

## CONTROL OF REAL ESTATE BY A FRANCHISOR: DOES THE FRANCHISOR HAVE AN ADVANTAGE UNDER THE BANKRUPTCY CODE?

By JEFFREY R. FINE,\* JOYCE G. MAZERO,†  
AND JOHN B. WEIMER\*\*

### I. INTRODUCTION

Since 1981, the number of bankruptcy cases filed in the United States has grown and there is every indication that the number of filings will continue to increase in coming years.<sup>1</sup> During the same time period, annual sales of goods and services through franchised businesses in the United States increased almost fifty percent to an estimated \$529 billion in 1985.<sup>2</sup> The number of businesses operated by franchise companies is expected to reach over 480,000 in 1985, an increase of approximately nine percent since 1983.<sup>3</sup> Similarly, sales of goods and services through franchised businesses is expected to increase annually over the next several years.<sup>4</sup>

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\* Associated with Strasburger & Price, Dallas, Texas. Member of Texas Bar. Benjamin N. Cardozo School of Law of Yeshiva University, J.D., 1981. Engaged in the practice of bankruptcy law; member of the Business Bankruptcy Committee of the American Bar Association.

† Member with Strasburger & Price, Dallas, Texas. Member of Texas Bar. St. Mary's Law School, J.D., 1979. Serves on the State Bar of Texas Franchising Committee; member of the Legal/Legislative Committee of the International Franchise Association.

\*\* Associated with Strasburger & Price, Dallas, Texas. Member of Texas Bar. Southern Methodist University School of Law, J.D., 1985; M.B.A., 1985. Currently engaged in the practice of corporate and banking law.

1. See *Annual Report of the Director of the Administrative Office of the United States Courts, REPORTS OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES HELD IN WASHINGTON, D.C. (1981 & 1985)*. There were 360,329 bankruptcy cases filed nationwide in the entire year of 1981, while 364,784 bankruptcy cases were filed nationwide from January through June 1985. *Id.* at 58 (1981), at 42 (1985).

2. See U.S. Department of Commerce, *FRANCHISING IN THE ECONOMY 1983-85* at 1 (Jan. 1985). The estimated figures represent the combined sales of product franchising (e.g., automobile and truck dealers, gasoline service stations, and soft drink bottlers) and business format franchising, which may involve the sale of a trademark product but is more often characterized by a system for marketing particular services to the public (e.g., restaurants, real estate services, personnel services). *Id.* at 1-5.

3. *Id.* at 1-4. The estimated figures include a decline in product franchisors since 1972 owing in part to a net loss of approximately 90,000 gasoline service stations between 1972 and 1983. *Id.* at 1-2.

4. *Id.* at 5-6.

Although it is difficult to calculate the number of franchise-related bankruptcy proceedings, it is not difficult to imagine that an increasing number of franchisors have unwillingly become acquainted with the vagaries of the bankruptcy court system. There are three major areas in which franchisors have become involved in the bankruptcy proceedings of franchisees. These three areas may be generally classified as proceedings involving (a) the status of the franchisor's franchise agreement, (b) the treatment of direct and indirect financing arrangements with franchisees, and (c) the status of real property which may comprise the franchised location.<sup>5</sup> This article will deal only with the last category and will include specific discussion of the franchisor's relationship with the franchisee-debtor under its franchise agreement and corresponding lease of the franchised premises. The relationship between the agreement and lease has been described as "interdependent" or "integral"<sup>6</sup> and has been pivotal, in certain circumstances, in the judicial determination of whether the franchisor will retain control of a franchised location.<sup>7</sup> When considered in conjunction with the recent amendments to the Bankruptcy Code concerning leases of nonresidential real property,<sup>8</sup> the interdependence of the franchise agreement and lease of the premises may figure prominently in a franchisor's bankruptcy strategy because the success of many franchised businesses is significantly associated with the commercial viability of the franchised location.

Unexpired leases receive special statutory treatment in proceed-

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5. See Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439 (1973) [hereinafter cited as Countryman]; Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. L. REV. 341 (1980); Garner, *Franchise and Dealer Agreements Under Chapter 11 of the Bankruptcy Code*, 59 AM. BANKR. L.J. 197 (1985); Mazero, *Bankruptcy of the Franchisee: The Franchisor's Initial Strategy*, 4 FRANCHISE L.J. 1 (1984); Quittner, *Franchises in Bankruptcy: Termination, Rejection and Assumption*, 90 COM. L.J. 83 (1984).

6. The construction of agreements as interdependent is not an unfamiliar legal principle as courts have regularly construed separate writings as one transaction when the parties are the same, the subject matter is the same, and the relationship between documents is clearly apparent. See D.H. Pritchard Inc. v. Nelson, 147 F.2d 939, 942 (4th Cir. 1945); Ashland Oil, Inc. v. Donahue, 223 S.E.2d 433, 437 (W. Va. 1976), *aff'd*, 264 S.E.2d 466 (W. Va. 1980).

7. See *infra* notes 121-136 and accompanying text (interdependence doctrine as a means by which a franchisor may retain control of the franchised location).

8. 11 U.S.C. §§ 101-1326 (Supp. III 1985). The Bankruptcy Code was enacted as the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). It was amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984) [hereinafter referred to as the 1984 Amendments].

ings under the Bankruptcy Code.<sup>9</sup> A debtor, including a franchisee, may reject, assume, and/or assign unexpired leases of real property, as well as executory contracts such as franchise agreements.<sup>10</sup> Typically, the Chapter 11 franchisee-debtor must maximize a cash return for the bankruptcy estate which results from the disposition of its unexpired leases of real property and franchise agreements.<sup>11</sup> When the franchisor and franchisee fail to agree to this disposition, the franchisor may attempt to prohibit the assumption of the franchisee's leased location and/or its franchise agreement. In bankruptcy proceedings, the franchisor may attempt to prevent the franchisee-debtor from differentiating between the treatment given to these agreements (e.g., assumption of the lease of nonresidential real property and rejection of the franchise agreement) by arguing that the franchise agreement and the lease of the franchised location are interdependent, or otherwise constitute an integral business and legal relationship not susceptible to separate treatment by the franchisee-debtor.<sup>12</sup> Similarly, the favored treatment afforded landlords of unexpired leases of nonresidential real property under the 1984 Amendments may be helpful to the franchisor. The amendments require the lessee's prompt

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9. See 11 U.S.C. § 365 (1984). See also *infra* note 51 and accompanying text (treatment of unexpired leases under the Bankruptcy Code).

10. *Id.*

11. 11 U.S.C. §§ 1101-1123. Most Bankruptcies filed by franchisees are filed under Chapter 11 of the Bankruptcy Code for the purpose of reorganizing their affairs rather than liquidating their operations.

12. The theory of interdependence has proved to be a disadvantage to a franchisor in certain non-bankruptcy contexts. In *Mlynek v. Headquarters Cos.*, 165 Cal. App. 3d 1133, 209 Cal. Rptr. 593 (1984), the court held that an unlawful detainer action filed by a franchisor against a franchisee was subject to arbitration because the franchise agreement and sublease made specific reference to the other. *Id.* The franchise agreement required the franchisee to perform all lease obligations and required the subleased property to be used in accordance with the franchise agreement. The franchise agreement also specified the duration of the sublease. *Id.* at 1136, 209 Cal. Rptr. at 595. The court stated: "Because the two documents are so interrelated we must conclude they must be viewed together. Thus the arbitration provision contained within the franchise agreement is construed to apply to the dispute over possession of the premises arising out of the sublease agreement." *Id.*

See *Ashland Oil, Inc. v. Donahue*, 223 S.E.2d 433 (W. Va. 1976), *aff'd*, 264 S.E.2d 466 (W. Va. 1980). This case was decided prior to the effective date of the Petroleum Marketing Practices Act, 15 U.S.C. § 2801 (1978), which includes a dealer's leased premises in the definition of "franchise" and regulates the termination and non-renewal of relationships involving the marketing and distributing of motor fuel. See also *Kaba Properties, Inc. v. Wissir Co.*, 1981-1 TRADE CAS. (CCH) ¶ 64,108, (E.D.N.Y.), *aff'd*, 671 F.2d 492 (2d Cir. 1981).

attention to its lease obligations and usually expedite the lessee's election to reject or assume the lease.<sup>13</sup>

This article reviews the 1984 Amendments as they specifically relate to the treatment of nonresidential leases of real property. It also considers other sections of the Bankruptcy Code which impact the franchisor-lessor's position in a franchisee's bankruptcy proceeding. The interdependence analysis will then be examined in specific bankruptcy cases.

## II. OUTLINE OF BANKRUPTCY AMENDMENTS AND FEDERAL JUDGESHIP ACT OF 1984

The Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 Amendments) were enacted on July 10, 1984.<sup>14</sup> In addition to establishing a new system of jurisdiction, the 1984 Amendments substantively changed a variety of Bankruptcy Code provisions.<sup>15</sup> The 1984 Amendments, as outlined in the following subsections, substantially affect nonresidential real property.<sup>16</sup>

### A. *Amendments to Section 365*

Section 365 of the Bankruptcy Code originated from section 70 of the now repealed 1898 Bankruptcy Act.<sup>17</sup> Prior to 1985, general conditions or covenants in a lease prohibiting assignment were unenforceable to prevent assumption and assignment of a lease by the

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13. See 11 U.S.C. § 365(d)(3) (rent must be paid until lease assumed or rejected). See also *id.* § 365(d)(4) (60-day time limit to assume or reject lease).

14. See Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in various sections found in titles 11 and 28 of the U.S. Code). See also *infra* notes 15-19 and accompanying text.

15. Title 28 of the United States Code was extensively amended; many of the prior jurisdictional provisions were revised and new procedural and substantive provisions were provided. See *supra* note 14. Title 11 of the United States Code was also extensively amended, including § 547 of the Code which now provides broadened defenses to preference actions. See 11 U.S.C. § 365(h)(1), (h)(2), and (i). Provisions were also added in § 365 of the Code which affected the rights of timeshare purchasers. A new § 557 as well as a substantive revision of § 507 provide for expedited procedures to determine rights to and disposition of grain or fish deposited with debtor grain storage facilities or fish produce storage facilities. *Id.* §§ 507, 557. Alterations to § 1113 of the Code make it somewhat more difficult for a Chapter 11 debtor-employer to reject collective bargaining agreements. *Id.* § 1113. But see *supra* note 137 and accompanying text. Many changes to Chapter 7 and Chapter 13 of the Code increase the categories of nondischargeable debts and otherwise curtail abuses of the bankruptcy process by consumer debtors. See *id.* §§ 703-66, 1301-29.

16. See 11 U.S.C. §§ 365, 541, & 362 (1978) (as amended 1985).

17. 11 U.S.C. § 110(b) (repealed 1978). Section 70 provided: "The trustee

trustee.<sup>18</sup> Express covenants terminating the lease, giving one party an election to terminate by operation of law, or the bankruptcy of a specified party were usually enforceable.<sup>19</sup> Each of the rehabilitative chapters of the 1898 Act contained a provision authorizing the court to permit rejection of the debtor's executory contracts on notice to contracting parties and such others as the court directed.<sup>20</sup> Under the 1898 Act, a contract that was entered into or assumed during the course of a rehabilitative proceeding which remained in whole or part executory upon conversion to a liquidation proceeding was deemed rejected, unless it was assumed within 60 days after the trustee's qualification.<sup>21</sup> If the contract was rejected, the resulting liability was a cost of administration of the superseded case.<sup>22</sup>

In 1978 Congress combined the rehabilitative chapters of the 1898 Act to form the new Chapter 11 provisions of the Bankruptcy Code.<sup>23</sup> The new section 365 of the Bankruptcy Code was made applicable, with few exceptions, to all proceedings under the Bankruptcy Code.<sup>24</sup> Pursuant to section 365, the trustee,<sup>25</sup> subject to court

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shall assume or reject an executory contract, including an unexpired lease or real property, within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later, but the court may for cause shown extend or reduce the time." *Id.*

18. *Id.*

19. See *Queens Blvd. Wine & Liquor Corp. v. Blum*, 503 F.2d 202 (2d Cir. 1974). Section 365(e) and (f) of the Bankruptcy Code followed *Queens Boulevard*, by making forfeiture clauses or antiassignment provisions generally unenforceable. See 11 U.S.C. § 365(e), (f).

