Plan will provide for an Effective Date, the date after the Court confirms the Plan in which the Plan is effectuated and enforceable.
119 In some instances, a creditor may object that the debtor has “artificially” impaired a class so as to obtain an accepting vote from the class and be able to proceed with confirmation. (see discussion below regarding “cram down”). However, there is case law to support the impairment even if it better the creditor’s treatment. See Acequia v. Clinton (In re Acequia, Inc.), 787 F.2d 1352, 1363 (9th Cir. 1986). The argument may be that the debtor acted in bad faith.
121 11 U.S.C. § 1129(a)(7). This is referred to as the “best interest of creditors test.”

4127158v1(99999.1)

38
executory contracts and leases. As indicated above in Section V, franchise agreements will be treated in this section although they may have been previously assumed or rejected during the course of the case. If the agreement is rejected, damages will be an unsecured claim and treated with other unsecured creditors.

3. Plan Confirmation

In confirming the Plan, the debtor bears the burden of proof by a preponderance of the evidence. The requirements for confirmation are outlined in Section 1129(a) of the Bankruptcy Code. These include, for example, that the Plan must be filed in good faith and in accordance with the provisions of the Code, that it must be feasible, that it must provide to creditors at least what they would receive if the debtor was liquidated, and that it must be accepted by all classes. With respect to acceptances of the Plan, a class is considered to have accepted the Plan if fifty-one percent (51%) in number and two-thirds in amount of the ballots cast vote in favor of the Plan. If all classes do not accept the Plan, so long as at least one impaired class has accepted and so long as all of the other applicable requirements of Section 1129(a) have been met, the Plan can still be confirmed in accordance with Section 1129(b). This procedure is known as "cramdown" because it forced confirmation on creditors who have voted against the Plan. The requirements of this subsection are that the plan does not discriminate unfairly, and is fair and equitable, with respect to each impaired class that has not accepted. For a secured creditor this means it will retain its lien(s) and receive a stream of cash payments with a present value equal to the value of the secured creditor's collateral on the filing date, or to otherwise realize the indubitable equivalent of their claims. For an unsecured creditor, it means that any junior claim i.e. equity cannot receive any distribution of property or retain any interest unless unsecured creditors are paid in full.

Parties can object to any provisions in the Plan as not complying with Section 1129. The most typical objections are that the debtor did not file the plan in good faith (such as a lender who claims the case was filed on the eve of foreclosure or that it is essentially a two-party dispute between the Debtor and the lender); the Plan is not feasible because projections of income are unrealistic; the Plan does not satisfy the best interests of creditors because the assets have been undervalued; and the lender is not treated fair and equitably because the proposed term and interest rate are below market. The Court will hold an evidentiary hearing on the confirmation objections which generally require considerable expert testimony on the issues described.

124 See In re Ambanc La Mesa Ltd. P'ship, 115 F.3d 650, 653 (9th Cir. 1997).
125 11 U.S.C. § 1129(a)(3): "the plan has been proposed in good faith and not by any means forbidden by law".
126 11 U.S.C. § 1129(a)(11): "Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."
127 11 U.S.C. § 1129(a)(7) (the "best interests of creditor's test."): "With respect to each impaired class of claims or interests—(A) each holder of a claim or interest of such class—(i) has accepted the plan; or (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date."
129 In re Philadelphia Newspapers, LLC, 599 F.3d 298, 304-05 (3d Cir. 2011); In re Seasons Partners, LLC, 439 B.R. 505, 516-17 (Bankr. D. Ariz. 2010).
If the Court approves the Plan, it will issue a confirmation order. This is the document that establishes the new restructured debtor referred to as the “Reorganized Debtor.” The order often is recorded in the county recorder’s office as evidence of the transactions contemplated by the Plan.

4. Inability to Confirm

If the debtor is unable to confirm the Plan, any number of scenarios may unfold. Depending on the nature of the Plan, the court may instruct the debtor that if it makes certain modifications, such as additional capital or a different interest rate, the court will confirm the Plan. Or, the court may deny confirmation and the debtor will have to determine if it will file a new plan. Or, if the court believes there is no reasonable likelihood that a plan can be confirmed, it may convert the case to a Chapter 7. In many cases, the lender has filed a motion to lift the automatic stay, and the parties agree to let the motion track with the confirmation hearing. Upon denial of confirmation, the court may lift the stay, and the lender can proceed with its remedies, likely a foreclosure of the property.

B. The Issues for Franchisors and Franchisees—*TRUISM* “Success Means Getting From A to B”

Because bankruptcies are fluid, the strategies that parties developed prior to the filing and during the case may have changed. But, the parties should still not lose sight and focus of their overall goals – the process of “getting from A to B.”

A simple case: The LaLa Hotel I, a 75-room hotel located in LaLa, Arizona is in financial straits. It is in default with its lender, SPE-LALA which purchased the debt as part of a loan portfolio, and it is on COD with many of its vendors. SPE-LALA has commenced foreclosure proceedings. The Hotel has declined in value due mainly to the overall drop in the real estate market. It is worth about $3M and the debt is $6M. LaLa I is the franchisee of a large chain that operates hotels of this size in resort areas. The hotel is in a state of disrepair and may be in violation of the franchise agreement. The principals of LaLa Hotel I own other LaLa hotels located in California and North Carolina. They have guaranteed all of the mortgage debt.

A possible plan:
Class 1: Real Estate taxes- paid over 5 years at statutory rate of interest
Class 2: SPE-LALA secured debt of $3M-paid over 10 years at 6 percent interest
Class 3: Equipment Lender-paid in accordance with contract except term extended one month
Class 4: General Unsecured Creditors-paid 20 percent of claims over 5 years
Class 5: SPE-LALA Unsecured Claim of $3M-paid 20 percent over 5 years
Class 6: Principals’ Loans of $1M-paid over 10 years at 6 percent interest
Class 7: Principals’ Equity Interests

On the Effective Date, the SaveuLaLa will invest $1M to be used for operations and to bring the hotel up to standard. The Principals’ interests will be cancelled and SaveuLaLa will become the owner of the Reorganized LaLa Hotel I.
The questions to ask:

1. What are the initial hurdles: a) Practically, can the company survive operationally as it moves through the bankruptcy process? Can it make adequate protection payments to the lender to avoid the stay being lifted and the foreclosure occurring? Can it continue to pay the franchisor? b) Legally, can this plan of reorganization be confirmed (questions regarding separate classification, artificial impairment, good faith)?

2. How is the franchise agreement treated in the initial stages—should immediate assumption or rejection be sought? In the Plan, how is the agreement treated in the section on “executory contracts”?

3. Are the debtor’s financial projections realistic (“feasible”) depending on whether renovations or other expenditures are required by the franchise agreement?

4. Does the plan propose a change of ownership or management that triggers a default under the franchise agreement or is otherwise unacceptable?

5. With the possible filing of multiple debtors, is there a proposed substantive consolidation?

6. Should the franchisor choose sides between the lender and franchisee?

IX. CONCLUSION

The bankruptcy rules are somewhat confusing and, occasionally, contradictory. At least one commentator has concluded that this is intentional and sees another truism: “Bankruptcy punishes a failure to negotiate.” In part this is true because these rules are interpreted by courts of equity that view a successful reorganization as the goal. In a typical franchisee bankruptcy, however, the franchisor has leverage beyond the bankruptcy rules that govern executory contracts because the franchisor provides the business format and indentifying trademarks of the business and is often seen by the court as the only party with a material stake in the outcome other than the lender and the franchisee. In other words, the franchisor can be seen as the “honest broker” if the franchisor plays its part correctly. In this role, if the franchisor recognizes the goals of the franchisee and the practical constraints of a traditional lender or the contractual duties of a CMBS special servicer, there is little reason why franchisors should dread negotiations in franchisee bankruptcies.
ATTACHMENT A

[Date]

«lender_name»
«lender_street»
«lender_city», «lender_state» «lenderZipCode»

Attn: «LenderContact»

Re: «brand»
«address»
«city», «state» «zip» (the "Hotel")

Dear Lender:

«Franchisor_Licensor» ("Franchisor") has entered into a Franchise Agreement (the "Franchise Agreement") dated «exe_date» with «Franchise_Name» ("Franchisee"). The Franchise Agreement permits Franchisee to operate the Hotel as a «brand» hotel. As of this date and to the best of our knowledge and belief, the Franchise Agreement is in full force and effect and Franchisor has issued no notice pursuant to which the Franchise Agreement is currently in default (the "No-Defaults Representation").

