In the United States Bankruptcy Court

for the Northern District of Iowa

BECKETT CHEVROLET-OLDS INC. Bankruptcy No. L-90-00401D
Debtor(s). Chapter 7

Ruling Re: Trustee's Proposed Sale of Franchise Agreement

The matter before the Court is the trustee's proposed sale of the franchise agreement between the debtor corporation and General Motors Corporation. The Court, having heard the evidence and testimony, and having considered the arguments of counsel, now enters its findings of fact, conclusions of law, and order pursuant to Fed.R.Bankr.P. 7052.

ISSUE

The issue before the Court is whether the trustee has any right under either bankruptcy or state law to assign the franchise agreement between the debtor and General Motors Corporation. The Court finds that the franchise agreement is an executory contract which has been rejected by the trustee and, therefore, the trustee has no rights which can be assigned to a subsequent purchaser.

Findings of Fact

The facts in this case are essentially undisputed. The facts relevant to the Court's determination of this issue are as follows.

1. The debtor, Beckett Chevrolet-Olds, Inc., operated a Chevrolet and Oldsmobile automobile dealership in Dyersville, Iowa. That dealership was operated pursuant to a dealer service agreement dated November 1, 1985 ("the franchise agreement"). Copies of the franchise agreements were entered into evidence as General Motors exhibits 1 and 2.

2. The debtor filed for Chapter 11 relief under the United States Bankruptcy Code on March 7, 1990. The debtor continued as a debtor-in-possession and operated its automobile dealership business until the case was converted to a Chapter 7 proceeding on March 12, 1990. Upon conversion to Chapter 7, Thomas G. McCuskey, was appointed interim trustee ("trustee").

3. It is somewhat unclear exactly when the dealership discontinued its business. However, it appears the discontinuation of the business occurred virtually simultaneously with the conversion to Chapter 7. The dealership was operated while the case was in a Chapter 11. However, upon conversion to the Chapter 7, the dealership was closed. In the Chapter 7 the trustee determined that he did not have the financial resources available to him to continue the operation of the automobile dealership in Dyersville. The dealership has not reopened since it closed on or about March 12, 1990.

4. The trustee did not seek an extension of time to accept or reject the franchise agreement under 11 U.S.C. § 365.[(1)] The trustee did not assume the contract within 60 days after the entry of the order of relief in the Chapter 7 and, in fact, has made no effort to assume the contract at any time since the case has been filed.

The trustee testified that because he did not have the financial resources to operate the dealership, it would be impossible for him to perform under the franchise agreement or to give adequate assurance of future performance.

5. The debtor's license to sell motor vehicles was revoked by the State of Iowa on April 28, 1990. one of the conditions

of a dealer's license is a requirement that the dealer post a surety bond. The surety bond which had previously been issued to the debtor was canceled shortly after the filing of the bankruptcy petition. Upon cancellation of the surety bond the state revoked the dealer's license.

6. Dave Ballstaedt Ford has contacted the trustee about purchasing the General Motors franchise. The trustee desires to sell the franchise in an attempt to generate additional assets for the benefit of the creditors of the debtor's estate. General Motors Corporation ("GMC") objects to the proposed sale. GMC argues that the trustee cannot assign the franchise since it was not assumed within 60 days following the entry of the order of relief. GMC has another GMC dealer which it proposes to operate a Chevrolet and Oldsmobile dealership in Dyersville, Iowa.

Conclusions of Law

I. Is the Franchise Agreement an Executory Contract

The test in this circuit for determining whether a particular contractual relationship is an executory contract is whether performance remains due on both sides. Matter of Newcomb, 744 F.2d 621, 624 (8th Cir. 1984). Applying that test to the franchise agreement between GMC and the debtor, the Court concludes that the franchise agreement is an executory contract. Both parties to the agreement have a number of continuing obligations. The dealer's responsibilities include providing dealership facilities, actively selling GMC vehicles, and providing service work (including warranty repairs) to owners of GMC vehicles. GMC's obligations under the agreement include selling and transporting GMC vehicles to the dealer, selling parts and accessories to the dealer, reimbursing the dealer for warranty repairs, and repurchasing damaged motor vehicles. These significant and unfulfilled responsibilities which remain due from both parties render the contract executory in nature.

A number of other courts which have reviewed similar franchise agreements have held either directly or by implication that those franchise agreements are executory in nature. In In re Pioneer Ford Sales, Inc., 729 F.2d 27 (1st Cir. 1984), the court discussed the right of a trustee to assume and assign an automobile franchise agreement under § 365. In the Pioneer Ford case there was no dispute that the franchise agreement was an executory contract and the court operated on that assumption in its discussion of the trustee's rights under § 365. In Moody v. Amoco Oil Co., 734 F.2d 1200 (7th Cir. 1984), the court considered a franchise agreement to sell petroleum products to be an executory contract when it discussed the right to assume or reject pursuant to § 365.