20. Section 116(1) of Chapter X (Corporate Reorganizations) provided: "Upon approval of a petition, the judge may, . . . (1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate." 11 U.S.C. § 516(1) (1898) (repealed 1978). See also *id.* § 365 (current parallel provision to § 116(1)).

21. The Bankruptcy Act § 238(b) (Chapter X); § 378(b) (Chapter XI); and § 843(b) (Chapter XII) contained such a provision; however, Chapter XIII (Wage Earners' Plans) did not. 11 U.S.C. § 348 (current version of §§ 238(b), 378(b), and 843(b)).

22. See 11 U.S.C. § 348 (1978).

23. See Report of the Comm. on the Judiciary, S. REP. No. 989, 95th Cong., 2d Sess. 5, 92, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5795-98. See also COLLIER'S ON BANKRUPTCY, app. 3 (15th ed. 1985) (general discussion of the new Chapter 11 statutory scheme).

24. With the exception of the special treatment accorded commodity broker liquidations, the provisions of § 365 (as well as most other provisions in Chapters 1, 3, and 5 of the Bankruptcy Code) are support provisions applicable to the reorganization, specialized proceedings, liquidation, and wage-earners chapters of the Bankruptcy Code. See 11 U.S.C. §§ 101-09, 301-66, 501-56.

25. See 11 U.S.C. §§ 902(4), 1107, & 1303 (sections generally provide that

approval, may assume or reject any executory contract or unexpired lease of the debtor.<sup>26</sup> Conditions for the assignment of unexpired leases and executory contracts, the treatment of existing defaults of an executory contract or unexpired lease and the time limits for exercising assumption or rejection are treated in subsections (b), (c), and (d) of section 365.<sup>27</sup> Section 365(b) of the Bankruptcy Code sets forth conditions which allow for the assumption of an executory contract or unexpired lease when there has been a default.<sup>28</sup> The trustee<sup>29</sup> may not assume such contract or lease unless, at the time of assumption, the trustee:<sup>30</sup>

- (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 such default; and
- (C) provides adequate assurance of future performance under such contract or lease.<sup>31</sup>

This provision remains unchanged by the 1984 Amendments.

Leases of real property in shopping centers which are subject to the provisions of section 365(b)(1) are also treated in section

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a debtor-in-possession is placed in the shoes of a trustee). *See also* S. REP. NO. 989, 95th Cong., 2d Sess. 5, 109, 116, 140, reprinted in U.S. CODE CONG. & AD. NEWS 5787, 5895, 5902, 5926.

26. *See* 11 U.S.C. § 365(a) (cross-reference to §§ 765 and 766 which provide special treatment to protect customer accounts in commodity broker liquidations). Section 365(a) also introduces the subsections (b), (c), and (d) which contain limitations upon the general authority to assume or reject executory contracts and unexpired leases.

27. *Id.* § 365(b)-(d).

28. 11 U.S.C. § 365(b) (trustee's treatment of unexpired leases and executory contracts). Pursuant to § 365(b)(2), defined defaults (for purposes of application of § 365(b)(1)) do not include a default that is a breach of a provision relating to:

- (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
- (B) the commencement of a case under this title; or
- (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

This provision remains unchanged by the 1984 Amendments.

29. *See supra* note 25 and accompanying text (role of trustees). *See also* 11 U.S.C. § 902(4) (definition of trustee).

30. 11 U.S.C. § 365(b)(1)(A)-(C).

31. *Id.*

365(b)(3).<sup>32</sup> Subsection 365(b)(3) substantially expands the test of section 365(b)(1) in the context of shopping-center leases through the extensive definition of what constitutes "adequate assurance of future performance."<sup>33</sup>

Prior to 1984, section 365(b)(3)(A) defined "adequate assurance of future performance" to generally include adequate assurance of the source of rent.<sup>34</sup> This section required that percentage rents not decline substantially,<sup>35</sup> assumption or assignment of the lease not breach provisions requiring tenants to maintain certain standards within shopping centers,<sup>36</sup> and assumption or assignment not substantially disrupt the tenant mix or balance in the shopping center.<sup>37</sup> The 1984 Amendments to subsections 365(b)(3)(A) set forth an "operating performance and financial condition" test,<sup>38</sup> while the amendments to subsection 365(b)(3)(C) require that assumptions and assignments conform to all provisions of the subject lease.<sup>39</sup>

A new section 365(c)(3)<sup>40</sup> was added by the 1984 Amendments

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32. *Id.* § 365(b)(3).

33. *Id.*

34. 11 U.S.C. § 365(b)(3)(f). *See infra* note 38 (complete text).

35. *Id.* § 365(b)(3)(B) (no substantial decline in rent).

36. *Id.* § 365(b)(3)(C) (maintenance of shopping center standards).

37. *Id.* § 365(b)(3)(D) (no substantial changes in tenant mix).

38. 11 U.S.C. § 365(b)(3) (amended 1984). Section 365(b)(3) provides:  
(3) For the purpose of paragraph (1) of this subsection and paragraph (2)(B) of subsection (1), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance:

(A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

Note that "operating performance" and "financial condition" are undefined terms which undoubtedly will be the subject of extensive litigation in future cases.

39. *Id.* § 365(b)(3)(C). *See supra* note 38 (complete text).

40. *See supra* note 38; 11 U.S.C. § 365(c)(3).

to prohibit assumption or assignment of a nonresidential lease of real property if the lease has been terminated under applicable non-bankruptcy law prior to the order for relief. This new provision should make it easier for lessors to enforce pre-bankruptcy terminations of leases.<sup>41</sup>

A revised section 365(d)(4) sets forth conditions under which a lease of nonresidential real property may be deemed rejected.<sup>42</sup> Upon rejection the trustee<sup>43</sup> must immediately surrender such nonresidential real property to the lessor, unless the trustee assumes or rejects the unexpired lease within 60 days after the entry of the order for relief.<sup>44</sup> Recent judicial interpretations of this provision, however, have been inconsistent. Some courts have indicated that an action evidencing the trustee's intent to assume the lease, by filing a motion to assume the unexpired lease within the 60-day period, may be sufficient to preclude rejection of the lease even if the bankruptcy court has not approved the debtor's motion within the 60-day period.<sup>45</sup> Other courts have interpreted section 365(d)(4) as requiring that both the motion to assume be filed as well as court approval of the motion be obtained

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41. See *In re Bronx-Westchester Mack Corp.*, 4 Bankr. 730 (Bankr. S.D.N.Y. 1980), for an example of a pre-1984 Amendments case in which a pre-bankruptcy termination of a distributorship agreement was held invalid by the bankruptcy court which was entertaining an application to assume and/or assign the subject agreement.

42. 11 U.S.C. § 365(d)(4).

43. See *supra* note 25 and accompanying text.

44. 11 U.S.C. § 365(d)(4) provides:

(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

45. This provision is applicable to cases under any chapter of the Bankruptcy Code, unless extended by the court on application prior to the expiration of the 60-day period. Most courts have declined to follow a literal reading of this statutory provision which might otherwise require that court approval of a debtor's motion to assume a nonresidential lease for real property must be obtained within the 60-day period. Accordingly, the debtor or trustee must act to assume or reject the lease, presumably by filing a motion, within the 60-day period, unless this period is extended for cause. See *In re Unit Portions of Del., Inc.*, 13 BANKR. Ct. DEC. (CRR) 635 (Bankr. E.D.N.Y. 1985). In *Unit Portions*, the court held that § 365(d)(4) was intended to assure that the trustee submit the request for assumption within 60 days and to preclude a court from extending the time for assumption where the application has not been timely made.

within the 60-day period.<sup>46</sup> Finally, new subsection (m) to section 365 makes clear that leases of real property, as referred to in sections 365, 541(b)(2), and 362(b)(9), include any rental agreement to use real property.<sup>47</sup>

### B. Amendments to Sections 362 and 541

A new section 362(b)(9) was added to make clear that the lessor need not take affirmative action<sup>48</sup> to obtain possession of leasehold property where there has been pre- or post-bankruptcy termination of the nonresidential real property lease.<sup>49</sup> The 1984 Amendments also added a new section 541(b)(2) which excludes from estate property any interest of a debtor as lessee of a lease of nonresidential real property which has undergone either pre- or post-bankruptcy termination.<sup>50</sup> It is noteworthy that the drafters of this new provision

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46. In cases where the courts have adopted a literal reading of § 365(d)(4), they have cited the specific language of this provision as requiring that the court grant the debtor's motion to assume within the 60-day period, or the lease is conclusively presumed to be rejected. See *In re Las Margaritas, Inc.*, 54 Bankr. 98 (Bankr. D. Nev. 1985).

47. 11 U.S.C. § 365(m). Presumably, a franchisee's lease of a sign bearing the franchisor's trade name or trademark affixed to the franchisee premises would constitute a rental agreement to use real property subject to the provisions of § 365. *Id.*

48. The filing of a motion for relief from stay is the appropriate action to obtain a court order modifying the stay to permit a lessor to take possession of property. This provision exempts lessors in the narrow situation of terminated nonresidential leases from the requirement of obtaining such relief prior to taking possession of the subject leasehold property. Draconian penalties for knowingly violating the automatic stay can be levied both upon the lessor and its counsel. See *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47 (2d Cir. 1976), *cert. denied*, 429 U.S. 1093 (1977).

49. 11 U.S.C. § 362(b)(9) reads as follows:

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. § 78(a)(3)), does not operate as a stay:

\*(9) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;

\*Note: The drafters of the 1984 Amendments failed to properly number 362 section (b) subsections. Hence, although § 362(b)(9) should have been renumbered as (b)(10), it will remain as (b)(9) until corrected by a currently pending technical corrections act. 11 U.S.C. § 362(b)(9).

50. 11 U.S.C. § 541(b)(2) (Supp. 1984). See also *supra* note 46 and accompanying text.

did not exclude from estate property, by implication, the property interests of lessors of nonresidential leases which have terminated either pre-bankruptcy or post-bankruptcy.<sup>51</sup> Presumably, a lessee who subleases space from a lessor may not be able to take any action to divest the debtor-lessor of his property interest as sublessor pursuant to sections 541(b)(2) and 362, unless the lessee first obtains relief from automatic stay.<sup>52</sup>

When read together, the 1984 Amendments to sections 365, 541, and 362 may greatly affect the landlord-tenant relationship which may involve a franchise relationship. Therefore, a more detailed discussion of these sections, and how they may be utilized by the franchisor-lessor to further its relative position upon the filing for debtor relief by a franchisee-lessee, is in order.

### III. PROPERTY OF THE BANKRUPTCY ESTATE

The filing of a petition in bankruptcy creates an estate that includes "all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>53</sup> The provisions of the Bankruptcy Code apply to the management and disposition of the property in the debtor's estate.<sup>54</sup> Although the Bankruptcy Reform Act of 1978<sup>55</sup> provided no definition of what constitutes a lease, the creation of a bankruptcy estate is broadly read under section 541 to consist of property of all kinds, whether tangible or intangible, including a debtor's leasehold interest in real property.<sup>56</sup>

This reading is further punctuated by certain recent revisions found in the 1984 Amendments which clarify those instances where an estate does *not* include a debtor's leasehold interest in real property. For example, as previously noted,<sup>57</sup> under new section 541(b)(2) the bankruptcy estate does not include any interest of a debtor as a lessee under a nonresidential lease that terminated prior to the expiry date of the lease and before the commencement of the case or during the case.<sup>58</sup>

It is generally recognized that a lease which has been effectively

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51. *Id.* § 362 (automatic stay provisions).

52. *Id.* See *infra* notes 102-204.

53. 11 U.S.C. § 541(a).

54. See generally S. REP. No. 989, 95th Cong., 2d Sess. 5, 82-83, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5868.

55. See *supra* note 8 and accompanying text.

56. See *In re American Int'l Airways, Inc.*, 44 Bankr. 143, 145 (Bankr. E.D. Pa. 1984); *In re Babco, Inc.*, 28 Bankr. 656, 658 (W.D. Pa. 1983).