«Lender_Name» ("Lender") and Franchisee have informed Franchisor that Lender has issued a commitment to loan funds or has loaned funds that will be used for the direct benefit of the Hotel and will be secured by the Hotel (the "Loan"). Lender and Franchisee have requested that Franchisor enter into this comfort letter, and the undersigned parties agree as follows:

1. Franchisee Default. Franchisor will copy Lender on any notice of default or termination issued to Franchisee under the Franchise Agreement. Lender shall have the right, but not the obligation, upon notice to Franchisor to cure such default on behalf of Franchisee during the time period for cure established in the default notice. Franchisor may extend Lender's right to cure for such reasonable period of time beyond the cure period established in the default notice if: (i) the default is not related to health or safety; (ii) the default is susceptible to cure by Lender; (iii) Lender notifies Franchisor of Lender's agreement to cure the default as soon as reasonably possible, but by no later than two (2) days prior to expiration of the cure period established in the default notice; (iv) all royalties, fees, charges, and other amounts due to Franchisor or any of its affiliates under the Franchise Agreement or in connection with the Hotel are kept current; (v) Lender diligently pursues cure of the default; and (vi) the Hotel is at all times operated in accordance with the Franchise Agreement, except for the specific default described in the default notice.

2. Lender Foreclosure.

A. If Lender acquires the Hotel through foreclosure, a deed in lieu of foreclosure, or through any other exercise of its rights as a secured lender, and Lender desires the Hotel to continue to be operated as a «brand» hotel, Lender may by notice and payment to Franchisor of a non-refundable $___ application fee within ten (10) days
of Lender’s acquisition elect to do either of the following, subject, in either case, to compliance with Paragraph 2.B. below:

(i) within thirty (30) days of Lender’s acquisition of the Hotel, enter into a management agreement for Franchisor (or Franchisor’s affiliated designee) to manage the Hotel on Lender’s behalf on mutually agreeable terms; or

(ii) request Franchisor to approve substitute qualified management for the Hotel pursuant to Paragraph 4. If Franchisor approves substitute management, Lender and Franchisor will execute a new «brand» franchise agreement within thirty (30) days of Lender’s acquisition of the Hotel. Such new franchise agreement shall be dated as of the date that Lender acquired the Hotel and shall be for a term equal to Franchisee’s then remaining term and shall be substantially identical to Franchisor’s then current form of agreement (as same is described in Franchisor’s then current franchise disclosure document), except that Franchisor shall not charge Lender any initial fee or require Lender to implement a new property improvement plan in connection with the execution of a new franchise agreement for the Hotel. Lender, however, shall be: (a) required to comply with any renovation or upgrading requirements that are set forth in the Franchise Agreement, (b) required to cure any quality, service or other deficiency in Franchisee’s prior performance of obligations under the Franchise Agreement, and pay Franchisor’s outside counsel costs in connection with negotiating a new agreement as part of such cure, and (c) subject to any renovation or upgrading requirements that are set forth in Franchisor’s then current form of agreement or are required of other «brand» franchisees.

B. Franchisor’s obligations under Paragraph 2.A. are subject to receipt by Franchisor of evidence, in form and substance satisfactory to Franchisor, that any party with whom Franchisor enters into a management agreement or franchise agreement pursuant to Paragraph 2.A. (including, without limitation, any and all of its directors and officers) and any of its affiliates and funding sources for any of the foregoing is not: (i) a Competitor or an Affiliate of a Competitor (as defined in the Franchise Agreement); (ii) a Specially Designated National or Blocked Person (as defined in the Franchise Agreement); or (iii) directly or indirectly owned or controlled by the government of any country that is subject to an embargo by the United States government or acting on behalf of a government of any country that is subject to such an embargo.

C. If Lender acquires the Hotel through foreclosure, a deed in lieu thereof, or through any other exercise of its rights as a secured lender, and Lender no longer desires that the Hotel be operated as a «brand» hotel, Lender agrees to notify Franchisor within ten (10) days of Lender’s acquisition of same, to cooperate with Franchisor in the removal of the Hotel from the «brand» hotel system, and to promptly comply with Paragraph 13 hereof.

3. Receivership. If Lender has a receiver appointed for the Hotel during a foreclosure proceeding, Lender shall have the right to have the Hotel operated by Franchisor or a management company approved by Franchisor pursuant to Paragraph 4 if, with respect to the Hotel: (i) Franchisor and Lender have reached agreement concerning the cure of any deficiencies in Franchisee’s prior performance obligations under the Franchise Agreement, including any deficiencies under any other agreements with Franchisor and its affiliates relating to the Hotel; (ii) Lender or the receiver enters
into a management agreement with Franchisor or a franchise agreement with Franchisor
on terms acceptable to Franchisor; and (iii) the receiver is specifically authorized by
order of the court appointing such receiver to enter into a franchise agreement or
management agreement as described herein, such order further requires the Hotel to be
operated in accordance with state, local and federal laws, and such order includes other
language as may be requested by Franchisor with respect to the operations of the Hotel
or the agreement. If the receiver is the party contracting with Franchisor, Franchisor
may condition its obligations under this Paragraph 3 on posting of a performance bond
for the receiver's obligations to Franchisor, on terms and conditions acceptable to
Franchisor, or on receipt of Lender's guaranty of such receiver's obligations under any
agreement with Franchisor.

4. **Substitute Manager.** Lender's right to propose a substitute manager for the Hotel
under this comfort letter shall be on the terms and conditions of this Paragraph 4. Upon
Lender's request, Franchisor will provide Lender a list of management companies that
Franchisor would approve for operation of the Hotel and, if possible, such list shall
contain at least three (3) management companies. Franchisor reserves the right to
approve only those management companies to operate the Hotel that, in Franchisor's
sole judgment, are experienced and qualified in operating «brand» hotels and are
otherwise able to adhere fully to the obligations and requirements of the franchise
agreement. Notwithstanding anything to the contrary in this comfort letter, if the Hotel is
operated by a management company not approved by Franchisor, Franchisor shall have
the right immediately upon notice and without further action to terminate the Franchise
Agreement, this comfort letter and the Hotel's relationship with the «brand» system of
hotels. Notwithstanding anything to the contrary contained in this comfort letter,
Franchisor will not be obligated to manage the Hotel if, in Franchisor's reasonable
business judgment, such management would violate any contractual or other legal
obligation of Franchisor or its affiliates.

5. **Notification of Franchisor.** Lender agrees to notify Franchisor ten (10) days in
advance of any action to: (i) commence foreclosure proceedings regarding the Hotel; (ii)
petition for appointment of a receiver, obtain the entry of an order for relief, or take any
action under federal or state bankruptcy laws or similar laws with regard to the Hotel; (iii)
accept a deed for the Hotel in lieu of foreclosure; or (iv) take ownership, possession or
control of the Hotel, directly or indirectly, in any manner. Such notice will identify the
court in which any such action referred to in subsection (i) or subsection (ii) is or will be
filed. Lender shall notify Franchisor in writing of the commencement by another party of
foreclosure proceedings or the filing of an action for the appointment of a receiver or
petition for relief under state or federal bankruptcy laws within thirty (30) days after
Lender receives notice of commencement of such proceedings. Lender also agrees to
notify Franchisor within ten (10) days after any termination or release of Lender's
mortgage, security deed or interest in the Hotel. Lender's obligations under the
immediately preceding sentence of this Paragraph 5 shall survive termination of this
comfort letter.

6. **No Assignment of Franchise Agreement.** Lender and Franchisee represent,
waiver and covenant to Franchisor that Franchisee has not and will not collaterally
assign, pledge, grant a security interest or otherwise transfer to Lender or its affiliates
any interest in the Franchise Agreement. Franchisee further represents, warrants and
covenants to Franchisor that the granting of the Loan will not cause Franchisee to violate
any financial covenants contained in the Franchise Agreement. If the Hotel is acquired

4127158v1(99999.1)
by anyone other than Lender, neither Lender nor Franchisee shall have the right or authority to sell, convey, assign or in any manner transfer any rights under this comfort letter (which is non-assignable) or under the Franchise Agreement without the consent of Franchisor.

