

In the United States Bankruptcy Court

for the Northern District of Iowa

UNITED STATES HOCKEY LEAGUE
d/b/a USHL
Debtor.

Bankruptcy No. 95-60891KW

Chapter 11

ORDER RE DEBTOR'S MOTION FOR AUTHORITY TO REJECT EXECUTORY CONTRACT WITH KEYSTONE HOCKEY, INC.

On August 24, 1995, the above-captioned matter came on for hearing pursuant to assignment. Attorney Dan Childers represented Debtor United States Hockey League. Attorney Eric Lam represented Keystone Hockey, Inc., Geoffrey Kelly and Janelle Kelly (collectively "Keystone"). The matter before the Court is Debtor's Motion for Authority to Reject Executory Contract with Keystone Hockey, Inc. (Madison Franchise) and Keystone's resistance thereto. After the presentation of evidence and arguments of counsel, the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(A).

STATEMENT OF THE CASE

Debtor operates an amateur hockey league. It has franchises with 12 teams which accommodate approximately 300 players between the ages of 17 and 19. Debtor provides the teams with administrative, organizational and dispute resolution functions. The teams are obliged to appear and compete in scheduled games and provide financial support for Debtor's expenses.

Problems began between Debtor and Keystone soon after Keystone acquired the Wisconsin franchise. Debtor voided Keystone's early trade of a player because the trade would have caused a competitive imbalance in the league. By the end of the season in early 1994, Debtor found it necessary to pay some of Keystone's expenses to allow the final games to be played as scheduled. This intervention by Debtor led to litigation in Wisconsin state court.

The Wisconsin Circuit Court concluded in a bench trial that Debtor violated the Wisconsin Fair Dealership Law by attempting to terminate the Keystone franchise. The court enjoined Debtor from terminating the franchise and awarded Keystone approximately \$100,000 in attorney fees. Debtor filed its bankruptcy petition on the day that the remainder of the case was scheduled for a jury trial on the issue of damages.

Keystone has made attempts to move the Madison team to Sioux Falls, South Dakota, leading to continuing problems for Debtor regarding the scheduling of games. Debtor alleges that this has also affected its reputation. Sioux Falls does not have a facility in which the team could play its hockey games.

Debtor wishes to reject its franchise agreement with Keystone. It asserts it is in the best interests of the estate and other franchisees if it rejects the franchise agreement with Keystone considering the extent of litigation between the parties, the Wisconsin judgment Keystone holds against Debtor, threats and concerns of future litigation, as well as Keystone's attempt to move the team.

Representatives of seven of the other franchise teams testified that they approved Debtor's bankruptcy petition and its decision to reject the Keystone franchise agreement. They testified that would only support Debtor's reorganization efforts if the Court allows Debtor to reject the Keystone agreement.

Keystone asserts that this is essentially a two-party dispute. It argues that allowing Debtor to reject the franchise agreement with Keystone improperly circumvents the Wisconsin state court judgment enjoining the termination of the franchise agreement. Keystone argues that the motion should be denied or at least continued until after ruling on its Motion to Dismiss scheduled for hearing on September 20, 1995.

Keystone asserts that the franchise agreement is not an executory contract. Further, it argues that the injunction entered in Wisconsin state court prevents Debtor from rejecting the franchise agreement. Keystone argues that Debtor filed its petition in bad faith and is not entitled to the protection of the business judgment test; no benefit to the estate will be gained by rejecting the agreement.

CONCLUSIONS OF LAW

In determining whether a contract is an executory contract which may be rejected pursuant to 365, the Court must ask if there are material, unperformed obligations by both parties remaining. Cameron v. Pfaff Plumbing & Heating, Inc., 966 F.2d 414, 416 (8th Cir. 1992). The only contracts excluded from the definition of executory contracts are those from which the debtor had enjoyed full benefit prepetition. Id. at 417. A contract is executory if performance remains due to some extent on both sides. In re Cedar Rapids Meats, Inc., 121 B.R. 562, 573 (Bankr. N.D. Iowa 1990).

In In re Beckett Chevrolet-Olds, Inc., No. L-90-00401D, slip op. at 4 (Bankr. N.D. Iowa Jan. 28, 1991), this Court determined that an automobile franchise agreement was an executory contract because both parties had a number of continuing obligations. In a franchise agreement, the franchisee has an interest in the continued undertaking of the franchisor to cooperate in the operation of its business and to insure that the franchise is not infringed upon. In re Rovine Corp., 6 B.R. 661, 666 (Bankr. W.D. Tenn. 1980). In return, the franchisee has the obligation to follow the mandates of the franchise agreement in conducting its business. Id.