57. See *supra* notes 50-51 and accompanying text.

58. *Id.*

terminated prior to the filing of a bankruptcy petition does not become property of the bankruptcy estate and the filing of a petition in bankruptcy will not revive the rights of a lessee in a terminated or expired lease.<sup>59</sup> Even so, most bankruptcy courts will carefully review the circumstances under which a lease for real property has been terminated.<sup>60</sup>

Whether or not a lease has been terminated prior to the filing of a petition in bankruptcy is generally a question of state law.<sup>61</sup> For example, in *In re Fontainebleau Hotel Corp.*,<sup>62</sup> a debtor defaulted under a lease. The lessor delivered its notice of termination, permitted the contractual grace period to expire, and delivered a notice to vacate the premises in accordance with the termination provisions contained in the lease. Before the lessor could obtain a judgment of possession, however, the debtor filed a bankruptcy petition and continued to remain in possession of the premises. The court of appeals held that the termination of the lease did not occur under Louisiana law until a judgment of possession was issued.<sup>63</sup> In *In re Foxfire Inn of Stuart Florida, Inc.*,<sup>64</sup> a lessee defaulted upon its rental payments under a lease and the landlord terminated the lease in accordance with its provisions on February 11, 1983.<sup>65</sup> The lessee did not cure its defaults within the grace period provided by the termination procedure. The Bankruptcy Court determined that the lease was terminated after the expiration of the grace period on March 13, 1983, even though the lessee remained in possession of the premises and the landlord had instituted but not concluded its eviction proceeding prior to the filing of the debtor's petition in bankruptcy on April 5, 1983.<sup>66</sup> Criticizing a decision which concluded that a lease does not expire until the tenant has voluntarily surrendered the premises or has been physically removed prior to bank-

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59. See *In re Triangle Laboratories, Inc.*, 663 F.2d 463, 467-68 (3d Cir. 1981). The court stated: "[A]n executory contract or lease validly terminated prior to the institution of bankruptcy proceedings is not resurrected by the filing of the petition in bankruptcy, and cannot therefore be included among the debtor's assets." See also *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1213 (7th Cir.), cert. denied, 105 S. Ct. 386 (1984).

60. See *In re Waterkist Corp.*, 775 F.2d 1089 (9th Cir. 1985); *In re Barclay Indus., Inc.*, 736 F.2d 75 (3d Cir. 1984).

61. See *In re Escondido W. Travelodge*, 40 Bankr. 152 (Bankr. S.D. Cal. 1984).

62. 515 F.2d 913 (5th Cir. 1975).

63. *Id.* at 914 (court's determination though an issuance of a judgment would have been *pro forma* under state law).

64. 30 Bankr. 30 (Bankr. S.D. Fla. 1983).

65. *Id.* at 31.

66. *Id.*

ruptcy,<sup>67</sup> the Bankruptcy Court entered an order lifting the automatic stay to permit the landlord to proceed with its eviction proceeding.<sup>68</sup>

A similar result occurred in *In re Maxwell*<sup>69</sup> which involved the termination of a lease by a franchisor under Illinois state law. In December 1979,<sup>70</sup> the franchisor, Chart House, and its franchisee, Maxwell, had entered into a Burger King franchise agreement and a sublease which covered the restaurant premises. Subsequently, Maxwell failed to make rental payments under the sublease as well as other required payments under the franchise agreement. On April 6, 1982, Chart House sent a letter to the franchisee demanding that the defaults in payment under both the lease and the franchise agreement be promptly cured within 30 days.<sup>71</sup> No cure was forthcoming and on May 7, 1982 the franchisor sent Maxwell a "Landlord's Five Day Notice" which stated that unless the franchisee paid his rent within 5 days its lease would be terminated, at which time possession of the premises was to return to the franchisor. The franchisee refused to pay the rent or relinquish possession of the restaurant. On May 19, 1982, the franchisor brought an action in state court for possession of the restaurant and for judgment in the amount of the arrearages. The franchisee filed a petition in bankruptcy on May 21, 1982.<sup>72</sup> The district court, reversing the bankruptcy court's decision, held that under Illinois law, upon the expiration of the 5-day notice, the franchisee lost its leasehold interest and became a tenant at sufferance.<sup>73</sup> The court stated: "The termination

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67. See *Executive Sq. Office Bldg. v. O'Connor & Assocs., Inc.*, 19 Bankr. 143 (Bankr. N.D. Fla. 1981) (*dictum* stating that a lease does not "expire" for purposes of § 365 unless, and until, the tenant voluntarily surrenders the premises or is physically removed by the sheriff before the bankruptcy petition is filed). But see *In re Fontainbleau Hotel Corp.*, 515 F.2d 913 (5th Cir. 1975) (applying Louisiana law which requires a landlord to obtain a judgment for possession in order to terminate a lease); *In re Maxwell*, 40 Bankr. 231, 236-37 (N.D. Ill. 1984) (court concurred with *Foxfire* that a lease is effectively terminated prior to bankruptcy filing once the grace period expires, even though the tenant has not voluntarily surrendered property or been evicted by the sheriff).

68. *Foxfire*, 30 Bankr. at 31. See also *In re Bahia Resorts, Inc.*, 46 Bankr. 44 (Bankr. M.D. Fla. 1985).

69. 30 Bankr. 982 (Bankr. N.D. Ill. 1983), *rev'd*, 40 Bankr. 231 (N.D. Ill. 1984). The decision of the federal district court was appealed. *In re Maxwell*, Nos. 84-1913 & 84-1914 (7th Cir.), was subsequently settled prior to a ruling by the Seventh Circuit and was dismissed upon stipulation of the parties on April 5, 1985. Telephone interview with G. Alexander McTavish of Ruddy, Myler, Rudy & Fabron (Oct. 7, 1986).

70. *Maxwell*, 40 Bankr. at 233.

71. *Id.* at 234.

72. *Id.*

73. *Id.* at 237.

before bankruptcy of a lease pursuant to its terms and applicable state law results in its expiration, even if, as the case here, the tenant remains in possession as a tenant at sufferance and the landlord has instituted but not yet concluded an eviction proceeding.<sup>74</sup>

It would appear that a lessor of real property has considerable incentive to ensure that its leases contain clear termination provisions which will be effective under the relevant state law.<sup>75</sup> Despite the fact that a lease has been effectively terminated prior to bankruptcy, several courts and commentators have taken the position that under certain circumstances, the termination of the debtor's interest in a lease may be set aside as a fraudulent transfer or a preference under the Bankruptcy Code.<sup>76</sup>

In a pre-Bankruptcy Code case, *In re Ferris*,<sup>77</sup> a lessor appealed an order of the bankruptcy court invalidating his termination of a lease held by the bankrupts.<sup>78</sup> The bankrupts had added improvements of roughly \$400,000 to the leasehold estate.<sup>79</sup> The unpaid balance of the notes and mortgages on the improvements totalled only \$214,000. The subsequent termination of the lease caused the bankrupts to lose approximately \$186,000 of equity in the leasehold estate. Under these circumstances, the court found, without elaboration, that the termination of the lease was a "transfer."<sup>80</sup> The court then determined that the termination of the lease was a fraudulent transfer as defined under the Bankruptcy Act of 1898,<sup>81</sup> because fair consideration in exchange for the termination was lacking, i.e., the substantial equity loss precluded an adequate exchange.<sup>82</sup> It should be noted that *Ferris* was decided under the fraudulent transfer pro-

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74. *Id.* at 237 (citing *Foxfire* as authority).

75. This seems true notwithstanding the *Kaba Properties, Inc.* and *Mlynek* decisions. See *supra* note 9 and accompanying text. The interdependence between a franchise agreement and a lease may affect the right of a franchisor-lessor to terminate a lease for real property despite such ostensibly clear termination provisions. This is so even though the provisions of state franchise laws generally do not cover the termination of leases. *E.g.*, CAL. BUS. & PROF. CODE §§ 20,000-20,043 (Deering 1984); HAWAII REV. STAT. § 482E-6 (Supp. 1985).

76. See *infra* notes 77-100 and accompanying text.

77. 415 F. Supp. 33 (W.D. Okla. 1976).

78. The Bankruptcy Court's order allowed the trustee to sell the lease, holding that the trustee was entitled to the ownership of the lease, subject to the lessor's right of payment for past due rents. *Id.* at 36.

79. In pre-Bankruptcy Code cases, it was appropriate to describe debtors as "bankrupts."

80. *Ferris*, 415 F. Supp. at 39.

81. 11 U.S.C. § 1(30) (repealed 1978). See *infra* note 66 and accompanying text.

82. *Ferris*, 415 F. Supp. at 39.

visions found in the Bankruptcy Act of 1898<sup>83</sup> which, as noted by at least one other court, incorporated lease agreements in a broader definition of "transfer" which included the language "parting . . . with the possession thereof."<sup>84</sup>

Fraudulent transfers under the Bankruptcy Code are defined to include transfers which occurred when the debtor was insolvent or left insolvent as a result of the transfer, or when the transfer took place within one year prior to filing the bankruptcy petition, and the transfer brought the debtor less than a "reasonably equivalent value."<sup>85</sup> A transfer meeting these criteria may be avoided by the trustee or debtor-in-possession as a fraudulent transfer.<sup>86</sup> In *In re Fashion World, Inc.*,<sup>87</sup> the debtor-lessee and the defendant-lessor entered into an agreement whereby the lessor obtained an option to terminate the lease in return for an agreement to mitigate damages by seeking out new tenants. Subsequent to entering into the agreement, the debtor filed for relief under Chapter 11 of the Bankruptcy Code and sought to avoid the option agreement as a fraudulent transfer.<sup>88</sup>

Although silent as to the reason for entering into the stipulation, the court noted that the lessor stipulated that the option to terminate the lease was a transfer.<sup>89</sup> The sole question left for consideration by the court was whether the debtor "received less than a reasonable equivalent value in exchange for" entering into the option agreement.<sup>90</sup> In analyzing the question of whether reasonably equivalent value was received, the court found that the lease was assignable and therefore had a market value.<sup>91</sup> It then concluded that the debtor was deprived of a valuable asset when the parties entered into the option agreement.<sup>92</sup> Since no reasonably equivalent value was given, the court held that the termination of the lease itself was a fraudulent transfer.<sup>93</sup>

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83. 11 U.S.C. §§ 101-1330 (repealed 1978).

84. See *In re Jermoo's Inc.*, 38 Bankr. 197, 205 (Bankr. W.D. Wis. 1984) (analysis of the *Ferris* decision and a definition of "transfer" under the Bankruptcy Act of 1898 which implies that the inclusion of the words "parting . . . with the possession thereof" in 11 U.S.C. § 1(30) (repealed 1979) specifically incorporated lease agreements).

85. See 11 U.S.C. § 548 (Supp. 1986).

86. *Id.*

87. 44 Bankr. 754 (Bankr. D. Mass. 1984).

88. *Id.* at 756.

89. *Id.*

90. *Id.*

91. *Id.* at 757-59.

92. *Id.* at 759.

93. *Id.* See generally *In re Jermoo's Inc.*, 38 Bankr. 197 (Bankr. W.D. Wis.

In *In re Jermoo's, Inc.*,<sup>94</sup> the court distinguished *Ferris*, noting that that decision was made under the Bankruptcy Act of 1898 which included a definition of transfer different from the definition under the 1984 Amendments. Although *Jermoo's* involved a question of whether or not the termination of a franchise relationship was a "transfer," the court implied that the new definition of transfer included in the 1984 Amendments<sup>95</sup> no longer included lease terminations.<sup>96</sup> As suggested in *Fashion World*, the court indicated that the assignability of the franchise agreement is significant in determining whether the termination of the franchise relationship might have deprived the debtor of a valuable property right.<sup>97</sup> Although the court held that the cancellation of the franchise relationship was not a transfer that could be avoided by the debtor-in-possession or trustee, it did suggest, *in dicta*, that the termination of a valuable property right of the debtor might rise to the level of a fraudulent transfer.<sup>98</sup>

Therefore, where the lease of nonresidential real property has not been effectively terminated in accordance with applicable state law, or the termination is otherwise set aside as a fraudulent transfer, the leasehold will be considered property of the bankruptcy estate under section 541.<sup>99</sup> As a result non-debtor parties, including non-debtor franchisor-lessors, are prohibited by the automatic stay from taking possession of the leasehold premises.<sup>100</sup>

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1984). See also *In re Commodity Merchants, Inc.*, 538 F.2d 1260, 1263 (7th Cir. 1976) (contracts for the sale of commodities did not have market value due to limitations alienability; therefore, seller's cancellation of contracts 10 days before bankruptcy adjudication of buyer did not constitute a "transfer").