7. **Transition of Control of the Hotel.** Lender, Franchisor and Franchisee shall cooperate so that any change in control of the Hotel pursuant to this comfort letter shall be conducted efficiently without inconvenience to the guests and employees of the Hotel and in accordance with applicable law, including, but not limited to, the WARN Act (29 U.S.C. §§ 2101 et seq.).

8. **No Claims.** Franchisor may discuss with Lender or its designee the status of the Hotel, the Franchise Agreement, or the terms of any agreement contemplated by this comfort letter or any of the matters to which Lender is entitled to notice. Franchisee hereby agrees that Franchisor and its respective owners, affiliates, agents, employees, officers, directors, successors, assigns and representatives ("Released Persons") shall not be liable to any person for taking any action or providing any information required or contemplated by this comfort letter ("Comfort Letter Acts") and Franchisee, on behalf of itself and its owners, affiliates, agents, officers, directors, employees, representatives, successors and assigns, hereby releases the Released Persons of and from any and all actions, causes of action, suits, claims, demands, contingencies, debts, accounts and judgments whatsoever, at law or in equity, for any Comfort Letter Acts. Franchisee also represents as of this date and to the best of its knowledge that there is no existing default by either Franchisee or Franchisor under the Franchise Agreement and no event has occurred which, with the giving of notice or passage of time, or both, would constitute a default by either Franchisee or Franchisor under the Franchise Agreement, and Franchisee has no claims against Franchisor.

9. **Notices.** All notices required under this comfort letter shall be in writing, sent by certified mail, return receipt requested, or by Federal Express or other national express delivery service and addressed, if to Lender, to:

```
«Lender_Name»
«lender_street»
«lender_city», «lender_state» «lenderZipCode»
Attn: «LenderContact»
```

With a copy to:

If to Franchisor, to:

```
«Franchisor_Licensor»
10400 Fernwood Road
Department 52/923
Bethesda, Maryland 20817
Attention: Franchise Attorney
```

Any notice sent pursuant to this comfort letter shall be deemed to be given three (3) days after mailing or on the next business day after such notice is deposited with a national express delivery service.
10. **No Representations or Warranties.** In no event shall this comfort letter or any other circumstances surrounding the provision of financing by Lender be construed to involve: (i) any representation by Franchisor that it endorses, approves, recommends or otherwise concurs in the financing; (ii) any guarantee or assurance by Franchisor that Franchisee or any other party to the Loan will be able to repay the Loan in accordance with its terms; (iii) any endorsement, approval, recommendation or concurrence in any financial projections submitted to Lender in connection with the Loan; or (iv) any endorsement, approval or recommendation of Franchisee's character or reputation. Because the No-Defaults Representation only covers the status of the Franchise Agreement as of the date of this comfort letter, Lender shall not rely on its belief, whether or not correct, that Franchisor has not given any notice under this comfort letter when Lender is making any decision or representation or warranty in connection with any material modification, securitization, or sale of the Loan. Franchisor agrees that upon the written request of Lender in connection with any material modification, securitization, or sale of the Loan, Franchisor will represent to Lender whether, as of that date, Franchisor has issued a notice pursuant to which the Franchise Agreement is then currently in default.

11. **Substitute Comfort Letter.** If Lender securitizes the Loan, appoints a third-party loan servicing agent to service the Loan, or transfers the Loan to a successor mortgagee that (i) is a financial institution in the business of routinely financing real estate transactions, (ii) is in good financial condition, (iii) is not a Competitor or an Affiliate of a Competitor, and (iv) is not an Affiliate of Franchisee, and provides a written request to Franchisor to issue a replacement comfort letter within ninety (90) days of the date of such securitization, appointment or transfer, setting forth the name, address and contact information of the entity to which the replacement comfort letter is requested to be issued, and the date of such securitization, appointment or transfer, Franchisor will issue a replacement comfort letter, substantially similar to this comfort letter, to such entity. Franchisor reserves the right to require representations and warranties or certifications that the conditions in this Paragraph are satisfied prior to issuing any replacement comfort letter. Any such replacement comfort letter shall supersede this comfort letter.

12. **Lender not Liable for Liquidated Damages.** Franchisor specifically acknowledges and agrees that Lender shall not be liable for payment of any liquidated damages not paid by Franchisee, but Franchisor does not waive any liquidated damages claims that may arise from operation of the Hotel following Lender’s election under Paragraph 2.A. hereof or by a receiver under Paragraph 3 hereof.

13. **Possession of the Hotel.** If Lender owns, controls or possesses the Hotel after termination of the Franchise Agreement for any reason, Lender shall (i) upon Franchisor's request immediately perform the requirements of [REFERENCE CORRECT ARTICLE/SECTION NUMBER] of the Franchise Agreement with respect to de-identifying the Hotel as a «brand» hotel and (ii) indemnify, defend and hold harmless Franchisor and its affiliates from and against any loss, claim or other liability of any kind arising from or in connection with the operation of the Hotel as a «brand» hotel during such ownership, control or possession. Lender's obligations under this Paragraph 13 shall survive termination of this comfort letter, and nothing in the comfort letter shall limit Franchisor's rights, if any, to seek legal redress for any unauthorized use of Franchisor's trademarks, service marks, or systems.
14. **Termination.** This comfort letter shall terminate and Lender shall have no rights hereunder if:

(i) Lender has been taken over in any manner by any state or federal agency or is in a receivership, conservatorship, reorganization, or liquidation, or Lender or any of its officers or directors has entered into or is subject to a cease and desist order or any other formal or informal written agreement with a federal or state regulatory agency;

(ii) Lender no longer holds a valid first mortgage or security deed with respect to the Hotel; provided that if this comfort letter is terminated under this clause (ii), Lender shall retain its right to request a substitute comfort letter pursuant to Paragraph 11 hereof for the time period set forth therein;

(iii) the Franchise Agreement has expired or terminated, unless such occurrence is the result of the timely exercise of Lender’s rights pursuant to Paragraphs 2, 3 or 4 of this comfort letter, in which case this comfort letter shall terminate upon the exercise or expiration of such rights, which in any event shall expire no more than forty-five (45) days after the expiration or termination of the Franchise Agreement; or

(iv) Lender breaches this comfort letter.

15. **Effectiveness.** Franchisor shall have no obligations hereunder unless Lender and Franchisee have evidenced their agreement with the provisions hereinabove by the execution of a copy of this comfort letter, which may be executed in a number of identical counterparts, each of which shall be deemed an original for all purposes and all of which shall constitute, collectively, one and the same comfort letter. Delivery of an executed signature page to this comfort letter by facsimile transmission shall be effective as delivery of a manually signed counterpart of this comfort letter.

Very truly yours,

«FRANCHISOR_LICENSOR»

By: ____________________________
Name: __________________________
Title: __________________________

«Franchise_Name»

By: ____________________________
Name: __________________________
Title: __________________________

«Lender_Name»

By: ____________________________
Its: ____________________________

cc:
ATTACHMENT B

SUBORDINATION, NON DISTURBANCE AND ATTORNMENT AGREEMENT

THIS SUBORDINATION, NON DISTURBANCE AND ATTORNMENT AGREEMENT (the “Agreement”) is made and entered into as of the _____ day of ________, 20___, by and between: (i) _____________________ (“Mortgagee”), a _______________ having an address at ______________________; and (ii) ______________________ (“Manager”), a Delaware __________________ having an address at ____________________, and pertains to property owned by ______________________ (“Owner”), a ___________________ having an address at _____________________.

RECITALS

A. Owner is the owner of the Hotel (defined in Section 1) and Mortgagee is the holder of the Mortgage (defined in Section 1) that encumbers the Hotel.

B. Manager and Owner have entered into the Management Agreement (defined in Section 1), pursuant to which Manager will manage the Hotel on behalf of Owner.

C. Mortgagee and Manager desire to provide for Manager’s continued management of the Hotel pursuant to the Management Agreement, notwithstanding any default by Owner under the Mortgage or the Management Agreement, upon the terms and conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto mutually agree and covenant as follows:

1. Definitions. Any capitalized term that is not specifically defined in this Agreement shall have the meaning set forth in the Management Agreement. The following terms when used in this Agreement shall have the meanings indicated:

   “Bankruptcy Code” shall mean Title 11 of the United States Code.

