WHEN A FRANCHISOR LIQUIDATES: WHAT FRANCHISEES, LANDLORDS AND SUPPLIERS SHOULD KNOW

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A wave of franchise-related bankruptcy filings has refocused attention on the treatment of franchise agreements, leases, and supplier relationships in bankruptcy. Recent cases span the franchise ecosystem: Red Lobster (May 2024, Chapter 11), Rubio's Coastal Grill (June 2024, Chapter 7), COVID-era cases such as NPC International and Friendly's, and most recently, In re Fat Brands Inc., Case No. 26-90126 (Bankr. S.D. Tex. filed Jan. 26, 2026), a multi-brand restaurant franchisor operating 18 brands across approximately 2,200 locations with 670 franchise partners worldwide. The Fat Brands filing illustrates the scale at which franchisor financial distress can simultaneously affect hundreds of franchise partners, particularly where whole-business securitization structures pledge franchise royalties as collateral for approximately $1.4 billion in securitization debt. Whether the distressed party is the franchisor, a major franchisee, or a related entity, stakeholders should understand how their contracts may be treated and act early to protect their interests.

The buyer does not automatically assume every obligation

Under 11 U.S.C. § 363(f), a buyer may acquire selected brands, intellectual property, operating assets, and contracts free and clear of liens, claims, and encumbrances without assuming the debtor's other liabilities. The sale order and asset purchase agreement determine which obligations transfer. A § 363 sale free and clear does not, however, automatically extinguish franchisees' intellectual property rights. Stakeholders should carefully review the proposed transaction rather than assuming that the new brand owner will honor every obligation of the former franchisor. Rights involving development commitments, marketing funds, rebates, indemnification, and unpaid amounts may remain with the bankruptcy estate.

Where, as in Fat Brands, franchise royalties are pledged as collateral under a whole-business securitization, additional tension arises between the securitization noteholders' priority claims and franchisees' expectations of continued brand support, system investment, and operational infrastructure.

Franchise agreements may be assumed, assigned or rejected

Franchise agreements are executory contracts under the Bankruptcy Code. In a Chapter 7 case, the trustee has 60 days to assume or reject; failure to act results in deemed rejection. 11 U.S.C. § 365(d)(1). With court approval, the debtor or trustee may assume the agreement, assign it to a buyer, or reject it. For franchisees, the outcome may affect:

- The continued right to use the brand and its intellectual property;
- Royalty and advertising-fund obligations;
- Access to operating systems and approved suppliers;
- Territorial or development rights; and
- Claims arising from the franchisor's failure to perform.

Two issues warrant particular attention. First, 11 U.S.C. § 365(n) protects licensees of "intellectual property" as defined in § 101(35A), but that definition excludes trademarks. After Mission Product Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652 (2019), rejection constitutes a breach rather than a rescission, and a trademark licensee may retain its rights post-rejection. Open questions remain regarding whether a franchisee must continue paying royalties to retain those rights and how Lanham Act quality-control obligations are satisfied when the licensor is a liquidating estate. Second, the circuit split on § 365(c)(1) determines whether a franchise agreement can be assumed without the franchisor's consent. The Third, Fourth, Ninth, and Eleventh Circuits apply the "hypothetical test," barring assumption if applicable law would prohibit assignment to a hypothetical third party. The First and Fifth Circuits apply the "actual test," permitting assumption where no assignment is contemplated. Franchisees should identify which test governs and review proposed cure amounts promptly.

Landlords should monitor lease decisions and cure amounts

Restaurant and retail locations involve valuable leases subject to strict statutory deadlines. Under § 365(d)(4), a nonresidential real property lease is deemed rejected if not assumed within 120 days of the order for relief (extendable by 90 days for cause). During the interim, § 365(d)(3) requires the trustee to perform all lease obligations. A debtor seeking to assume and assign a lease must cure defaults and provide adequate assurance of the assignee's future performance. For shopping center leases, § 365(b)(3) imposes additional protections concerning tenant mix, use restrictions, and exclusivity.

Landlords should review proposed cure amounts and the assignee's financial and operational qualifications. Where a lease is rejected, the landlord's damages claim is capped under 11 U.S.C. § 502(b)(6) at the greater of one year's rent or 15% of the remaining lease term (not to exceed three years). Courts have disagreed on whether the cap is a function of rent reserved or time remaining. See In re Gantos, Inc., 176 B.R. 793 (Bankr. W.D. Mich. 1995). Non-rent damages such as maintenance and common-area charges may fall outside the cap. See In re Best Products Co., 229 B.R. 673 (Bankr. E.D. Va. 1998). Where the franchisor is master tenant, rejection terminates the sublease, leaving sub-tenants without privity.

Suppliers should distinguish between old and new obligations

Suppliers have several potential avenues for recovery depending on the timing and nature of their claims. Goods delivered within 20 days before the petition date qualify for administrative expense priority under § 503(b)(9), a significant advantage because administrative claims are paid ahead of general unsecured creditors. See In re NE Opco, Inc., 501 B.R. 233 (Bankr. D. Del. 2013) (limited to goods, not services). Separately, § 546(c) provides a reclamation right for goods delivered within 45 days pre-petition, subject to a written demand and prior secured creditor rights. Payments received within 90 days pre-petition are subject to preference avoidance under § 547, with key defenses including ordinary course of business (§ 547(c)(2)), new value (§ 547(c)(4)), and contemporaneous exchange (§ 547(c)(1)).

Suppliers asked to continue deliveries post-petition should insist on current payment terms or adequate assurance. The critical-vendor doctrine, under which courts authorize payment of select pre-petition claims to preserve going-concern value, is unavailable in Chapter 7 liquidations.

Monitor the case and act promptly

Franchisees, landlords and suppliers should consider taking the following steps when a franchisor enters bankruptcy:

- Review all notices, contract schedules and proposed sale documents;
- Confirm applicable objection, claim and cure deadlines, which are often short;
- Identify amounts owed and the agreements governing the relationship;
- Evaluate whether critical rights are transferring to the buyer;
- Preserve communications and records concerning defaults or performance; and
- Assess operational alternatives if the relationship will not continue.

Franchise bankruptcies move quickly. Courts routinely approve § 363 sales on compressed timelines to preserve brand value and going-concern operations. Waiting until a transaction closes may substantially limit a stakeholder's available remedies.

Berger Singerman’s Business Reorganization Team represents franchisees, landlords, suppliers and other stakeholders in bankruptcy proceedings and distressed transactions. Please contact a member of our team if your business is affected by a franchise-related bankruptcy, liquidation or sale.

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