The Court concludes that the franchise agreement between Debtor and Keystone is an executory contract under 365. Debtor has continuing obligations to schedule games, provide officials, and generally run the league in order that the teams can be viable. Keystone has continuing obligations to follow league regulations and attend and compete in games scheduled by Debtor.

The injunction entered by the Wisconsin state court does not make the contract nonexecutory. Furthermore, the right of the Debtor to reject the contract under 365 was not precisely the same issue presented in the state court when it granted the injunction. See In re Monarch Tool & Mfg. Co., 114 B.R. 134, 136 (Bankr. S.D. Ohio 1990). In Chapter 11, Debtor has privileges under 365 of the Bankruptcy Code which were not available to it in defending against Keystone's state court action.

Generally, in order to obtain rejection of an executory contract, the debtor-in-possession or trustee must satisfy a business judgment test, proving that rejection would benefit general unsecured creditors. In re Pierce Terminal Warehouse, Inc., 133 B.R. 639, 645 (Bankr. N.D. Iowa 1991); Cedar Rapids Meats, 121 B.R. at 574. Deference is given to the business discretion of the debtor unless the decision that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice. In re Johnston, No. X88-00898S, slip op. at 3 (Bankr. N.D. Iowa Aug. 15, 1988) (citing Lubrizol Enterprises v. Richmond Metal Finishers, 756 F.2d 1043, 1047 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986)). The purpose of allowing rejection of an executory contract is to make the debtor's rehabilitation more likely by relieving the debtor of a

contractual obligation and creating a breach of the contract enabling the contracting party to file a claim as a creditor. In re Silk Plants, Etc. Franchise Sys., Inc., 100 B.R. 360, 362 (M.D. Tenn. 1989) (approving rejection of retail franchise agreement).

Keystone attempts to posture this issue in terms of Debtor's bad faith. In one case it relies upon, In re Southern California Sound Systems, Inc., 69 B.R. 893 (Bankr. S.D. Cal. 1987), the court simultaneously considered the debtor's rejection of a licensing agreement and the creditor's motion to dismiss for bad faith. The court concluded that the case should be dismissed as filed in bad faith. Id. at 900. Keystone also cites In re Matusalem, 158 B.R. 514, 521 (Bankr. S.D. Fla. 1993), which is distinguishable from the present case. The court there noted that the case was probably filed in bad faith. Id. at 522. It based its decision not to allow the debtor to reject a subfranchise agreement on the debtor's poor business judgment in destroying the franchisee as part of a vendetta in order to try to run the business without having the necessary facilities or management expertise. Id. at 521. The court concluded that the debtor's business plan was not viable and the rejection would result in no economic benefit to unsecured creditors. Id. at 522.

The Court concludes that Debtor has made its decision to reject the Keystone franchise agreement using sound business judgment. Debtor has been in disputes with Keystone almost since the beginning of their franchise relationship. Debtor feels that Keystone has acted in a manner contrary to the good of the league by its early attempt at trading players and recent attempts to move the team to Sioux Falls. The remaining franchisees have real concerns over the viability of the league if the Keystone agreement is not rejected. Continuing litigation with Keystone could so diminish Debtor's resources as to preclude any reorganization efforts. The Court is aware that there are few general unsecured creditors to benefit. However, the Court concludes that rejection of the contract will benefit Debtor's estate, the few unsecured creditors and the other franchisees.

Considering the manner in which this matter is postured and the order of the motions filed in this case, the Court prefers not to enmesh the decision of whether to allow rejection of the franchise agreement with allegations of bad faith. Those considerations are more properly addressed in terms of Keystone's Motion to Dismiss, currently scheduled for hearing next week. The Court is aware that it may have to readdress the underlying facts and law at that point, but reserves discussion of bad faith issues for that more appropriate time. The Court concludes that under the present state of this record, Debtor's decision to reject the contract is not so manifestly unreasonable that it could only be indicative of bad faith, whim or caprice. See Johnston, slip op. at 3.

WHEREFORE, Debtor's Motion for Authority to Reject Executory Contract with Keystone Hockey, Inc. (Madison Franchise) is GRANTED.

SO ORDERED this 14th day of September, 1995.

Paul J. Kilburg
U.S. Bankruptcy Judge