   “Foreclosure” shall mean any exercise of the remedies available to Mortgagee, upon a default under the Mortgage, which results in a transfer of title to, or possession or control of, the Hotel. The term “Foreclosure” shall include, but not be limited to: (i) a transfer by judicial foreclosure; (ii) a transfer by deed in lieu of foreclosure; (iii) the appointment by a court of a receiver to assume possession or control of the Hotel; (iv) a transfer of either ownership or control of the Owner, direct or indirect in either case, by exercise of a stock pledge or otherwise; (v) a transfer resulting from an order given in a bankruptcy, reorganization, insolvency or similar proceeding or a transfer approved by a court in such a proceeding (including, but not limited to, a sale pursuant to Section 363 or Section 1123(a)(5) of the Bankruptcy Code); (vi) if title to the Hotel is held by a tenant under a ground lease, an assignment of the tenant’s interest in such ground lease; or
(vii) a transfer through any similar judicial or non judicial exercise of the remedies held
by the holder of the Mortgage.

"Foreclosure Date" shall mean the date on which title to, or possession or control
of, the Hotel is transferred by means of a Foreclosure.

"Hotel" shall mean that certain hotel containing approximately _____ (__) guest rooms that is located on the site described in Exhibit A hereto.

"Management Agreement" shall mean that certain management agreement,
dated ______________, ____, between Owner and Manager pursuant to which
Manager will manage the Hotel on behalf of Owner. The term "Management
Agreement," as used in this Agreement, shall include (i) any amendments, modifications,
supplements, replacements or extensions of the original Management Agreement; and
(ii) any New Management Agreement entered into pursuant to Section 3.B of this
Agreement.

"Mortgage" shall mean that certain mortgage, dated as of the date hereof in the
principal amount of ______________________ Dollars ($_______) and which
encumbers the Hotel. The term "Mortgage," as used in this Agreement, shall include: (i)
any amendments, modifications, supplements or extensions of the original "Mortgage"
that was recorded as set forth above; and (ii) any existing or future financing by
Mortgagor that is wholly or partially secured by the Hotel, including a "blanket mortgage"
encumbering properties other than the Hotel.

"Mortgagor" shall mean any of the following: (i) the entity identified as the
"Mortgage" in the Preamble, (ii) any successors or assigns of that entity, (iii) any
nominee or designee of that entity (or any other entity described in this definition), (iv)
any initial or subsequent assignee of all or any portion of the interest of that entity in the
Mortgage, or (v) any entity that is a participant in the financing secured by the Mortgage,
or otherwise acquires an equitable interest in the Mortgage.

"Subsequent Owner" shall mean any individual or entity that acquires title to, or
assumes or obtains possession or control of, the Hotel at or through a Foreclosure
(together with any successors or assigns thereof), including, but not limited to: (i)
Mortgagor, (ii) any purchaser of the Hotel from Mortgagor, or any lessee of the Hotel
from Mortgagor, (iii) any purchaser of the Hotel at Foreclosure, or (iv) any receiver
appointed by a court to assume possession or control of the Hotel.

2. **Subordination.** Subject to the parties' compliance with the provisions of
this Agreement, the right, title and interest of Manager in and to the Hotel under the
Management Agreement (the "Manager's Interests") are and shall be subject and
subordinate solely to the lien of the Mortgage; provided, however, that, notwithstanding
the foregoing subordination: (i) neither Mortgagor nor any Subsequent Owner shall
name Manager as a defendant in any Foreclosure or otherwise take steps that are
inconsistent with Section 3 of this Agreement, and (ii) the Manager's Interests shall not
be subordinate to any mortgage other than the Mortgage.
3. **Non Disturbance**

A. In the event any Subsequent Owner acquires title to, or assumes or obtains possession or control of, the Hotel, Mortgagee agrees (which agreement shall be binding on all Subsequent Owners) that if, at such time, the Management Agreement has not expired or otherwise been earlier terminated in accordance with its terms, then (i) Mortgagee and all Subsequent Owners shall recognize Manager's rights under the Management Agreement, (ii) Manager shall not be named as a party in any Foreclosure action or proceeding (unless such joinder is necessary to foreclose the lien of the Mortgage, but in such case only for such purpose and not for the purpose of terminating the Management Agreement) but Mortgagee and all Subsequent Owners shall furnish copies of any pleadings filed in connection therewith to Manager within two (2) business days of their filing or receipt of same, (iii) Manager shall not be disturbed in its right to manage and operate the Hotel pursuant to the provisions of the Management Agreement, and (iv) Subsequent Owner shall assume all of the obligations of the "Owner" under the Management Agreement that are continuing or that arise after the Foreclosure Date (or such later date of acquisition of title to the Hotel), pursuant to a written assumption agreement reasonably acceptable to Manager and delivered to Manager within twenty (20) days after the Foreclosure Date (or, in the event such Subsequent Owner acquires title to the Hotel after the Foreclosure Date, within twenty (20) days after the date of such acquisition of title to the Hotel).

B. If, at the time a Subsequent Owner acquires title to, or assumes or obtains possession or control of, the Hotel, the Management Agreement has been terminated or Manager no longer has the right to manage or operate the Hotel due to (i) the exercise of any purported rights of Owner under the law of agency (notwithstanding Section 11.03 of the Management Agreement), or (ii) a court ruling in any proceeding or action involving bankruptcy, receivership, assignment for the benefit of creditors, dissolution procedure or process, or similar proceedings or actions (but in no event due solely to an Event of Default by Manager under the Management Agreement or a termination by Manager under the Management Agreement) such Subsequent Owner shall immediately enter into a new agreement with Manager for the management of the Hotel on the same terms and conditions as the Management Agreement (the "New Management Agreement"). Subsequent Owner shall be so obligated even if Manager is then no longer managing or operating the Hotel, provided that (a) Manager is contesting such a termination or such a loss of right that has not been subject to a final non appealable order from court having jurisdiction, and (b) Manager has not actually received payment equal to the present value of the damages it incurred as a result of such termination or, if applicable, the full amount of its allowed claim in any bankruptcy proceeding. The term of the New Management Agreement shall commence effective as of (1) the earliest date on which Subsequent Owner acquired title to, or assumed or obtained possession or control of, the Hotel, if Manager is then currently managing or operating the Hotel, or (2) ninety (90) days after the date Subsequent Owner acquired title to, or assumed or obtained possession or control of, the Hotel, if Manager is not then currently managing or operating the Hotel, and shall expire on the date the term of the Management Agreement would have otherwise expired but for such termination or loss of right.

C. In the event Owner seeks protection under the Bankruptcy Code or any similar statute, during any proceeding with respect thereto, Mortgagee shall ensure, to the extent of Mortgagee's ability, that the Management Agreement remains in full force
and effect. To that end, Mortgagee shall take no action to terminate or cause the termination of the Management Agreement.

D. Mortgagee hereby recognizes Manager's rights under the Management Agreement, acknowledges that Manager must operate the Hotel pursuant to the provisions of the Management Agreement, and agrees that at any time Mortgagee directly or indirectly exercises any rights or receives any benefits of "Owner" under the Management Agreement, Mortgagee shall act in a manner that is commercially reasonable and consistent with the provisions of the Management Agreement. During the appointment of a receiver for the Hotel, Mortgagee shall (i) take no action to cause a receiver to act in contravention of the Manager's rights under the Management Agreement and Manager's rights of non disturbance contained herein, and (ii) object to any such actions by any receiver of which Mortgagee has actual knowledge.

4. Attornment

A. Subject to Section 4.B, if, at the time a Subsequent Owner acquires title to, or assumes or obtains possession or control of, the Hotel, (i) the Management Agreement is in effect, and has not expired or otherwise been earlier terminated in accordance with its terms, and (ii) Mortgagee and Subsequent Owner are in compliance with this Agreement, then Manager shall attorn to any Subsequent Owner, Manager shall remain bound by all of the terms, covenants and conditions of the Management Agreement, and Manager shall enjoy all of its rights under the Management Agreement, for the balance of the remaining term thereof (and any renewals thereof that may be effected in accordance with the Management Agreement) with the same force and effect as if such Subsequent Owner were the "Owner" under the Management Agreement.