94. 38 Bankr. 197 (Bankr. W.D. Wis. 1984).

95. See *supra* note 81 and accompanying text.

The definition of "transfer" under the 1984 Amendments is "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption . . . ." 11 U.S.C. § 101(48).

96. *Jermoo's*, 38 Bankr. at 205.

97. *Id.* at 205. See *Commodity Merchants*, 538 F.2d at 1263. See also 11 U.S.C. § 101(48).

98. *Jermoo's*, 38 Bankr. at 205. The court cited *Allen v. Archer, Daniels Midland Co.*, 538 F.2d 1260, 1263 (7th Cir. 1976). See G. GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 133 (2d ed. 1940), which discusses circumstances under which the transfer of a property interest might be found to be a fraudulent transfer or a preference. *Id.* at 205-06.

99. 11 U.S.C. § 541 (property of the debtor's estate).

100. *Id.* § 362(a)(3) (automatic stay provisions applicable to acts affecting possession of property).

#### IV. LANDLORD'S RIGHTS UNDER SECTION 362 AND THE AUTOMATIC STAY

Although the 1984 Amendments to section 365 have been summarized in this article,<sup>101</sup> a brief review of the section's time requirements is required in order to analyze a lessor's alternatives pending the decision of the trustee or the debtor to assume or reject the lease.<sup>102</sup>

During the interim period between the entry of an order for relief and the decision of the trustee or debtor to assume or reject the lease, the Bankruptcy Reform Act of 1978 did not require the trustee to meet most leasehold obligations.<sup>103</sup> In a Chapter 7 proceeding, if the trustee did not assume or reject a lease within 60 days from the order of relief the lease was deemed rejected, unless within the 60-day period the bankruptcy court, for cause, granted the trustee additional time to decide to assume or reject the lease.<sup>104</sup> In other bankruptcy proceedings there was no such deadline. Rather, upon request of a lease party the bankruptcy court was empowered to require the trustee or lessee to assume or reject the lease within a specified time period.<sup>105</sup>

The ever increasing number of bankruptcy filings, crowded trial dockets and corresponding time delays prompted the commercial real estate industry to complain about the damage these procedural requirements caused to lessors and their tenants.<sup>106</sup> As a partial response, Congress, in the 1984 Amendments, provided in section 365(d)(4) that the trustee or the debtor must decide whether or not to assume or reject a lease for nonresidential real property within

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101. See *supra* notes 15-50 and accompanying text.

102. See Bordewieck, *The Post-Petition, Pre-Rejection, Pre-Assumption Status of an Executory Contract*, 59 AM. BANKR. L.J. 197 (1985) [hereinafter cited as Bordewieck].

103. See *supra* note 13 and accompanying text.

104. 11 U.S.C. § 365(d)(1) (time limits for assuming or rejecting unexpired leases).

105. Other time requirements imposed by the Bankruptcy Code involve § 1121(b), under which a debtor has the exclusive right to file a plan of reorganization within 120 days after the date of entry of the order for relief in a Chapter 11 case. The failure to propose a plan within the time prescribed by the bankruptcy court may subject the debtor to conversion to a Chapter 7 case under § 1112(b)(4), the appointment of a trustee or examiner in the Chapter 11 proceeding under § 1104, or the filing of a plan of reorganization by creditors or other interested parties. Under § 365(a) a trustee may assume or reject an executory contract or unexpired lease before the confirmation of the plan; however, under § 365(d)(2) a nondebtor party may request the bankruptcy court to order the trustee to determine within a specific period of time whether to assume or reject an executory contract or an unexpired lease. See 11 U.S.C. §§ 365(a), 365(d)(2), 1104, 1112(b)(4), 1121(b).

106. See S. Rep. No. 70, 98th Cong., 1st Sess. 12 (1983).

60 days after the order of relief was entered under any chapter of the Bankruptcy Code.<sup>107</sup> Section 365(d)(4) also provides that the court, for cause, within the 60-day period, may permit the trustee or debtor additional time beyond the 60-day period.<sup>108</sup>

As noted previously, the language of section 365(d)(4) has not been uniformly interpreted to require court approval of the debtor's motion to assume within the 60-day period.<sup>109</sup> This also appears to be true with respect to a debtor's motion to extend time.<sup>110</sup> For example, in *In re By-Rite Distributing, Inc.*,<sup>111</sup> the bankruptcy court held that approval, including the hearing on motion for approval of the debtor's assumption of a nonresidential lease, may not fall outside the 60-day period even if the debtor's motion to assume the lease is filed within the 60-day period.<sup>112</sup> The district court reversed the bankruptcy court's decision and held that as long as the debtor acts within the 60-day period to assume the nonresidential lease, such as by filing a motion to assume, the debtor is afforded protection under section 365(d)(4).<sup>113</sup> This is so even if the court has not approved the debtor's motion to assume the lease within the 60-day period.<sup>114</sup> The court cited *In re Bon Ton Restaurant & Pastry Shop, Inc.*,<sup>115</sup> in which the lessor of real property relied upon the bankruptcy court's decision in *By-Rite Distributing*<sup>116</sup> to support the argument that its lease had been rejected by operation of law because the debtor's motion for a time extension to assume or reject the lease had not been heard and granted within the initial 60-day period.<sup>117</sup> The court, however, held that there was no requirement that court approval be obtained within the 60-day period so long as the trustee acts<sup>118</sup> within

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107. 11 U.S.C. § 365(d)(4).

108. *Id.*

109. See *supra* notes 45-47 and accompanying text.

110. See *supra* note 47.

111. 47 Bankr. 660 (Bankr. C.D. Utah), *rev'd*, 55 Bankr. 740 (N.D. Utah 1985).

112. *Id.* at 670.

113. *By-Rite Distributing*, 55 Bankr. at 742.

114. *Id.*

115. 52 Bankr. 850 (Bankr. N.D. Ill. 1985). See *In re Dulan*, 52 Bankr. 739 (Bankr. C.D. Cal. 1985), where the bankruptcy court determined that the debtors were entitled to an evidentiary hearing on the question of whether they should be excused on equitable grounds for their failure to timely exercise the option to extend the lease. See also *Unit Portions of Del., Inc.*, 13 BANKR. CT. DEC. at 635.

116. *By-Rite Distributing*, 55 Bankr. at 743.

117. *In re Bon Ton Restaurant & Pastry Shop, Inc.*, 52 Bankr. 850 (Bankr. N.D. Ill. 1985).

118. "Acts" in both *By-Rite Distributing* and *Bon Ton Restaurant & Pastry Shop* appear to mean the filing of a motion to assume a lease by the debtor. The court

that time period.<sup>119</sup> It concluded that if the trustee acts to assume the lease, section 365(d)(4) may not be used by a lessor to recapture a lease and obtain a windfall to which it may not be equitably entitled.<sup>120</sup>

There is, however, authority supporting the proposition that section 365(d)(4) does in fact require court approval of the debtor's motion to assume within the 60-day period. In *In re Las Margaritas, Inc.*,<sup>121</sup> the court held that while debtors are generally afforded a great deal of flexibility in deciding whether to assume or reject most executory contracts and unexpired leases, this flexibility is expressly denied under section 365(d)(4) to debtors with leases of nonresidential real property.<sup>122</sup> It cited the bankruptcy court's initial *By-Rite Distributing*<sup>123</sup> decision as authority for its holding that the lease must be assumed during the 60-day period, or it will be conclusively presumed to be rejected.<sup>124</sup>

These cases indicate that the issue of whether section 365(d)(4) requires only a filing to assume by the debtor within the 60-day period, or both a filing and court approval of the assumption within 60 days, is unsettled. Regardless of holdings such as *Las Margaritas*,<sup>125</sup> it may be that what initially has been perceived as a major advantage for lessors of nonresidential real property may, in reality, simply require action by the debtor to evidence its intent to assume the lease within the 60-day period. Moreover, the period of time in which the lessor's property remains property of the debtor's estate may again be prolonged.<sup>126</sup>

Section 365(d)(3) also requires the trustee or debtor to perform all of the debtor's obligations under the lease, pending the assumption or rejection of a lease for real property.<sup>127</sup> The trustee or debtor

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conceded that the debtor's motion to assume the lease was not filed within 60 days of the original petition in bankruptcy. The court, however, relied upon its equitable powers and held that the debtor's motion could be heard. See *In re Curio Shoppes, Inc.*, 55 Bankr. 148 (Bankr. D. Conn. 1985).

119. *By-Rite Distributing*, 55 Bankr. at 744.

120. *Id.* at 745.

121. 54 Bankr. 98 (Bankr. D. Nev. 1985).

122. *Id.* at 99.

123. 47 Bankr. 660 (Bankr. D. Utah 1985).

124. *Las Margaritas*, 54 Bankr. at 99. See also *In re Southwest Aircraft Servs., Inc.*, 53 Bankr. 805 (Bankr. C.D. Cal. 1985) (court held that a lease was deemed rejected if the trustee or debtor-in-possession did not obtain a hearing and a decision within 60 days after an order for relief was filed).

125. 54 Bankr. 98 (Bankr. D. Nev. 1985).

126. See generally 11 U.S.C. § 365(h) (lessee treatment of unexpired lease).

127. 11 U.S.C. § 365(d)(3).

may petition the bankruptcy court for more time to perform such obligations during the 60-day period; however, no extension of time for performance can be made beyond the 60-day period.<sup>128</sup> It appears that if the time period for making the decision to assume or reject the lease is extended, all obligations required under the lease must be timely performed.<sup>129</sup>

Assuming the debtor's continued performance of its obligations under the lease, almost all actions against the lessee to recover past rent due, to enforce conditions concerning the appearance and operation of the location and, more importantly, to recover possession of the property prior to the trustee's or debtor's decision to reject or assume the lease are automatically stayed by the provisions of section 362 of the Bankruptcy Code.<sup>130</sup> In most cases, the trustee or debtor may use the leased property in the ordinary course of business without any need to obtain permission of the court or the lessor.<sup>131</sup>

Given the more onerous obligations placed upon a lessee under new section 365 of the Bankruptcy Code, a lessor of nonresidential real property may be satisfied with receiving the rental payments required under the lease while it looks for a new tenant or waits for the lessee to decide to assume or reject the lease.<sup>132</sup> The lessor may very well view the requirements of section 365 as "buying time" because it is financially better off receiving rental payments from a debtor in bankruptcy than not receiving any payments as a result of a default by a lessee under non-bankruptcy law. Since the lessee is required to perform all of the obligations under the lease pending its decision to assume or reject a lease, a lessor may be able to argue that the automatic stay is inapplicable to prevent the lessor from taking possession of the leased premises if the lessee fails to perform such lease obligations in a timely manner.<sup>133</sup> However, since the lessee may petition the bankruptcy court for more time to perform

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128. *See id.* § 365(d)(4). If the debtor fails to assume the lease within the 60-day period or the additional time period fixed by the bankruptcy court, the lease is deemed rejected and the debtor is required to immediately surrender the premises to the lessor. *Id.*

129. *See id.* § 365(d)(3) which states in pertinent part: "The trustee shall timely perform all obligations of the debtor, except those specified in Section 365(b)(2), arising from and after the order of relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." *Id.*

130. *Id.* § 362(a)(3).

131. *Id.* § 1108 (both a trustee and debtor-in-possession may operate the debtor's business pursuant to 11 U.S.C. § 1107).

132. *See supra* notes 42-47 and accompanying text.