More directly, several district and bankruptcy courts have explicitly held that franchise agreements are executory contracts. The district court for the middle district of Tennessee, for example, held that a franchise agreement is an executors contract. Silk Plants, Etc. Franchise Systems v. Register, 100 B.R. 360, 361-362 (M.D. Tenn. 1989) (citing In re Roving, 6 B.R. 661, 666 (Bankr. W.D Tenn. 1980)); see also In re Masterworks, Inc., 100 B.R. 149 (Bankr. D. Conn. 1989).

It is readily apparent in this case that the trustee also considered the franchise agreement to be an executory contract. He made a conscious decision not to assume the contract because he determined that he did not have the financial resources available to cure the defaults and to make adequate assurance of future performance as required by § 365(b)(1). Contrary to the assertions contained in the brief filed by Dave Ballstaedt Ford, there is no evidence in this record that GMC in any way mislead the trustee about the value of the franchise agreement or that the trustee lacked knowledge about the existence of the franchise.

II. May the Trustee Assign an Unassumed Executory Contract Under § 365 the Chapter 7 trustee must accept or reject an executory contract within 60 days after the entry of the order for relief. If the trustee fails to accept an executory contract within the 60 day time period, the contract is deemed rejected. § 365(d)(1). In this case, the trustee did not make any attempt to accept the contract within the 60 days following the date of conversion to Chapter 7, nor did the trustee request an extension of time to make the decision to accept or reject the contract. Accordingly, the executory contract is deemed rejected.

Once a contract is terminated, it cannot be revived and the right to assume the contract is extinguished. When the deemed rejection occurs because the time limit set forth in § 365(d)(1) expires, that rejection is conclusive. In re

Arizona Appetito Stores, Inc., 893 F.2d 216, 219 (9th Cir. 1990); Counties Contracting and Construction Co. v. Constitution Life Insurance Company, 855 F.2d 1054, 1060-61 (3rd Cir. 1988).

The Bankruptcy Code specifically prohibits the trustee from assigning an executory contract which has not been assumed. Section 365(f)(2) states as follows:

> The trustee may assign an executory contract or unexpired lease of the debtor only if-
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> (A) the trustee assumes such contract or lease in accordance with the provisions of this section; and
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> (B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

In Matter of Chicago, Rock Island & Pacific Railroad, 865 F.2d 807, 816 (7th Cir. 1988), the court specifically stated that a contract not validly assumed cannot be assigned since the successor in interest to the debtor cannot claim any rights under the agreement.

Since the contract is now deemed rejected, § 365(f)(2) of the Bankruptcy Code prohibits assignment. However, the trustee and Dave Ballstaedt Ford argue that the Bankruptcy Code must be read together with Iowa Code Chapter 322A (1989). That chapter generally deals with motor vehicle franchises and sets out requirements which must be met before a franchiser can terminate a franchise agreement. Section 322A.11(2) prohibits a franchiser from terminating a franchise agreement except for good cause and upon a showing that another dealer will provide equivalent service for the same line and make in the community. Chapter 322A provides to a franchisee the right to an administrative hearing and ultimate judicial review of any decision to terminate a franchise over the objection of the franchisee. Section 322A.12 also requires a franchiser to recognize the sale or transfer of a franchise agreement notwithstanding any prohibition against the transfer which may be contained in the franchise agreement. Buckwalter Motors, Inc. v. General Motors Corp., 593 F. Supp. 628 (S.D. Iowa 1984).

GMC had not terminated its franchise agreement with the debtor prior to the debtor filing this case. Since the filing of the case GMC has made no attempt to have the automatic stay lifted in order to proceed with post-petition termination procedures under Chapter 322A. Consequently, the trustee and David Ballstaedt Ford argue that the franchise can still be transferred regardless of the fact that the franchise agreement has been rejected by operation of law under the Bankruptcy Code.[(2)]

Chapter 322A is applicable only in those situations where a franchiser (in this case GMC) attempts to terminate a franchise agreement without the consent of the franchisee. In this case, the franchise agreement has effectively been terminated by the trustee, as successor to the franchisee, without any action by GMC. The trustee decided that closing down the business, ceasing performance under the franchise agreement, and allowing the executory contract to be rejected by operation of law were in the best interest of creditors. The trustee, not GMC, made the decision to reject the contract and terminate the franchise agreement. Hence, section 322A.2 would not be applicable to this situation.

GMC also makes a persuasive argument that Chapter 322A is not applicable since there is no longer a contract in existence. Section 322A.1(4) defines a "franchise" as ". . . a contract between two or more persons. . ." In this case, the contract has been rejected by the trustee. Since there is no contract there cannot be a franchise to which Chapter 322A is applicable. once a party rejects a contract, the rejection excuses performance by the other party to the rejected contract. In re Pacific Express, Inc., 780 F.2d 1482, 1486 n.3 (9th Cir. 1986); see also In re Auto Dealer Services, Inc., 96 B.R. 360, 364 (Bankr. M.D. Fla. 1989). By rejecting the contract the franchisee effectively terminates the franchise and GMC is relieved of any further obligations under the agreement.