B. If, (a) at the time a Subsequent Owner acquires title to, or assumes or obtains possession or control of, the Hotel, such Subsequent Owner would not qualify as a permitted transferee under the applicable section of the Management Agreement or similar section of the New Management Agreement, or (b) such Subsequent Owner does not assume all of the obligations of the "Owner" under the Management Agreement in accordance with clause (iv) of Section 3.A, then (1) Manager shall have no such obligation to so attorn, (2) an Event of Default by "Owner" shall be deemed to have occurred under the Management Agreement or New Management Agreement, and (3) Manager shall thereafter have a continuing right to terminate the Management Agreement or New Management Agreement upon ninety (90) days' prior written notice to such Subsequent Owner, unless, at the time of Manager's exercise of such termination right, such Subsequent Owner then qualifies as a permitted transferee under the applicable section of the Management Agreement or similar section of the New Management Agreement and such Subsequent Owner assumes all of the obligations of the "Owner" under the Management Agreement that are continuing or that arise after the Foreclosure Date (or such later date of acquisition of title to the Hotel), pursuant to a written assumption agreement reasonably acceptable to Manager and delivered to Manager within five (5) days after Manager's exercise of such termination right.

C. Upon the written request of Mortgagee, Manager shall periodically execute and deliver a statement, in a form reasonably satisfactory to Mortgagee, reaffirming Manager's obligation to attorn as set forth in this Section 4.
5. **Notice and Opportunity to Cure**

A. So long as the Mortgage remains outstanding and unsatisfied, then in the event of a Default by Owner in the performance or observance of any of the terms and conditions of the Management Agreement, and in the event that Manager gives written notice thereof to Owner pursuant to the applicable section of the Management Agreement or similar provision in the New Management Agreement, Manager shall also give a duplicate copy (herein referred to as the "First Notice") of such notice to Mortgagee, in accordance with Section 8 of this Agreement. In addition, in the event that such Default is not cured within the applicable cure period under the applicable section of the Management Agreement (the “Owner’s Cure Period”), and Manager intends to exercise its remedy of terminating the Management Agreement, Manager shall send a second notice (the “Second Notice”) to Mortgagee, in accordance with Section 8 hereof, stating Manager’s intention to terminate the Management Agreement. Mortgagee shall have the right to cure any such Default during the period commencing with Manager’s service of the First Notice and continuing through the thirtieth (30th) day after Manager’s service of the Second Notice (the “Mortgagee’s Cure Period”). From and after the expiration of the Owner’s Cure Period, Manager shall be entitled to exercise its remedy of terminating the Management Agreement and take any and all actions necessary in connection with such termination, but any such exercise by Manager shall be subject to Mortgagee’s cure right set forth herein and shall be rendered null and void if Mortgagee cures such Default prior to the expiration of the Mortgagee’s Cure Period.

B. No notice given by Manager to Owner shall be effective as a notice under the applicable section of the Management Agreement or similar provision under the New Management Agreement unless the applicable duplicate notice to Mortgagee that is required under Section 5.A hereof (either the First Notice or the Second Notice, as the case may be) is given to Mortgagee in accordance with this Agreement. It is understood that any failure by Manager to give such a duplicate notice (either the First Notice or the Second Notice, as the case may be) to Mortgagee shall not be a default by Manager either under this Agreement or under the Management Agreement, but rather shall operate only to void the effectiveness of any such notice by Manager to Owner under the applicable section of the Management Agreement.

C. Manager agrees to accept performance by Mortgagee with the same force and effect as if the same were performed by Owner, in accordance with the provisions and within the cure periods prescribed in the Management Agreement (except that Mortgagee shall have the additional thirty (30) day cure period, not available to Owner, set forth in Section 5.A hereof).

D. Except as specifically limited in the foregoing paragraphs, nothing contained herein shall preclude Manager from exercising any of its rights or remedies against Owner with respect to any default by Owner under the Management Agreement.

6. **Notice to Manager.** If Mortgagee sends Owner a notice of default under the Mortgage, then Mortgagee shall on the same day send Manager a copy thereof in accordance with Section 8 of this Agreement. If Mortgagee intends to seek appointment by a court of a receiver to assume possession or control of the Hotel, Mortgagee shall provide Manager with at least two (2) business days’ prior written notice of such intention, which notice shall identify the name and location of the court where such
appointment will be sought and shall include a draft of the proposed appointment order for such receiver so that Manager will have the opportunity to review and comment on the proposed order to ensure that such order is consistent with the terms of this Agreement and the Management Agreement.

7. **Assignment of Management Agreement.** Owner has, pursuant to the applicable provisions of the Mortgage, collaterally assigned to Mortgagee, as additional security for the indebtedness evidenced by the Mortgage, all of Owner's right, title and interest in and to the Management Agreement, including the right to distributions payable to Owner pursuant to Article III and Article IV thereof (or similar provisions of the New Management Agreement). Manager hereby acknowledges that it has been given a copy of the foregoing assignment. If, pursuant to such assignment (or subsequent loan documentation entered into between Owner and Mortgagee with a similar purpose), Manager receives (which it may, from time to time) a notice or notices from Mortgagee directing Manager to pay to Mortgagee distributions under the Management Agreement that would otherwise be payable to Owner, Manager shall comply with any such notice. Manager shall continue to make payments in compliance with any such notice from Mortgagee until Manager receives written instructions to the contrary from Mortgagee. It is understood that Manager shall comply with the direction set forth in any such notice without any necessity to investigate Mortgagee's reasons for sending such notice, or to confirm whether or not Owner is in fact in default under the terms of the Mortgage.

8. **Notices.** Notices, statements and other communications to be given under the terms of this Agreement shall be in writing and delivered by hand against receipt or sent by certified or registered mail, postage prepaid, return receipt requested or by nationally recognized overnight delivery service, addressed to the parties as follows:

**To Mortgagee:**

_____________________________
_____________________________
Attn: _______________________
Phone: (____)___-_____
Fax: (____)___-_____

**To Manager:**

_____________________________
Attn: Law Department
Senior Operations Attorney
Phone: (____)___-_____
Fax: (____)___-_____

or at such other address as is from time to time designated by the party receiving the notice. Any such notice that is mailed in accordance herewith shall be deemed to have been received when delivery is received or refused, as the case may be. Additionally, notices may be given by confirmed telephone facsimile transmission, provided that an original copy of said transmission shall be delivered to the addressee by nationally recognized overnight delivery service by no later than the second (2nd) business day following such transmission. Telephone facsimiles shall be deemed delivered on the date of such transmission if received during the receiving party's normal business hours or, if not received during the receiving party's normal business hours, then on the next succeeding date on which such receiving party is open for normal business.
9. **Estoppel Certificates**

   A. **Manager** shall, at any time and from time to time upon not less than thirty (30) days’ prior written notice from **Mortgagee**, execute, acknowledge and deliver to Mortgagee, or to any third party specified by Mortgagee, a statement in writing: (a) certifying (i) that the Management Agreement is unmodified and in full force and effect (or if there have been modifications, that the same, as modified, is in full force and effect and stating the modifications), and (ii) the date through which the management fees due and payable under the Management Agreement have been paid; and (b) stating whether or not to the best knowledge of Manager (i) there is a continuing default by Owner in the performance or observance of any covenant, agreement or condition contained in the Management Agreement, or (ii) there shall have occurred any event that, with the giving of notice or passage of time or both, would become such a default, and, if so, specifying each such default or occurrence of which Manager has actual knowledge. Such statement shall be binding upon Manager and may be relied upon by Mortgagee and/or such third party specified by Mortgagee as aforesaid.

   B. **Mortgagee** shall, at any time and from time to time upon not less than thirty (30) days’ prior written notice from Manager, execute, acknowledge and deliver to Manager, or to any third party specified by Manager, a statement in writing: (a) certifying to the best knowledge of Mortgagee that the Management Agreement is unmodified and in full force and effect (or if there have been modifications, that the same, as modified, is in full force and effect and stating the modifications); and (b) stating whether or not to the best knowledge of Mortgagee (i) there is a continuing default by Owner in the performance or observance of any covenant, agreement or condition contained in the Management Agreement, or (ii) there shall have occurred any event that, with the giving of notice or passage of time or both, would become such a default, and, if so, specifying each such default or occurrence of which Mortgagee has actual knowledge. Such statement shall be binding upon Mortgagee and may be relied upon by Manager and/or such third party specified by Manager as aforesaid.