133. *See supra* notes 103-108 and accompanying text.

such obligations within the 60-day period, such a position may be tenable only when the lessee is not permitted more time to perform its lease obligations.<sup>134</sup> Before the 60-day period has elapsed, the lessee may receive an extension of the time period to assume or reject the lease but may not be permitted further extensions of time in which to timely perform its lease obligations.<sup>135</sup>

The bankruptcy court's interpretation of the scope of a lessee's obligations under a lease where the debtor-lessee is also a franchisee will be of substantial interest to the franchisor-lessor. The lessee's franchise agreement may make specific reference to the franchisee's obligations under the lease and the lease may also specifically reference the franchisee's obligations under the franchise agreement. Even if the franchisor is not the lessor of the property, the franchise agreement will generally provide that a default under the lease agreement is a default under the franchise agreement.<sup>136</sup>

The scope of the franchisee-lessee's obligations under section 365(d)(3) under a lease of nonresidential real property is particularly important considering that the United States Supreme Court in *NLRB v. Bildisco & Bildisco*<sup>137</sup> has apparently adopted the position that a debtor will not be obligated to perform its obligations under an executory contract, such as a franchise agreement, pending its decision to assume or reject the franchise agreement.<sup>138</sup> Bolstered by prior decisions decided on the basis of the interdependence between the franchise and lease relationships,<sup>139</sup> an aggressive franchisor-lessor

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134. 11 U.S.C. § 365(d)(3). *See supra* note 129 and accompanying text.

135. 11 U.S.C. § 365(d)(3).

136. *See Mleynek v. Headquarters Cos.*, 165 Cal. App. 3d 1133, 209 Cal. Rptr. 593 (1984).

137. 465 U.S. 513 (1984). *Bildisco* involved the rejection of a collective bargaining agreement wherein the Supreme Court held that a debtor in bankruptcy cannot be required by the non-debtor party to perform obligations under an executory contract until the executory contract is assumed by the debtor. *Id.* at 534. The Court stated, "[F]rom the filing of a petition in bankruptcy until formal acceptance the collective bargaining agreement is not an enforceable contract . . . ." *Id.* at 532. However, a non-debtor party may not refuse to perform its obligations under an executory contract which has neither been assumed or rejected under § 365 of the Bankruptcy Code. *See In re Whitcomb & Keller Mortgage Co.*, 715 F.2d 375 (7th Cir. 1983). An executory contract is generally defined as a contract under which the obligations of both parties to 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." *Countryman, supra* note 5, at 460. This definition was adopted in *In re Knutson*, 563 F.2d 916, 917 (8th Cir. 1977). *See also In re Rovine Corp.*, 6 Bankr. 661 (Bankr. W.D. Tenn. 1980) (definition adopted).

138. *Bildisco*, 465 U.S. at 531.

139. *See In re Maxwell*, 40 Bankr. 231 (Bankr. N.D. Ill. 1984); *In re Holland Enterprises, Inc.*, 25 Bankr. 301 (Bankr. E.D.N.C. 1982). Under § 365(a)(4),

may argue that compliance with all the obligations under a lease necessarily includes the franchisee-debtor's obligations under its franchise agreement.<sup>140</sup> Such obligations might well include the continued periodic payment of royalties and advertising fees to the franchisor.<sup>141</sup>

The payment of royalties fees, advertising fees, and lease payments by the franchisee-debtor pending its decision to assume or reject a lease should be indicative of the franchisee-debtor's ability to continue performance of its obligations in the event it attempts to assume the lease and/or the franchise agreement. The importance of such an evaluation to a franchisor who is awaiting the debtor's decision to assume or reject cannot be overestimated. In these circumstances, relief provided to an ailing business by a Chapter 11 proceeding may minimize the franchisor's loss. While the automatic stay may frustrate any effort already in progress by the franchisor-lessor to terminate its franchise agreement or lease, it may temporarily save other property critical to the reorganization of the franchised business from repossession by secured creditors.<sup>142</sup> Under certain circumstances, a reorganization plan may afford the franchisee the opportunity to offer its creditors a compromise and/or extension of their claims.<sup>143</sup> A franchisor may well find this a more desirable alternative to the losses that would result from dissolution of the franchisee in accordance with the applicable nonbankruptcy law.<sup>144</sup>

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perhaps the interdependence of the franchise agreement and the lease provides an advantage for the franchisor rather than the disadvantages described in *Kata Properties*, 1981-1 Trade Cas. (CCH) at ¶ 64,108, *aff'd*, 671 F.2d at 491, and *Mleynek v. Headquarters Cos.*, 165 Cal. App. 3d 1133, 209 Cal. Rptr. 593 (1984).

140. See *infra* notes 162-213 and accompanying text (lease obligations are interdependent with franchise obligations).

141. Once the franchisor has convinced the court, using the interdependence argument, that the more favorable treatment of landlords of nonresidential real property is applicable to the less favorable treatment of executory contracts such as franchise agreements, the court may then apply the interdependence argument to a variety of factual circumstances. For example, should the debtor's decision to assume or reject the franchise agreement be deferred once it has rejected the lease for the franchised premises, if the court has already determined that the agreements form an integral business relationship? Such an impractical outcome might result in the debtor retaining its rights under the franchise agreement to offer trademarked goods and services without a corresponding location from which to provide such goods and services.

142. *In re Anne Cara Oil Co.*, 32 Bankr. 643, 647 (Bankr. D. Mass. 1983). See also *In re Beck*, 5 Bankr. 169 (Bankr. D. Hawaii 1980) (automatic stay did not prevent expiration of license agreements as stay only protects property interests).

143. 11 U.S.C. § 1123(b).

144. One of the most important features of bankruptcy law is the stay of creditors' actions which is automatically set in place upon the filing of a bankruptcy petition by or against a debtor. Although dissolution schemes may exist outside the

Alternatively, the franchisor may conclude that the franchisee-debtor cannot sustain its long-term monetary obligations under the franchise agreement or its lease. In this event, there are a number of opportunities in which the franchisor may seek to bring the reorganization effort to an early conclusion. For example, the automatic stay imposed by section 362 is not permanent. In some instances, the bankruptcy court will determine whether cause exists for modifying the stay upon request by the party seeking such relief.<sup>145</sup> However, "cause" remains an undefined term under the Bankruptcy Code and continues to be evaluated by the bankruptcy courts on a case-by-case basis.<sup>146</sup>

The lack of adequate protection of an interest in the leasehold of the party seeking relief from the automatic stay is one cause for obtaining relief.<sup>147</sup> Once the lessor seeks relief from the stay, the trustee or debtor will lose the protection of the stay unless the bankruptcy court finds the lessor adequately protected, has equity in the leasehold, or the lease is necessary for an effective reorganization.<sup>148</sup> Usually a lessor is entitled to adequate protection of its interest under an unexpired lease with a debtor.<sup>149</sup> One recent case, *In re Dabney*,<sup>150</sup> involved lessees who failed to make rental payments under a lease for real property and, as a result, the lessor obtained a judgment for eviction against the lessees. Pending adjudication of their appeal, the lessees were ordered to escrow the rental payments.<sup>151</sup> When the lessees failed to perfect the escrow, a default judgment

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bankruptcy context as a part of virtually all state laws regarding corporations and partnerships, the automatic stay provision of the Bankruptcy Code provides a unique procedure for protecting the rights of all creditors. *See* 11 U.S.C. § 362.

145. 11 U.S.C. § 363(e) provides:

Notwithstanding any other provision of this section, at any time, or on request of an entity that has an interest in property used, sold or leased or proposed to be used, sold or leased by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest.

*Id.* See *infra* notes 196-239 and accompanying text.

146. *See* 11 U.S.C. § 362(d). *See also* *Cathey v. Johns-Manville Sales Corp.*, 711 F.2d 60 (6th Cir. 1983) (bankruptcy court has exclusive authority to grant relief from the automatic stay under § 362(d)).

147. 11 U.S.C. § 362(d)(1).

148. *Id.* § 362(d).

149. *See* *In re Inn at Longshore, Inc.*, 32 Bankr. 942, 945 (Bankr. D. Conn. 1983). The court held that the debtor had been using and occupying the leased premises while attempting to reorganize and, as a result, the debtor had to at the very least pay all post-petition rent as provided by the lease terms. *Id.*

150. 45 Bankr. 312 (Bankr. E.D. Pa. 1985).

151. *Id.*

was entered against the lessees for possession of the premises.<sup>152</sup> Thereafter, one of the lessees filed a petition under Chapter 13 of the Bankruptcy Code.<sup>153</sup> The lessor commenced proceedings to modify the automatic stay in order to recover possession of the premises.<sup>154</sup> The court decided that neither the lessee's failure to pay the post-petition rent nor its lack of compliance with the escrow order constituted sufficient cause to entitle the lessor to relief from the automatic stay.<sup>155</sup> Rather, the court determined that modifying the stay was not justified as long as the lessee could provide the lessor with adequate protection which would constitute compliance with the provisions of the lease.<sup>156</sup> This was to be accomplished by paying the lessor the rental payments as each became due and proposing an arrangement for payment of the arrearages.<sup>157</sup>

An opposite result was reached in *In re Sweetwater*,<sup>158</sup> a case which concerned a lease for personal property.<sup>159</sup> In *Sweetwater*, the debtor, a business involved in condominium timesharing, was an assignee under several leases for personal property with the lessor. The debtor filed a petition under Chapter 11 of the Bankruptcy Code.<sup>160</sup> The lessor filed a motion to compel the debtor to adequately protect its interest in the leased property for the period between the filing of the petition and the date of the debtor's assumption or rejection of the leases and, alternatively, to grant relief from the automatic stay in the event adequate protection was not provided. In passing on the debtor's motions, the court acknowledged that the "prevailing view in bankruptcy courts and among commentators is that lessors are entitled to adequate protection under section 363(e), pending a decision to assume or reject the lease."<sup>161</sup> The court determined that

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152. *Id.* at 313.

153. See 11 U.S.C. § 1301.

154. See *id.* § 362. See also *supra* note 144.

155. *Dabney*, 45 Bankr. at 314.

156. *Id.* (modification of stay required for adequate protection of lessor).

157. *Id.*

158. 40 Bankr. 733 (Bankr. D. Utah 1984).

159. See *In re Attorneys Office Management, Inc.*, 29 Bankr. 96 (Bankr. C.D. Cal. 1983). The court stated:

The plaintiffs argue that the relief from stay provisions of § 362(d) are applicable during the period when the trustee is making its decision to assume or reject. Such relief, however, would frustrate the purpose of § 365 which assures the trustee a sufficient amount of time to assume or reject these obligations. Therefore, the lessors must look only to the provision of § 365 for protection of their interests.

*Id.* at 98.

160. 11 U.S.C. §§ 1101-1146 (Supp. 1986).

161. *Sweetwater*, 40 Bankr. at 743. See also *In re Attorneys Office Management*,

Congress did create two mutually exclusive methods for protecting the interests of lessors and the interests of lienholders during bankruptcy proceedings, and stated:

Congress recognized that the rights of lessors are fundamentally different from those of secured creditors. Congress has effectively dealt with the rights and remedies of lessors under Section 365 of the Code. The decision to seek an early determination of whether to assume or reject an unexpired lease rests with the lessor. If the debtor elects to assume, the lessor, unlike any other creditor, is entitled to have its entire prepetition debt cured, as well as adequate assurance of future performance under the terms of the lease.

If the lease is ultimately rejected, the estate is liable for the reasonable value of the leased property during the "breathing spell" after the filing and before rejection.<sup>162</sup>

Prior to the 1984 Amendments, lessors might have strenuously argued for "adequate protection" in the form of timely performance of monetary and non-monetary obligations under a lease of property pending assumption or rejection by the debtor.<sup>163</sup> However, at least as applied to leases of nonresidential real property, this may no longer be an issue since new section 365(d)(3) provides a form of adequate protection through the requirement of timely performance of all obligations by the debtor-lessee pending the assumption or rejection of a lease of such property.<sup>164</sup>

Apart from the issue of adequate protection, a creative franchisor-lessor postulated a novel argument in *In re Maxwell*<sup>165</sup> to obtain relief for cause from the automatic stay in order to terminate a lease and a franchise agreement with its debtor-franchisee. In *Maxwell*, the court found that, based upon the interdependence between the franchisor's franchise agreement and its lease with the debtor-fran-

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Inc., 29 Bankr. 96 (Bankr. C.D. Cal. 1983) (discussing what actions by trustee will constitute adequate protection); *In re Richards Pontiac*, 6 Bankr. 773 (Bankr. E.D. Pa. 1980) (trustee has burden of proposing or providing lessor with adequate protection); Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. L. REV. 341 (1980) (discussing what constitutes adequate protection).

162. *Sweetwater*, 40 Bankr. at 745.

163. 11 U.S.C. § 365(d)(1) (requirements after assumption or rejection of leases).

164. 11 U.S.C. § 365(d)(3).

