



## Bankruptcy ADVISORY ■

**FEBRUARY 18, 2014**

### Seventh Circuit Poised to Decide Treatment of Franchise Agreements in Bankruptcy

*A & F Enterprises, Inc. v. IHOP Franchising LLC (In re A & F Enterprises, Inc.)*, 2014 WL 494857 (7th Cir. 2014)

In *A & F Enterprises*, the Seventh Circuit recently considered the powers of a restaurant franchisee (the “Debtor”) to continue to operate its franchise in bankruptcy court. The Seventh Circuit considered a situation in which, in addition to typical franchise agreements, the debtor had corresponding building and equipment leases for its restaurants. The *A & F* decision holds important consequences for what happens to those leases and franchise agreements when a franchisee files bankruptcy.

#### **Background**

In bankruptcy, a debtor can assume (i.e., continue to perform) an executory contract or reject it any time before confirming a plan of reorganization. However, unexpired leases of real property must be assumed within 210 days of filing bankruptcy or they are considered rejected. In *A & F*, the Debtor did not assume its building leases within 210 days. Eager to sell the franchises to a third party, the franchisor argued that, pursuant to a cross-default provision in the franchise agreement, the franchise agreement and equipment leases also expired because the Debtor had failed to timely assume the building leases. The debtor countered that the building and equipment leases constituted a single integrated contract with the franchise agreements, thereby giving the Debtor until plan confirmation to assume the single contract.

#### **Relevant Decisions**

Siding with the franchisor, the bankruptcy court and district court ruled that building leases had been rejected and, consequently, that the franchise agreement and equipment leases expired. The Debtor sought a stay pending appeal of this issue to avoid losing the franchises, but the bankruptcy court and district courts denied the stay on the basis that the Debtor’s argument lacked merit. The issue before the Seventh Circuit in *A & F* was whether the lower courts’ orders should be stayed pending resolution of the appeal.

This advisory is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

The Seventh's Circuit's decision in *A & F* is important because it held, without deciding the issue, that there *is merit* to the argument that a franchise agreement and building lease should be treated as a single integrated contract. According to the Seventh Circuit, the text of the Bankruptcy Code leads to conflicting results on this issue, and so courts must look beyond the text of the statute. While not deciding the issue, the *A & F* decision strengthens the argument that a franchise agreement should be treated as a single integrated contract, to the benefit of franchisees.

Ultimately, the Seventh Circuit stayed the issue pending appeal because the potential harm to the Debtor—i.e., losing its franchise agreements—outweighed the harm to the franchisor—i.e., losing value in the franchisor's trademark through the Debtor's continued (and allegedly poor) operation of the franchises. As a result, franchisors and franchisees should stay tuned for developments out of the Seventh Circuit. That court is now poised to consider the interplay between franchise and lease agreements, and decide how long franchisees can wait to assume a franchise agreement in bankruptcy when the rights under the franchise agreement are intertwined with other contractual obligations.

If you would like to receive future *Bankruptcy Advisories* electronically, please forward your contact information to [bankruptcy.advisory@alston.com](mailto:bankruptcy.advisory@alston.com). Be sure to put "subscribe" in the subject line.

If you have questions regarding the information in this bankruptcy and restructuring update, please feel free to reach out to:

---

Jason H. Watson  
404.881.4796  
[jason.watson@alston.com](mailto:jason.watson@alston.com)

David A. Wender  
404.881.7354  
[david.wender@alston.com](mailto:david.wender@alston.com)

Kevin M. Hembree  
404.881.7831  
[kevin.hembree@alston.com](mailto:kevin.hembree@alston.com)

## ALSTON & BIRD LLP

---

[WWW.ALSTON.COM](http://WWW.ALSTON.COM)

© ALSTON & BIRD LLP 2014

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777  
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719  
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111  
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899  
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213-576-1100  
NEW YORK: 90 Park Avenue ■ 12th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444  
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260  
SILICON VALLEY: 275 Middlefield Road ■ Suite 150 ■ Menlo Park, California, USA, 94025-4004 ■ 650-838-2000 ■ Fax: 650.838.2001  
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.756.3300 ■ Fax: 202.756.3333