10. **Confirmatory Documentation.** The provisions of Section 2, Section 3 and Section 4 of this Agreement are and shall be fully effective and binding between the parties and any Subsequent Owner, upon the occurrence of the conditions set forth in such Sections, without the execution of any further instruments by any party. Notwithstanding the foregoing, each party to this Agreement shall have the right (from time to time, for so long as this Agreement is in effect) to request any other party to execute documentation (in form reasonably satisfactory to all signing parties) confirming (if true) that such conditions (if any) have been satisfied and that the provisions of Section 2, Section 3 and/or Section 4 hereof have been implemented. In such event, each of the parties that is requested to execute such confirmatory documentation agrees to execute it within a reasonable period of time (not to exceed thirty (30) days) after its receipt of such request.

11. **Miscellaneous**

   A. This Agreement may be executed in a number of identical counterparts. If so executed, all counterparts shall, collectively, constitute one agreement, but in making proof of this Agreement, it shall not be necessary to produce or account for more than one such counterpart, provided that photocopy or facsimile copies of all signatures are produced.
B. The terms and conditions of this Agreement shall inure to the benefit of, and be binding upon, the respective successors, heirs, legal representatives and assigns of each of the parties hereto, and in furtherance of the foregoing, any party to this Agreement may require or cause it to be recorded in the public land records of the jurisdiction where the Hotel is located at any time.

C. Notwithstanding anything herein to the contrary, the commencement and prosecution of Foreclosure proceedings under the Mortgage is a matter entirely within the discretion of Mortgagee.

D. The use of the neuter gender in this Agreement shall be deemed to include any other gender, and words in the singular number shall be held to include the plural, when the sense requires.

E. In the event the Management Agreement shall be amended, modified or supplemented, the Management Agreement, as so amended, modified or supplemented, shall continue to be subject to the provisions of this Agreement without the necessity of any further act by the parties hereto.

F. The provisions of this Agreement shall not be modified, amended, waived, discharged or terminated except by a written document signed by all of the parties hereto.

G. This Agreement and its validity, interpretation and enforcement shall be governed by the laws of the state in which the Hotel is located.

H. Captions of Sections herein are inserted only for convenience and are in no way to be construed as a limitation on the scope of the particular Sections to which they refer.

I. If any term, covenant or condition of this Agreement is held to be invalid, illegal or unenforceable in any respects, all other terms and conditions of this Agreement shall remain in full force and effect.

J. The waiver by any party of the performance of any covenant, condition or promise shall not invalidate this Agreement and shall not be considered a waiver of any other covenant, condition or promise. No such waiver shall constitute a waiver of the time for performing any other act or identical act required to be performed at a later time. The exercise of any remedy provided in this Agreement shall not constitute a waiver of any remedy provided by law or in equity, and the provision in this Agreement of any remedy shall not exclude any other remedy unless such remedy is expressly excluded hereby.

SIGNATURES FOLLOW ON NEXT PAGE
IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed under seal as of the day and year first written above.

MORTGAGEE:

__________________________________________

a __________________________________________

By: _________________________________________

Name: _______________________________________

Title: _______________________________________

STATE OF ____________________________________ )

CITY/COUNTY OF ___________________________ ) ss:

I hereby certify that on this __________ day of __________________, before me, the undersigned officer, personally appeared _______________________, who acknowledged herself/himself to be the __________________________________________ of __________________________________________, and that she/he, in such capacity, being authorized to do so, executed the foregoing instrument for the purposes therein contained, by signing the name of ________________________________, as ________________________________ of __________________________________________.

IN WITNESS WHEREOF, I hereunto set my hand and Notarial Seal.

_________________________________________

Notary Public

My Commission expires: _______________________

4127158v1(99999,1)

B-9
MANAGER:

________________________________________
a Delaware corporation

By: ______________________________________
Name: ____________________________________
Title: _____________________________________

STATE OF ___________________________ )
CITY/COUNTY OF ___________________ ) ss:

I hereby certify that on this ____________ day of ____________________, before
me, the undersigned officer, personally appeared ________________________, who
acknowledged herself/himself to be the ____________________________ of
__________________________, and that she/he, in such capacity, being authorized to do
so, executed the foregoing instrument for the purposes therein contained, by signing the
name of ____________________________, as ____________________________ of
__________________________.

IN WITNESS WHEREOF, I hereunto set my hand and Notarial Seal.

_____________________________________
Notary Public

My Commission expires: ____________________
EXHIBIT A

LEGAL DESCRIPTION OF THE SITE
OWNER'S CONSENT AND AGREEMENT

In exchange for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and in connection with the execution and delivery of that certain Subordination, Non Disturbance and Attornment Agreement dated as of ________________, 20__ by and between ________________, as "Mortgagee" thereunder and ________________, as "Manager" thereunder (the "SNDA"), from which the undersigned party ("Owner") is receiving material benefit, Owner hereby (i) consents to any such payments by Manager to Mortgagee referenced in Section 7 of the SNDA that are in compliance with any such notice referenced in Section 7 of the SNDA, (ii) acknowledges and agrees that any such payment by Manager to Mortgagee referenced in Section 7 of the SNDA satisfies Manager's obligations under the Management Agreement to distribute such funds to Owner, and (iii) releases Manager from any and all obligations relating to such payments referenced in Section 7 of the SNDA. The consent and agreement by Owner evidenced hereby shall be deemed to be irrevocable until the entire debt secured by the Mortgage referenced in the SNDA has been discharged, as evidenced either by the recordation of a satisfaction or release executed by Mortgagee, or by the delivery of a written statement to that effect from Mortgagee to Manager.

Date: ________________, 20__

OWNER:

_________________________________________

a __________________________

By: ______________________________

Name: ______________________________

Title: ______________________________

[NOTARY BLOCK IS ON NEXT PAGE]
STATE OF __________________ )
CITY/COUNTY OF ____________ ) ss:

I hereby certify that on this ________ day of __________________, before me, the undersigned officer, personally appeared ____________________, who acknowledged herself/himself to be the __________________ of __________________, and that she/he, in such capacity, being authorized to do so, executed the foregoing instrument for the purposes therein contained, by signing the name of ________________________, as ______________________ of ____________________.

IN WITNESS WHEREOF, I hereunto set my hand and Notarial Seal.

________________________________________
Notary Public

My Commission expires: ____________________
ATTACHMENT C

FORECLOSURES/RECEIVERSHIPS

PROCESS AND CLOSING CHECKLIST

I. UPON RECEIPT OF NOTICE OF FORECLOSURE/RECEIVERSHIP

A. Pull files for review and request QA and renovation or PIP status and payment status.

B. Notify internal client - send copy of notice letter, and if there is a comfort letter, include a copy of redline comfort letter – who will send If comfort letter has negotiated confidentiality provision, state in the email that no one should discuss the notice with Franchisee.

C. Send initial response letter:
   - Response Letter BEFORE Receiver Order Entered
   - Response Letter AFTER Receiver Order Entered

II. NEGOTIATE RECEIVERSHIP ORDER

A. Obtain agreement that the Receivership Order will include standard language contained in BEFORE Response Letter

B. Confirm in writing (at least via email) any agreement/discussions with Lender/Special Servicer regarding language for Receivership Order

III. NEGOTIATE FRANCHISE AGREEMENT

A. Determine appropriate form to use.
   1. 90-Day Receiver Franchise Agreement
   2. "Step-In" Receiver Franchise Agreement (Lender can take assignment of FA at end of receivership)
   3. Receiver or Lender Franchise Agreement with Hotel Exiting System (typically 1-3 year term)
      - For full service hotel system exit, obtain client authorization and approval

B. Provide "Deficiency List" and upcoming Renovation Schedule for Hotel
IV. TERMINATION OF EXISTING FRANCHISE AGREEMENT

Termination should occur simultaneously upon execution of new Franchise Agreement by either:

1. Executing a Termination Agreement and Release:
   - Get Termination Payment in lieu of liquidated damages or reserve LD's
   - Payment of Outside Counsel Fees
   - Past Due Balances

2. Issuing a Notice of Default and Termination:
   - Reserve LDs and all rights in case hotel later exits the system

V. PRIOR TO OR IN CONNECTION WITH EXECUTION OF FRANCHISE AGREEMENT

A. FDD Receipt signed and dated

B. Final Receivership Order – approved by the Court

C. Termination Agreement and Release or Notice of Termination

D. Confirm receipt of all payments due

   - Application Fee (typically $____ under C/L)
   - Termination payment from exiting franchisee (if applicable)
   - Collect past due balances from Receiver
   - Provide wire transfer instructions for payments due
   - Ensure payment of outside counsel fees