165. 40 Bankr. 231 (Bankr. N.D. Ill. 1984).

chisee, cause existed to lift the automatic stay so as to permit such termination.<sup>166</sup>

On appeal from an order of the bankruptcy court denying the franchisor's motion to lift the automatic stay, Chart House, a franchisor of Burger King restaurants, argued that the automatic stay should be lifted because the sublease and franchise agreement between the parties had been terminated prior to the filing of the bankruptcy petition.<sup>167</sup> Chart House and its franchisee, Maxwell, had entered into a Burger King franchise agreement and a sublease in December 1979. The sublease covered the same premises as the franchise agreement which allowed the franchisee to operate a Burger King restaurant.<sup>168</sup>

The franchise agreement contained a termination provision which stated that Chart House had the option to terminate the franchise agreement in the event the franchisee failed to pay certain royalties or advertising fees due under the agreement, or such payments were not made within 30 days of notice to cure the default. The sublease agreement provided, in relevant part, that Chart House could declare the term of the sublease ended and repossess the premises in the event that Maxwell failed to pay any installment of rent required by the lease or the payments were not made within 30 days after notice to pay the same.<sup>169</sup> In early 1982, Maxwell failed to make the required advertising and royalty payments under the franchise agreement or the rental payments under the sublease. On April 6, 1982, Chart House sent a notice to Maxwell which described these defaults under the agreements and demanded that each be promptly cured.<sup>170</sup> The franchisee neither cured the defaults nor reached an

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166. *Id.* at 235. It appears that the court lifted the stay for cause since the question of the debtor's equity in the property or its necessity for an effective reorganization was not addressed by the court. This indeed may be a case where the court used its inherent equitable powers to fashion a remedy to fit a particular factual situation. The authors agree with Mr. Bordewieck's assertion that a non-debtor party may not terminate an executory contract because of the failure of the debtor-in- possession to cure a pre-petition default before it has elected to assume or reject the contract. However, a franchisor successfully arguing the interdependence argument should be able to distinguish Mr. Bordewieck's conclusion by shifting the court's attention to the § 365 treatment of functionally interdependent documents such as a nonresidential lease of real property. *See* Bordewieck, *supra* note 102, at 203.

167. *Maxwell*, 30 Bankr. at 983-84.

168. *Maxwell*, 40 Bankr. at 233-34.

169. *Id.* at 234.

170. *Id.*

acceptable repayment arrangement with the franchisor. On May 7, 1982, Chart House sent Maxwell a 5-day notice which stated that unless the rent payments were made within that period the sublease would be terminated. Further, it demanded immediate possession of the premises in the event of nonpayment.<sup>171</sup>

Maxwell did not pay the past due rent payments or relinquish the premises to the franchisor. Consequently on May 14, 1982, Chart House brought an action in state court for possession of the restaurant and for judgment in the amount of the past due rent payments. This action was automatically stayed when Maxwell filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on May 21, 1982.<sup>172</sup> After filing the petition in bankruptcy, Maxwell's indebtedness to Chart House increased although the franchisee made some rental, royalty, and advertising payments. Maxwell also remained in possession of the premises.<sup>173</sup>

Before the bankruptcy court, Chart House argued that the sending of the notices to cure the defaults under both agreements and to terminate the sublease, as well as the filing of the forcible entry and detainer action, terminated the sublease and constituted affirmative acts which terminated the franchise agreement.<sup>174</sup> Conversely, the bankruptcy court adopted the viewpoint that the sublease and the franchise agreement were "both separate and interdependent" agreements and both agreements had to be terminated simultaneously in order to terminate either agreement.<sup>175</sup> The court found that the letter of April 6, 1982, advising the franchisee to cure its financial defaults under the franchise agreement, complied with such pre-termination procedures.<sup>176</sup> The "interdependence" of the sublease and franchise agreement was described by the court as follows:

Certainly the two agreements are closely interdependent. The franchise agreement is limited to the specific premises which are the subject of the sublease. As Maxwell points out, termination of the sublease leaves the franchisee with a franchise that is worthless because there is no place

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171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* at 235.

175. *Id.* at 233-34. On appeal, the district court found that, as a result of the "interdependance" of the two agreements, the termination of the sublease also caused the termination of the franchise agreement, assuming that Chart House followed the termination procedure contained in the franchise agreement. *Id.* at 235.

176. *Id.* at 235.

to operate it. In addition, the franchisee's obligation to make royalty and advertising payments is based upon the volume of its sales. Clearly, termination of the sublease means no sales by franchisee and thus renders the franchise agreement nugatory. In light of this interdependence, Maxwell argues that so long as the franchise agreement is in effect, the continuing existence of the sublease must be implied.

....

A better view is that because of the *functional interdependence* of these two contracts, termination of the sublease would also serve to terminate the franchise agreement, assuming that the pretermination procedures for the franchise agreement had been followed.<sup>177</sup>

A similar viewpoint was expressed in *In re Clarkstown Transmissions Corp.*,<sup>178</sup> in which the franchisee entered into a twenty year lease with the owner of the leasehold premises. Subsequently the lessee entered into a franchise agreement with Gibraltar Transmission whereby the franchisee was permitted to enter the business of automotive transmission repair under the Gibraltar trade-name. As part of the franchise requirements, the franchisee was required to assign its lease to Gibraltar as security for its performance under the fran-

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177. *Id.* at 234-35 (emphasis added). Although Chart House also argued that the franchise agreement had been terminated, its position was premised on the fact that Chart House was entitled to terminate the franchise agreement upon 30 days written notice in the event Maxwell failed to cure the defaults existing under the franchise agreement and no further affirmative act was required of Chart House after the expiration of the 30-day period. *In re Maxwell*, 40 Bankr. 231 (Bankr. N.D. Ill. 1984) (citing Brief of Plaintiff-Appellant, Chart House, Inc., at 19-20). It is interesting to note that the finding of interdependence between the franchise agreement and the sublease was a function of the court's analysis and not largely related to the arguments of Chart House. Rather, the court found that the bankruptcy court correctly determined that the franchise agreement did not lapse automatically after the 30 days elapsed but at the expiration of the 30 days Chart House could terminate the franchise agreement at its option. *Id.* at 235. It further stated:

The bankruptcy judge was correct in deciding that the franchise agreement did not lapse automatically after these thirty days had elapsed. Rather, at the expiration of the thirty days Chart House could terminate the franchise agreement "at its option." Since the viability of the franchise agreement so obviously rested upon the continued existence of the sublease, Chart House's five-day notice of the impending termination of the sublease and its filing of suit in state court clearly advised Maxwell of Chart House's termination of the relationship between the parties.

*Id.* at 235.

178. 45 Bankr. 807 (Bankr. S.D.N.Y. 1985).

chise agreement. The franchisee executed a written assignment of its lease to Gibraltar on June 12, 1979.<sup>179</sup> The right to occupy the leased premises was described and incorporated by the terms and conditions contained in the Gibraltar franchise agreement and the duration of the lease was co-extensive with the duration of the franchise agreement. In March 1982, the original principles of the franchisee assigned their interests to Michael Nantista who continued to operate under the Gibraltar franchise with the consent of the franchisor.<sup>180</sup> In May 1983, the franchisor discovered that Nantista had removed all the signs bearing the Gibraltar trade-name and continued doing business at the same location as Clarkstown Transmissions Corporation.<sup>181</sup> Gibraltar commenced an action in state court to terminate the franchise and remove Nantista from the leasehold premises. The state court found that the actions by Nantista in removing Gibraltar's name from various signs violated the franchise agreement.<sup>182</sup> The New York Supreme Court ruled that Gibraltar was entitled to a judgment declaring that the franchisor was entitled to possession of the leasehold premises and directed Nantista to vacate.<sup>183</sup> A judgment was entered to this effect, and the sheriff's department served the franchisee with a 72-hour notice to vacate the premises. Approximately two weeks thereafter, the franchisee filed a petition for relief under Chapter 11 of the Bankruptcy Code.<sup>184</sup> Before the Bankruptcy Court, the franchisee-debtor attempted to reject the franchise agreement and the assignment of the lease while reaffirming the underlying lease. Upon Gibraltar's filing of a motion for relief from stay,<sup>185</sup> the court stated:

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179. *Id.* at 808.

180. *Id.*

181. *Id.* at 808-09.

182. *Id.* at 811.

183. *Id.*

184. 11 U.S.C. § 301.

185. When the parties agree that the lease and/or franchise agreement have not been terminated pre-bankruptcy, then typically a franchisor or lessor will often file a motion to compel assumption of the agreements in order to obtain a speedier determination of assumption or rejection of the agreements by the debtor. However, where there is a substantial dispute concerning pre-bankruptcy termination and the franchisor or lessor is confident in the validity of his purported pre-bankruptcy termination, the franchisor or landlord may then file a motion for relief from stay. As in *Clarkstown*, what is sought is essentially a declaratory judgment that the lease and franchise agreements are indeed terminated, which in turn allows the landlord to take possession of the premises. Franchisors and landlords may also file for relief from stay so as to have the matter heard quickly, since § 362 requires a preliminary hearing to be held within 30 days of the motion being filed. See 11 U.S.C. § 362(e).

In this case, the debtor originally recognized in the franchise agreement that the franchised business "was located and selected with the aid of Gibraltar, who also assisted in negotiating the lease terms for the site premises" and that the lease was assigned to Gibraltar as security for the debtor's performance under the franchise agreement. The lease was an integral part of the franchise agreement by its incorporation in the agreement and was coextensive with it.

. . . .

Gibraltar's entitlement to possession under the lease by reason of its right to protect its franchised trade name at the business location in question was sustained by the New York Supreme Court on August 16, 1984. In order to block Gibraltar from pursuing its possessory interest under the assigned lease and from furthering its right to exploit the trade name "Gibraltar" at the location in question, the debtor must come forward and satisfy the burden imposed under 11 U.S.C. § 362(g)(2), by providing adequate protection within the meaning of 11 U.S.C. § 361. This the debtor has failed to do. On the contrary, the debtor wishes to pursue a competing automobile transmission repair business on the franchised site, free from the franchised obligations, including the payment of royalties, and based upon naked possession. To accomplish this objective, the debtor would have this court disregard the fact that it previously assigned the lease for the premises to Gibraltar as security for the debtor's performance under the franchise. In sum, the debtor seeks to be put in a better position than it occupied before the commencement of its chapter 11 case and failed to regard the proprietary rights of Gibraltar, to whom no adequate protection is offered. This position is inconsistent with the relief afforded under the automatic stay, as expressed in 11 U.S.C. § 362(a).<sup>186</sup>

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186. *In re Clarkstown Transmission*, 45 Bankr. at 810. The court made reference to the question of whether the franchisor had properly perfected its assignment of leasehold prior to the filing of the bankruptcy petition by the debtor. *Id.* at 809. It indicated that the franchisor may have been subject to the trustee's avoidance power under § 544 because it had not properly perfected the leasehold interest prior to the bankruptcy case. However, the judicial determination that the leasehold interest had been assigned prior to bankruptcy mooted the § 544 avoidance question.

The court then lifted the automatic stay to permit Gibraltar to enforce its contractual and judicially determined rights to possession of the transmission repair shop occupied by the franchisee-debtor.<sup>187</sup>

If the franchisor who also leased the franchised premises to the debtor is successful in persuading the bankruptcy court that the interdependence between the franchise agreement and the lease should require the debtor to perform its obligations under both agreements or according to similar reasons addressed by the *Maxwell* court,<sup>188</sup> the franchisee-debtor is permitted to continue operating under the franchisor's franchise agreement.<sup>189</sup> Pending the franchisee's decision to assume or reject such agreement the franchisor is entitled to some protection under the Bankruptcy Code, e.g., the franchisor is entitled to administrative claims for post-bankruptcy services rendered to the franchisee-debtor prior to rejection of the franchise agreement or the lease. Section 365(d)(3) provides for these payments pending the assumption or rejection of a lease for non-residential real property.<sup>190</sup> Section 365(b)(4) also provides for similar payments for services and supplies tendered by a lessor under an unexpired lease prior to assumption of the lease.<sup>191</sup> This payment is known as either an administrative rent or an administrative priority claim.<sup>192</sup> Administrative rent does not necessarily represent the contract rate but is based upon the reasonable value of the services received by the debtor.<sup>193</sup> A claim

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*Id.* This *dicta* indicates that the basis of the court's decision rested upon an analysis of § 362 of the Bankruptcy Code. The authors believe this case could have been decided by solely analyzing the parties' rights under § 365 of the Bankruptcy Code.