This case is similar in many respects to the case of In re Deppe, 110 B.R. 898 (Bankr. D. Minn. 1990). In that case, the debtor had a franchise agreement with Amoco Oil Company to which the Petroleum Marketing Products Act (15 U.S.C. § 2801 et seq.) was applicable. As in this case, Amoco was required to comply with statutory procedures in order to terminate the franchise agreement. The Deppe trustee did not timely move to accept the executory contracts. The court in the Deppe case ruled that the failure to accept the executory contracts meant the trustee no longer had any right to compel enforcement of the agreements and the automatic stay could be lifted to allow Amoco to proceed to terminate

the agreements pursuant to its contract and the Petroleum Marketing Practices Act. 110 B.R. at 905-06.

In summary, the trustee's decision not to accept the executory contract within the time allotted under the Code means the franchise agreement between the debtor and GMC has now been rejected. Since the contract has been rejected, the trustee no longer has any rights in the franchise to assign to Dave Ballstaedt Ford or any other purchaser.[(3)]

One of the main purposes of Chapter 322A of the Iowa Code is to continue the operation of motor vehicle dealerships in Iowa communities. In this case the position being put forward by the trustee and Dave Ballstaedt Ford thwarts the intent of the Iowa statute. GMC has a dealer ready and able to continue the Chevrolet-Oldsmobile dealership in Dyersville, Iowa. Yet, because of the uncertainties over the trustee's rejection of the franchise and Dave Ballstaedt's subsequent attempt to purchase the franchise, Dyersville has been without an Chevrolet-Oldsmobile dealership since March of 1990. It is obvious to this Court that the franchise has been terminated by the trustee through the trustee's rejection and the trustee no longer has any rights which may be assigned to Dave Ballstaedt Ford or any other purchaser.

ORDER

IT IS THEREFORE ORDERED that the trustee's application to sell and assign the franchise agreement between the debtor and General Motors Corporation is denied.

DONE AND ORDERED this 28th day of January, 1991.

Michael J. Melloy
Chief Bankruptcy Judge

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1. All statutory references are to Title 11, United States Code, the "Bankruptcy Act" of 1979", unless otherwise indicated.

2. The Court is expressing no opinion about whether GMC has grounds to terminate the franchise agreement with the debtor under Chapter 322A. However, it should be noted that Chapter 322A certainly seems to contemplate that any dispute over termination would involve an operating franchisee who is continuing to sell and service the franchiser's motor vehicles. The revocation of the dealers license by the Iowa Department of Transportation pursuant to Chapter 322 may be sufficient grounds itself to terminate the franchise agreement.

Even if the Court were to assume that the trustee had the right under the Bankruptcy Code to assign the franchise to Dave Ballstaedt Ford, that would not be the end of the discussion. The attorney for Dave Ballstaedt Ford pointed out at oral argument that Chapter 322A of the Iowa Code was modeled on a similar statute from California. A recent decision from a California bankruptcy court holds that an assignment of a motor vehicle franchise agreement must comply with both the Bankruptcy Code and applicable state statutes. In re Van Ness Auto Plaza, Inc., 120 B.R. 545, 546-47 (Bankr. N.D. Cal. 1990). Thus, even if the franchise were assigned, GMC may have the right to seek termination if it can make the necessary showing to support termination under Chapter 322A, Code of Iowa.

3. It is unclear exactly what the trustee is seeking to sell. The trustee has not, as of this date, made any attempt to assume the franchise agreement. It is the understanding of the Court that the parties intend to assign the franchise to Dave Ballstaedt Ford and then allow the Court to determine what must be paid in order to assume the franchise agreement and cure defaults. Under the Bankruptcy Code, once a trustee assigns an executory contract the estate is relieved of any liability for breach of the contract after the assignment. § 365(k). It is unclear what will happen if the Court ultimately determines that it will require a substantial payment by the assignee (Dave Ballstaedt Ford) in order to cure defaults. It appears that Dave Ballstaedt Ford wants the option left open to reject the assignment and return the franchise to the trustee if it determines the amount required to cure is too onerous. That procedure is contrary to the statutory scheme of the Bankruptcy Code which requires the trustee to first assume and then assign; not assign the contract and then assume if the assignee determines the amount required to cure is not too burdensome. It is arguable that if the Court approved the assignment, Dave Ballstaedt Ford would become contractually obligated under the franchise agreement and

Bankruptcy Code to cure the defaults in an amount to be determined by this Court and would not have the option of "backing out" of the agreement.