E. Third-party Manager Consented to by MI
   - Confirm who has been selected as Manager
   - Obtain consent from client

F. Insurance Certificates

G. OFAC Memorandum
   (NOTE: Receiver will typically be an individual, so run the OFAC check on that name)

H. Copies of each of the following documents, fully executed and attested/witnessed:

   1. Franchise Agreement (ensure compliance with 7-day rule)
   2. Guaranty (if applicable)
   3. Management Company Acknowledgment
   4. Electronic Systems License Agreement
   5. Memorandum of Right of First Refusal
   6. Termination Agreement and Release (if applicable)
ATTACHMENT D

[RESPONSE LETTER PRIOR TO HOTEL RECEIVER ORDER BEING ENTERED]

___________, 201__

VIA E-MAIL and OVERNIGHT MAIL

[SPECIAL SERVICER or LENDER]

________________________________________

________________________________________

Attn: ___________________________________

Re: The Franchise Agreement dated as of __________, ___ (the
    "Franchise Agreement") between Franchisor and [Franchisee]
    ("Franchisee") for the ______ hotel located at ________ (the
    "Hotel")

Ladies and Gentlemen:

You have informed Franchisor by letter dated _____, 201__, that you intend to
[choose one: commence a foreclosure action on the Hotel and/or bring an action for the
appointment of a receiver for the Hotel]. Franchisor would like to discuss with you, and
agree on, a short-term or longer-term solution to ensure that Franchisor's rights are
protected as you proceed through the process. We understand that the Hotel and its
revenues are assets that you wish to protect, and to the extent possible Franchisor
wishes to avoid "taking sides" as between you and your borrower. However, it is
important that you are aware of Franchisor's position if the Hotel is transferred without
an agreement with Franchisor. Note that if you have a "comfort letter" with respect to the
Hotel, that document provides a framework for the discussion but is not an agreement
that resolves these issues.

The loss of possession by the Franchisee and/or operation of the Hotel by an
unapproved operator would constitute a material default under the Franchise Agreement
with Franchisee pursuant to which Franchisor may terminate the Franchise Agreement
and any agreements ancillary to the Franchise Agreement. Those agreements, in
addition to providing a license to use Franchisor's trademarks, confidential information,
and systems, also provide the Hotel with credit through the use of systems like the
reservation system, and through programs like CTAC, which provide payment for
reservations to third-parties on behalf of the Hotel.

If Franchisee loses possession of the Hotel and you or the receiver desire to
continue identifying the Hotel as a "___________," and other trademarks
confidential information, and systems in connection with the operation of the Hotel,
Franchisor will require you or the receiver to either enter into a new franchise agreement
for the Hotel or, if it makes sense, to assume the Franchise Agreement. If a third party
wishes to take possession following a foreclosure sale, that party will need to apply for a franchise just like any other franchise applicant.

Franchisor strongly prefers to resolve any issues prior to the existing franchisee and operator turning the Hotel over to you or a receiver, and you should treat this letter as a request to do so despite your notice of an impending action with respect to the Hotel. If, however, you are unable to honor this request for a legitimate business reasons, we should immediately discuss whether a short-term (e.g., 60 to 90 days) agreement is appropriate so that the parties can develop a plan for the Hotel in an orderly basis and reflect that plan in the agreements. For all agreements, even for a short-term agreement, Franchisor will require that there are no outstanding life safety issues and the following: (i) the Hotel must at all times be operated and managed by a management company acceptable to Franchisor in its sole discretion and in accordance with all of the terms and conditions of a franchise agreement, and (ii) you will maintain adequate insurance over the Hotel in compliance with the Franchise Agreement and deliver to Franchisor (Attention: Insurance Department), a certificate of insurance (or certified copy of such insurance policy if requested by Franchisor) evidencing the coverages required in the Franchise Agreement and setting forth deductibles and the amount thereof, if any. If you are seeking appointment of a receiver, the order appointing the receiver must contain the following language, which Franchisor has received on numerous other occasions:

"The Receiver has the right to enter into the form franchise agreement ("Franchise Agreement") with Franchisor International, Inc. ("Franchisor") in form and substance satisfactory to the Receiver and Franchisor, and to have the Hotel operated in accordance with the terms of the Franchise Agreement by a third-party management company approved by Franchisor in accordance with the terms thereof. The obligations of the Receiver shall be to insure that the Hotel is operated in accordance with state, local and federal laws, and maintained in accordance with the Standards required by the Franchise Agreement, and that both past due payments and those that come due under the Franchise Agreement during the receivership shall be promptly paid to Franchisor as on-going operating expense ahead of those payments due to the Receiver and Plaintiff. In the event there are insufficient funds from the operation of the Hotel to pay all amounts due to Franchisor or its affiliates under the Franchise Agreement (or related thereto), Plaintiff shall fund such amounts due to Franchisor. In the event the Receiver fails to comply with the terms of the Franchise Agreement and cure any defaults that may be cured under the terms of the Franchise Agreement, Franchisor shall have the absolute right to terminate the Franchise Agreement consistent with its terms, immediately on written notice to the Receiver. The Receiver shall have the right to expend and disburse funds for payment to Franchisor for amounts due from time to time under the Franchise Agreement without the approval of Plaintiff."

Finally, Franchisor is entitled to have you cure all deficiencies under the Franchise Agreement, including payment of all outstanding amounts due under the Franchise Agreement and cure of any outstanding quality issues together with ongoing maintenance of the Hotel to Franchisor standards. Depending on the circumstances, you may also be required to pay all costs and expenses, including attorney's fees,
related to the matters contemplated hereby and Franchisor shall have received adequate assurances that such amounts, costs and expenses incurred in the future in connection with the Hotel shall be paid in full. Please consider your plan for these matters if we are discussing a longer relationship.

Nothing in this letter grants any right or permission for anyone other than the approved Franchisee or management company under the Franchise Agreement to operate the Hotel as a [_______] hotel. Unauthorized use of Franchisor’s trademarks is grounds for a claim under the federal Lanham Act and applicable state and common law. Such use could subject you to substantial liability to Franchisor, which could include profits resulting from your infringing use of the Proprietary Marks as well as preliminary and permanent injunctive relief. Moreover, a finding of intentional infringement could subject you to liability for treble damages, as well as Franchisor’s costs and attorneys’ fees in bringing a lawsuit to rectify the situation pursuant to Lanham Act, 15 U.S.C. Section 1117. Additionally Franchisor may pursue all remedies at law and under the Franchise Agreement to cause the de-identification of the Hotel and payment of any damages.

We are not able to comment at this time with respect to any other default under, or breach of, the Franchise Agreement. This letter does not supersede or affect any other default under, or breach of, the Franchise Agreement and is without prejudice to any other rights of Franchisor under the Franchise Agreement and applicable law.

We hope we can work together during this transition to reach an agreement that is mutually beneficial. [To facilitate a transaction, we will send you under separate cover a copy of the Franchise Disclosure Document, as we are required to do under certain state and federal laws.] If you wish to determine who is an approved operator, please have them contact [Insert]. If you wish to discuss the terms of an agreement, please contact [Insert signing Attorney’s name].

Sincerely,

cc: [FRANCHISEE]
ATTACHMENT E

[RESPONSE LETTER AFTER HOTEL RECEIVER ORDER ENTERED]

___________, 20__

VIA E-MAIL and OVERNIGHT MAIL

[RECEIVER]

____________________________________

____________________________________

Attn:________________________________

[FRANCHISEE]

____________________________________

____________________________________

Attn:________________________________

Re: _______ Franchise Agreement dated as of __________, _____ (the "Franchise Agreement") between Franchisor and [Franchisee] ("Franchisee") for the _______ hotel located at __________ (the "Hotel")

Ladies and Gentlemen:

Pursuant to the [Order Appointing Receiver entered on _____, 20__] (the "Receiver Order"), we understand that [Receiver] is the receiver for the Hotel. The appointment of a receiver for the Hotel constitutes a material default under the Franchise Agreement pursuant to which Franchisor may, at its option, terminate the Franchise Agreement and all agreements ancillary to the Franchise Agreement and exercise all other rights and remedies available to it.