187. *Id.* at 811.

188. *Maxwell*, 40 Bankr. at 231. See *supra* notes 165-186 and accompanying text.

189. See *Maxwell*, 40 Bankr. at 240. See also *supra* notes 168-189 and accompanying text.

190. 11 U.S.C. § 365(d)(3).

191. *Id.* § 365(b)(4).

192. *Id.* See also *Dallas-Fort Worth Regional Airport v. Braniff Airways*, 26 Bankr. 628 (N.D. Tex. 1982). The creditor's claim for administrative rent is described as an administrative priority under § 503(b)(1) if the debtor, in fact, received the benefit of the creditor's service. See *In re Cochise College Park, Inc.*, 703 F.2d 1339, 1355 (9th Cir. 1983); *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976).

193. There is authority, however, which holds that the amount of administrative rent may in fact be the rental price fixed in the lease agreement, and that, in the absence of a showing to the contrary by the debtor, this amount is presumptively reasonable. See *In re Fred Sanders Co.*, 22 Bankr. 902 (Bankr. E.D. Mich. 1982) (debtor was held liable for accumulated lease obligations under a personal property lease from the inception of the Chapter 11 proceedings).

for administrative rent is without merit unless the debtor has received the benefit of the services for which the claim is made.<sup>194</sup> However, the future payment of a claim for administrative rent may provide little incentive to a franchisor or any other non-debtor party to a contract to continue providing services to a debtor while the debtor ponders its decision to assume or reject.<sup>195</sup>

The franchisor-lessor who makes a successful interdependence argument utilizing section 365(b)(4) may suggest that it does not have to provide services or supplies under its franchise agreement even though the franchisee-debtor is otherwise not in default under its lease. This argument seems contrary to the recent *Bildisco* decision,<sup>196</sup> but the facts of *Bildisco* are distinguishable because the court was concerned only with an executory contract (i.e., a collective bargaining agreement) and not a lease for nonresidential real property.<sup>197</sup>

Despite the protections afforded by administrative claims, a non-debtor party to a contract who decides not to cooperate with the debtor's reorganization effort, or who otherwise may be unable to assess the viability of the effort, may accelerate the debtor's decision to assume or reject the contract or lease by petitioning the bankruptcy court<sup>198</sup> to shorten the time period in which the debtor's decision

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194. The nature of the franchise relationship strongly suggests that a franchisee-debtor continues to receive the benefits of a franchise agreement even if the franchisor does not supply the franchisee-debtor with additional products (e.g., the franchisor's national advertising campaign will offer the franchisee the benefit of national recognition and goodwill because the franchisee is continuing to operate under the franchisor's trademark, and is constructed and designed to look and operate like the franchisor's other franchisees nationwide).

195. In contrast, under § 365(b)(4) a lessor is not required to provide services or supplies incidental to a lease where there has been a default in the lease other than a kind that is breach of a provision relating to the insolvency or financial condition of the debtor. In seeking relief under the Bankruptcy Code, or the post-bankruptcy appointment of a trustee, no services or supplies are required, unless the lessor is to be compensated under the terms of the lease for services and supplies before assumption of the lease. 11 U.S.C. § 365(b)(4).

196. See *supra* note 137.

197. *Bildisco*, 465 U.S. at 519-27.

198. Petitioning the bankruptcy court is normally accomplished by the filing of a motion to compel assumption or rejection which is a contested matter governed by Bankruptcy Rule 9014. Bankruptcy Rule 9014 incorporates many of the adversary proceeding rules including those permitting extensive discovery of the debtor. The franchisor who takes the opportunity to take discovery relative to its motion to compel assumption or rejection may be able to uncover the true status of the debtor's operations. 11 U.S.C. Bankr. R. 9014 (1984).

must be made.<sup>199</sup> Although the bankruptcy court is not required to grant such a request, section 363 of the Bankruptcy Code may provide shallow relief to one who is not a secured creditor in the traditional sense.<sup>200</sup> The better move may be to attempt to accelerate the time by which the debtor is required to reveal its intentions about the future of its contract or lease. This strategy was addressed by the Second Circuit in *American A. & B. Coal Corp. v. Leonardo Arrivabene, S.A.*,<sup>201</sup> which involved a claim by creditors for administrative rent arising from the debtor's possession of the creditor's cargo ships after filing a bankruptcy petition. The debtor, although in possession of the ships, did not use any of the ships to carry cargo.<sup>202</sup> As a result, the court found that the debtor had not received a benefit from the creditor, and the creditor was not entitled to an administrative priority for the rental of the ships.<sup>203</sup> Specifically noting that the creditor allowed the ships to remain idle in the possession of the debtor, the court stated: "[I]t was open to appellants to move for an immediate affirmance or rejection; having failed to do this, they cannot be heard to argue that it was inconceivable the Court would have listened to them if they had."<sup>204</sup>

Counsel for the franchisor-lessor may be well advised to suggest the filing of a motion to compel assumption or rejection of the franchise agreement or the lease upon entry of the order of relief in order to preserve its rights to administrative payments.

#### IV. ASSUMPTION, REJECTION, AND ASSIGNMENT UNDER SECTION 365

Section 365 is ostensibly constructed to allow a trustee or debtor sufficient time to evaluate whether the assumption or rejection of an unexpired lease or an executory contract is in the best interest of the estate.<sup>205</sup> For example, once a lease is assumed, it will be treated

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199. See *Jermoo's*, 38 Bankr. at 197; *In re Physique Forum Gym, Inc.*, 27 Bankr. 691 (Bankr. D. Md. 1982).

200. See also 11 U.S.C. § 363.

201. 280 F.2d 119 (2d Cir. 1960).

202. *Id.* at 124.

203. *Id.* at 126.

204. *Id.*

205. 11 U.S.C. § 365(d)(1) provides:

In a case under Chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60 day period, fixes, then such contract or lease is deemed rejected.

the same as any other lease, contract, or obligation that is undertaken by the debtor after the filing of the bankruptcy petition.<sup>205</sup> That is, the estate will be responsible for the full performance of the lease as an expense of administration.<sup>206</sup> Similarly, once a lease is rejected, the rejection is final and the debtor is prohibited from asserting any claim based upon rights, privileges, or advantages arising out of the lease or executory contract.<sup>207</sup>

For debtors whose primary business is a retail establishment one of the most valuable assets of the bankruptcy estate is usually an unexpired lease for real property.<sup>208</sup> As noted earlier, the goal of the debtor or trustee in this situation is to maximize the return to the bankruptcy estate in the rejection or assumption and assignment of the unexpired lease.<sup>209</sup> In a situation involving franchised leasehold premises, as long as a potential assignee meets the minimum requirements of the Bankruptcy Code,<sup>210</sup> the franchisee-debtor desirous of assuming and assigning its lease is generally unconcerned if the potential assignee is unacceptable to the landlord or fails to fulfill the franchisor's criteria for a prospective franchisee. The landlord and/or the franchisor, on the other hand, would often like nothing better than to terminate the unexpired lease and re-let to a new non-debtor tenant or a more creditworthy franchisee. The battle over these converging interests is often waged in the courtroom at a hearing to determine the parties' respective rights under section 365 of the Bankruptcy Code. Thus, court approval of the rejection, assumption, or assignment of an unexpired lease may be the single most important

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206. *Id.* § 365(e)(3) (Supp. 1986).

207. See *In re Rhymes, Inc.*, 14 Bankr. 807 (Bankr. D. Conn. 1981).

208. See 11 U.S.C. § 365(g)(1) (rejection of an unassumed lease is treated as a pre-petition breach of the lease which gives rise to an allowance claim under § 502(g)). See also § 1123(b)(2) (rehabilitation plan may provide for the assumption or rejection of a lease which has not been previously rejected).

209. Landlords who rent to retailers are especially aware of the value of their unexpired leases in a bankruptcy proceeding. See S. REP. NO. 70, 98th Cong., 1st Sess. 8 (1983), where it was noted that out of 23,300 shopping centers in the nation, at least 15,400 had one or more tenants involved in bankruptcy in 1981 and that the bankruptcies of approximately 17,450 retail stores involved almost 65% of all shopping centers in the nation.

210. See *supra* note 11 and accompanying text.

211. 11 U.S.C. § 365(b)(1). The interdependence analysis could be useful to a franchisor objecting to the assumption and assignment of a franchise agreement and lease to a third party. The same factors relied upon by the courts (e.g., prohibition of the selective assumption of the leasehold and rejection of the franchise agreement to avoid continuing obligations to the franchisor such as the payment of royalty fees) may be applied equally to third parties seeking an assignment of the debtor's interests. *Id.*

proceeding for the franchisee-debtor and the debtor's landlord and/or franchisor.<sup>212</sup>

In many cases a franchisee who has had the use of the franchisor's merchandising, advertising, and other conceptual programs may attempt to reject the franchise agreement in the hope of retaining the franchised premises to continue an operation similar to the franchised business under another name.<sup>213</sup> The franchisor obviously perceives the errant franchisee as a threat exceeded in scope only by the prospective loss of a franchise location which over a period of time has acquired consumer recognition. Under similar situations, bankruptcy courts have applied the interdependence analysis under section 365 to determine the fate of the franchised premises.

In *In re Holland Enterprises, Inc.*,<sup>214</sup> a franchisee entered into a franchise agreement with a franchisor to operate a transmission shop under the franchisor's service mark. The franchisee had received an assignment of the leasehold premises from a former franchisee.<sup>215</sup> The lease contained a clause conditionally assigning all rights in the lease to the franchisor upon termination of the franchise agreement and an option to assume the franchisee's obligations under the lease. Although the franchisee was in default under the franchise agreement at the time the bankruptcy proceeding was initiated, the franchisor had not yet terminated the franchise agreement.<sup>216</sup> Subsequent to the commencement of the bankruptcy case, the franchisee operated a transmission shop under a name other than the franchisor's service mark at the same location. The franchisee moved to assume the lease and to reject the franchise agreement and the conditional assignment clause as executory contracts under section 365.<sup>217</sup> The bankruptcy court allowed the franchisee to reject both the franchise agreement and the conditional assignment on the ground that they were executory contracts that imposed future obligations on the franchisee-debtor.<sup>218</sup> On appeal by the franchisor, the district court held that the conditional assignment agreement could not be rejected because it was a provision of the assumed lease rather than a separate contract between the franchisor, franchisee, and lessor.<sup>219</sup> In assuming

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212. *Id.*

213. See *infra* notes 214-250 and accompanying text.

214. 25 Bankr. 301, 303 (Bankr. E.D.N.C. 1982).

215. *Id.* at 302.

216. *Id.*

217. *Id.*

218. *Id.* at 303.

the lease and attempting to reject the conditional assignment agreement, the court found that the franchisee-debtor had attempted:

to avoid the debit of the License Agreement (royalties, reports, etc.) while it enjoys the credits thereof (the location brought on by [the franchisor], the public's familiarity with the location as a transmission shop, etc.). This it cannot do. Debtor may not have its cake and eat it too. To permit such action denies [the franchisor] the right to assume the premises given the debtor's knowing rejection of the License Agreement.<sup>220</sup>

Although decided under section 365 of the Bankruptcy Code, the *Holland* analysis has been carried over to situations using the interdependence argument; for example, in *Maxwell* and *Clarkstown*, this analysis was used in regard to section 362 of the Bankruptcy Code.<sup>221</sup> It seems reasonable to assume that the *Maxwell* and *Clarkstown* courts would have arrived at similar decisions had they analyzed the interdependence argument under section 365 of the Bankruptcy Code.<sup>222</sup>

In *In re Clarkstown Transmission Corp.*,<sup>223</sup> the debtor, in response to Gibraltar's request for relief from the automatic stay,<sup>224</sup> attempted to reject the executory franchise agreement with Gibraltar and the reassigned lease while declaring its intentions to reaffirm the underlying lease. The assignment of the lease in *Holland* was a conditional assignment exercisable by the franchisor upon the termination of the franchise relationship, whereas the assignment of the lease in *Clarkstown* was a collateral assignment provided to the franchisor as security for the franchisee's performance under the franchise agreement.<sup>225</sup> Had Gibraltar's right to terminate the franchise relationship and evict the debtor from the lease premises not been judicially determined prior to the debtor's petition in bankruptcy, the court's usage of the interdependence analysis in *Holland* could have been applicable to prevent the debtor from rejecting the assignment of the

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219. *Id.*

220. *Id.* See also *In re Clarkstown*, 45 Bankr. 807 (Bankr. S.D.N.Y. 1985) (debtor-franchisee's failure to provide adequate protection to franchisor permitted the franchisor to modify automatic stay).