This letter is a formal demand that you (i) immediately and permanently cease to use, by advertising or in any other manner whatsoever, the names "_______," "_______," and "Franchisor" and all variations thereof and all other Proprietary Marks, any other identifying characteristics and marks of the System, and all Intellectual Property in connection with the operation of the Hotel or (ii) contact _____________ at (_________) by 5:00 P.M., EST, on __________, 20__, to commence negotiations for new franchise agreements for the Hotel.

While we are willing to work with you to negotiate a franchise agreement for this Hotel, please understand that nothing in this letter grants any right or permission to operate the Hotel as a ________ after the date hereof and Franchisor will take all steps necessary to preserve and protect the ownership and validity of its Intellectual Property and its rights under the Franchise Agreement, including without limitation filing suit against you and seeking injunctive relief, if good faith negotiations do not commence.
immediately as set forth above. As you know, Franchisor owns all right, title and interest in and to the Proprietary Marks and the goodwill associated therewith and symbolized thereby. Your unauthorized use of the Proprietary Marks constitutes trademark infringement, unfair competition and dilution in violation of the federal Lanham Act and applicable state and common law. Such use could subject you to substantial liability to Franchisor, which could include profits resulting from your infringing use of the Proprietary Marks as well as preliminary and permanent injunctive relief. Moreover, a finding of intentional infringement could subject you to liability for treble damages, as well as Franchisor's costs and attorneys' fees in bringing a lawsuit to rectify the situation pursuant to Lanham Act, 15 U.S.C. Section 1117. Absent our agreement to the contrary, you will be in violation of the Lanham Act until the Hotel is completely de-identified and all representations end.

Additionally, Franchisor may pursue all remedies at law and under the Franchise Agreement to cause the de-identification of the Hotel and satisfaction of all post-termination obligations set forth in the Franchise Agreement, including without limitation the payment of liquidated damages pursuant to the Franchise Agreement.

As a condition precedent to commencing any negotiations for a new franchise agreement for the Hotel, Franchisor will require the following: (i) that the Hotel must at all times be operated and managed by a management company acceptable to Franchisor in its sole discretion and in accordance with all of the terms and conditions of a franchise agreement, (ii) that you will maintain adequate insurance over the Hotel in compliance with the Franchise Agreement and deliver to Franchisor (Attention: Insurance Department), a certificate of insurance (or certified copy of such insurance policy if requested by Franchisor) evidencing the coverages required in the Franchise Agreement and setting forth deductibles and the amount thereof, if any, (iii) that you have taken action to cause the Receiver Order to be amended to include the provisions set forth herein as Exhibit A, which reflects language Franchisor has received on numerous other occasions and (iv) all deficiencies under the Franchise Agreement shall be cured, including any outstanding quality issues, together with ongoing maintenance of the Hotel to Franchisor standards, and the payment of all outstanding amounts due under the Franchise Agreement, and Franchisor shall receive adequate assurances that such amounts incurred in the future in connection with the Hotel shall be paid in full. You will also be required to pay all costs and expenses of Franchisor, including attorney's fees, related to the matters contemplated hereby.

This letter does not supersede or affect any other default under, or breach of, the Franchise Agreement and is without prejudice to any other rights of Franchisor under the Franchise Agreement and applicable law. Franchisor reserves the right to pursue all remedies available to it in the event of any other default under, or breach of, the Franchise Agreement. Capitalized terms not otherwise defined in this letter shall have the meanings set forth in the Franchise Agreement.

Sincerely,

cc: [SPECIAL SERVICER or LENDER]

______________________________

______________________________

Attn: _______________________

4127158v1(99999.1)

E-2
EXHIBIT A

RECEIVER ORDER AMENDMENT

The Receiver has the right to enter into the form franchise agreement ("Franchise Agreement") with Franchisor International, Inc. ("Franchisor") in form and substance satisfactory to the Receiver and Franchisor, and to have the Hotel operated in accordance with the terms of the Franchise Agreement by a third-party management company approved by Franchisor in accordance with the terms thereof. The obligations of the Receiver shall be to insure that the Hotel is operated in accordance with state, local and federal laws, and maintained in accordance with the Standards required by the Franchise Agreement, and that both past due payments and those that come due under the Franchise Agreement during the receivership shall be promptly paid to Franchisor as on-going operating expense ahead of those payments due to the Receiver and Plaintiff. In the event there are insufficient funds from the operation of the Hotel to pay all amounts due to Franchisor or its affiliates under the Franchise Agreement (or related thereto), Plaintiff shall fund such amounts due to Franchisor. In the event the Receiver fails to comply with the terms of the Franchise Agreement and cure any defaults that may be cured under the terms of the Franchise Agreement, Franchisor shall have the absolute right to terminate the Franchise Agreement consistent with its terms, immediately on written notice to the Receiver. The Receiver shall have the right to expend and disburse funds for payment to Franchisor for amounts due from time to time under the Franchise Agreement without the approval of Plaintiff.
Carolyn Johnsen is Chair of the Business Restructuring & Reorganization Section at Jennings, Strouss & Salmon. For twenty-five years, Ms. Johnsen has served as a commercial bankruptcy and restructuring attorney, litigator and appellate attorney. She has extensive experience in every aspect of commercial reorganizations, representing both debtors and creditors and has been solely responsible for confirming multiple and complex plans of reorganization for clients in the real estate, manufacturing, refining, and hotel industries. In addition, Ms. Johnsen has represented numerous Unsecured Creditor Committees in some of the most high-profile cases filed in Phoenix.

Ms. Johnsen has lectured widely and written extensively on bankruptcy topics for state and national audiences. She has been recognized as one of 50 Southwest Super Lawyers for 2007-2011, named to Best Lawyers in America for 2008-2011, and was chosen a finalist for the Arizona Woman of the Year in 2009. In addition, in 2011 she was selected one of 25 lawyers nation-wide for the Direct Women Board Institution on Corporate Director Service. She is one of the 15 founding Masters of the Arizona Bankruptcy Inn of Court.

Ms. Johnsen is the founder of Arizona’s CARE (Credit Abuse Resistance Education) program designed to teach high school and college students about financial responsibility. She also served as Co-Chair of the state-wide committee to raise funds to revitalize programs at the Sandra Day O’Connor School of Law in Justice O’Connor’s honor and received the School’s Distinguished Achievement Award. Ms. Johnsen received a BS degree in Wildlife & Fisheries Science from Texas A&M University, a JD degree from Texas Tech School of Law and in 2011 an MA in Military History from Norwich University.
Steven M. Goldman is Executive Vice-President and Associate General Counsel for Marriott International, Inc. He is responsible for Marriott's Brand Transactions & Franchise group and the Intellectual Property group. He has been with Marriott since 1997. Steve received a J.D., cum laude, from the University of Georgia in 1985, was Articles Editor of the Georgia Law Review, and received a B.A., with Honors, from the University of Vermont in 1982, where he was Phi Beta Kappa.

After Law School, he clerked in the 5th Circuit for a federal district and a federal appeals judge before returning home to Atlanta where he worked in two of the large Atlanta firms. Following that he was Vice-President and General Counsel of the ITT Sheraton Franchise Division and Senior Litigation Counsel with Holiday Inn Worldwide.

Steve is a past Chair of the ABA Forum on Franchising and an Editor of the Franchise Law Compliance Manual and of the Fundamentals of International Franchising. He frequently speaks and publishes on franchise and hospitality law.
Glenn D. Moses is a shareholder in the Miami law firm of Genovese, Joblove & Battista, P.A., and specializes in the areas of complex bankruptcy and insolvency matters, business reorganization, creditors' rights and commercial litigation. Glenn represents chapter 11 debtors-in-possession, trustees, creditors' committees, secured and unsecured creditors, and purchasers of businesses and assets from bankruptcy estates. Glenn has substantial experience in litigating a wide variety of bankruptcy related claims at both the trial and appellate levels, including fraud claims and avoidance litigation. He also has significant experience in the representation of franchisors in numerous franchisee bankruptcies throughout the country.

Glenn holds an AV® Preeminent peer review rating from Martindale-Hubbell and has been named as a Super Lawyer by Florida Super Lawyers Magazine and has been recognized as one of South Florida's Top Lawyers by the South Florida Legal Guide and among the Legal Elite by Florida Trend magazine. He earned his J.D. degree from Boston University School of Law and his B.A. degree from the University of Massachusetts at Amherst.