221. See *supra* notes 69-70, 178-187 and accompanying text.

222. 11 U.S.C. § 365.

223. 45 Bankr. 807 (Bankr. S.D.N.Y. 1985).

224. See *supra* note 186 and accompanying text.

225. *Clarkstown*, 45 Bankr. at 808.

lease and the franchise contract while assuming the lease for the franchised premises under section 365 of the Bankruptcy Code.<sup>226</sup>

Similarly, the sublease was found to have been terminated by the franchisor prior to the initiation of bankruptcy proceedings in *Maxwell*.<sup>227</sup> The *Maxwell* court, however, could have utilized an interdependence analysis similar to the *Holland* court's analysis under section 365 to require the corresponding assumption or rejection of the lease upon the assumption or rejection of the franchise agreement.<sup>228</sup>

In *In re Vista VI, Inc.*,<sup>229</sup> the debtor was a franchisee under a franchise agreement which permitted it to operate a retail store under the name "Hickory Farms of Ohio," filed a petition for reorganization under Chapter 11 of the Bankruptcy Code.<sup>230</sup> Its primary asset was an unexpired and unassigned lease located in a shopping center operated by the lessor. The lease contained a provision which required the debtor to operate its business under the name "Hickory Farms of Ohio" and to use the leased premises only for the operation of a retail store selling items such as meats, candies, cheeses, and other sundries normally sold by Hickory Farms of Ohio stores.<sup>231</sup> Subsequently, the bankruptcy court issued a permanent injunction prohibiting the debtor from using the name "Hickory Farms of Ohio" to describe its business.<sup>232</sup> The debtor informed the lessor of its intent to continue operating the store under the name "The Gourmet Cheese Shoppe," and continued to pay the rent. The lessor thereafter informed the debtor that the debtor was in default under the lease for failing to operate a Hickory Farms of Ohio retail store and demanded that the default be cured or lessor would exercise its rights under the lease.<sup>233</sup> The court found that the debtor did breach the use clause of the lease with the lessor but that the previously described injunction made it impossible for the debtor to cure this breach.<sup>234</sup> It then turned to the issue of whether the court could allow the debtor to assume the lease without curing its default.<sup>235</sup>

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226. The interdependent analysis may have been utilized by comparing the collateral assignment in *Clarkstown* to the conditional assignment in *Holland*.

227. See *Maxwell*, 40 Bankr. at 234.

228. See *supra* note 220 and accompanying text.

229. 11 BANKR. CT. DEC. (CRR) 450 (Bankr. N.D. Ohio 1983).

230. *Id.* at 451.

231. *Id.*

232. *Id.* at 452.

233. *Id.* at 451.

234. *Id.*

235. *Id.* at 452.

The court, in citing *In re U.L. Radio Corp.*,<sup>236</sup> held that the new Bankruptcy Code gave the court the power to refuse to enforce all the provisions of a lease and to allow assumption of a lease despite less than literal compliance with all lease terms.<sup>237</sup>

The lessor argued that special considerations arise when the lease is a shopping center lease; i.e., in order to protect the "tenant mix," literal compliance with the lease was required.<sup>238</sup> In response, the court found that the lessor's reliance on proposed language changes to section 365 contained in Senate Bill 549 was misplaced because the intent of the bill's drafters was to prevent assignments which would change the underlying business of the tenant, but would not operate to prevent assignments which would only change the name of the tenant.<sup>239</sup> The court found that the lessee's use of the leased premises would not affect the basic tenant mix and competitive structure of the lessor, and allowed the debtor to continue with the lease.<sup>240</sup>

*Vista* was based upon a use clause which the lessor accepted at the time the lessee was a franchisee of Hickory Farms of Ohio. Many use clauses in leases requiring the operation of a business under a certain name are predicated upon a franchise or license agreement to use and operate under a specific trade name. To this extent, the court may have reached a different result under the 1984 Amendments.<sup>241</sup> Section 365(b)(3)(C) now provides that assumption or assignment of such lease is subject "to *all* the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision . . . ."<sup>242</sup> In *Vista*, it is likely that the lessor did rely upon the existence of a franchise relationship in initially granting the lease to the debtor. The lessor apparently had no control over the continuation of the franchise relationship and therefore could not use the franchise relationship to bolster its argument that the tenant must continue to be a franchisee of Hickory Farms of Ohio in order to assume the lease. Although the lessor's argument was

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236. 19 Bankr. 537 (Bankr. S.D.N.Y. 1982).

237. *Id.* at 544.

238. The lessor cited proposed S. 549, 98th Cong., 1st Sess. (1983), which would have deleted the word "substantially" from subsections 365(b)(3)(C) and (D). *U.L. Radio Corp.*, 19 Bankr. at 543-45. See *supra* note 38 (complete text of § 365(b)(3)(C)).

239. S. REP. NO. 70, 98th Cong., 1st Sess. 16 (1983).

240. *Vista VI*, 11 BANKR. CT. DEC. (CRR) at 452. See *U.L. Radio Corp.*, 19 Bankr. at 544-45.

241. See *infra* note 246 and accompanying text.

242. 11 U.S.C. § 365(b)(3)(C) (emphasis added).

specifically based upon the use clause, it appears to result from an analysis of the interdependence between the use clause and the rights granted under the prior franchise agreement.<sup>243</sup> Had the lessor also been the franchisor, the lessor's reliance upon the use clause could have been strengthened because arguably the interdependence between the lease and the franchise relationship prevented the assumption of the lease because of the nonexistence of the franchise agreement.<sup>244</sup> The desire of the tenant to operate under a different trade name would have operated as an attempted rejection of the franchise agreement and thus would have prevented the selective assumption of the lease.<sup>245</sup>

The interdependence analysis has also been used in circumstances not involving a franchise relationship. For instance, in *In re Hardaway Restaurant, Inc.*,<sup>246</sup> the debtor purchased the Once-Upon-A-Stove Restaurant from Stove, Inc. (Stove). It also gave a collateral assignment of three of four leaseholds as security for its performance under several promissory notes to Stove. The collateral assignment of leases was unrecorded. Upon default of these leases, Stove served notice of default on the debtor and demanded that the debtor leave the restaurant premises.<sup>247</sup> Prior to the filing of bankruptcy proceedings, Stove commenced actions in state court to recover a money judgment and to recover possession of the restaurant premises pursuant to the collateral assignment of leases.<sup>248</sup> Subsequent to the initiation of bankruptcy proceedings, the debtor argued that the assignment of the leases was avoidable under the powers of a bona fide purchaser found in section 544(a)(3) of the Bankruptcy Code.<sup>249</sup> The court's analysis in determining whether the assignment of leases was avoidable was based upon whether a hypothetical bona fide purchaser would be put on notice of Stove's assignment of the leaseholds.<sup>250</sup> The court found that inquiry by a prospective bona fide purchaser would reveal that the restaurant premises were originally leased to

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243. The lessor may have created an additional problem because the court found the lessor was negotiating with a shoe store to lease the same space, thus weakening the use argument. *See Vista VI*, 11 BANKR. CT. DEC. at 452.

244. *See Holland Enterprises*, 25 Bankr. at 302-03.

245. *Id.* at 301.

246. 31 Bankr. 322 (Bankr. S.D.N.Y. 1983).

247. *Id.* at 325.

248. *Id.*

249. 11 U.S.C. § 544(a)(3).

250. *Hardaway Restaurant*, 31 Bankr. at 331.

Stove by the landlord and that these leases were assigned by Stove to the debtor.<sup>251</sup> Such information could be verified by providing the bona fide purchaser with copies of the unrecorded leases to Stove by the landlord and the subsequent assignments of leases by Stove to the debtor.<sup>252</sup> A prospective purchaser who inquired would be satisfied that although the debtor's leaseholds were not recorded, they were genuine. However, since neither the leases nor the lease assignments made any reference to the assignments of leases to Stove for security, a prospective bona fide purchaser would not be given notice of Stove's lien interest.<sup>253</sup>

Stove contended that the bona fide purchaser would have been put on notice of the assignment of lease upon review of the written consents of the landlord concerning the original assignment of lease to the debtor. Since these consents made reference to the debtor's assignments to Stove for security, the debtor argued that the prospective bona fide purchaser would have been put on notice of Stove's unrecorded interest in the restaurant's premises.<sup>254</sup> The court found, however, that the required inquiry by a hypothetical bona fide purchaser could have been satisfied merely by obtaining comfort letters from the landlord stating that it had consented to Stove's assignments of the leases to the debtor.<sup>255</sup> Since this inquiry would not have disclosed Stove's unrecorded interest in the leaseholds, the bankruptcy court found that the debtor could take advantage of the status of a bona fide purchaser under section 544(a)(3) to avoid Stove's unrecorded assignment of leases for security.<sup>256</sup>

The failure to refer to Stove's lease assignments for security in the lease or in the landlord's comfort letter was the undoing of what could have been construed as an interdependent or integral transaction between Stove and the debtor. The purchase of the restaurant premises involved the purchase of assets as well as the lease of the premises, the execution of promissory notes and the taking of the leaseholds as collateral; therefore, references in each document would have assisted Stove's argument that a bona fide purchaser would have been put on notice of its lien.

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251. *Id.*

252. *Id.*

253. *Id.* at 330.

254. *Id.* at 331.

255. *Id.*

256. *Id.* at 332.

## V. CONCLUSION

The franchisor faced with the operation of one or more of its units by a franchisee who is also a debtor-in-possession under Chapter 11 of the Bankruptcy Code must determine whether the reorganization effort is sufficiently realistic and advantageous to him to warrant his cooperation with the franchisee's plan for the use or disposition of the assets of the bankruptcy estate. Alternatively, the franchisor must decide whether such use or disposition is contrary to its plans for the continued operation of its franchise program in the franchisee-debtor's market. In circumstances in which the franchisor elects to oppose the franchisee's proposed use or disposition of its assets, the franchisor historically has been met with substantial delays in obtaining judicial resolution of issues concerning the franchisee-debtor's assumption or rejection of its franchise agreement, and the assumption or rejection of the lease for the franchised premises. Such delays have at various times resulted in loss of income to the franchisor, a decrease in quality of services and products made available to the public under the franchisor's service mark or trade-name, a lack of compliance by the franchisee-debtor with the franchise program's standards and specifications, and the loss of a potential sale to a third party anxious to accept the franchisee-debtor's rights and obligations under the franchise agreement and/or lease. In some cases, upon rejection of the franchise agreement, these delays often create new competition for the franchisor in the form of the debtor who remains in possession of the franchised location and operates a business substantially similar to the franchise program.

The 1984 Amendments to the Bankruptcy Code provide some relief to non-debtor lessors of nonresidential real property by limiting the statutory time period for a debtor to reject or assume its lease and requiring the timely performance of its lease obligations. However, the special protections afforded lessors of nonresidential real property have not been extended to the treatment of franchise agreements as executory contracts. The non-debtor who is both a lessor of real property and a franchisor to the debtor may more easily receive the special protections afforded lessors while experiencing difficulties receiving similarly advantageous treatment as a franchisor. For example, the franchisor might readily obtain possession of the franchised premises but remain unable to terminate the franchise relationship. This impractical result can prevent the franchisor from marketing his franchise program at the very location it possesses and may require the franchisor to seek judicial relief from the automatic

stay in order to terminate the franchise agreement. In addition, the franchisor may avoid this unsavory business result in some cases by utilizing the judicially created interdependence analysis to extend the favorable treatment granted landlords under the unexpired leases to the franchise relationship. Apart from the Bankruptcy Code, the franchisor may similarly use the interdependence analysis to prevent the debtor from retaining the benefits of the lease agreement while rejecting its franchise agreement which, in conjunction with the lease, governs the operation of the business at the leased location.

