

BLOGS

Successor Liability

Third Circuit Holds Franchisor Liable for Predecessor's Debts

The United States Court of Appeals for the Third Circuit recently affirmed an order holding a franchisor liable for damages awarded against its predecessor in an arbitration proceeding brought by one of the predecessor's franchisees. *Regis Corp. v. S. El Dorado Corp. (In re Trade Secret Inc.)*, 2015 U.S. App. LEXIS 9912 (3d Cir. June 10, 2015). Houston BW, Inc., the franchisee, had filed an arbitration action seeking to terminate its franchise agreements with the original franchisor, Trade Secret, Inc. Trade Secret then filed for bankruptcy, and its assets and liabilities were eventually purchased by Regis. Following the sale, Trade Secret moved to dismiss the bankruptcy case, but Houston objected because there was no assurance it would retain its right to payment for the claims in the arbitration.

In its order granting Trade Secret's motion to dismiss, the bankruptcy court preserved Regis's liability to pay Houston any award granted in the arbitration proceeding pursuant to the franchise agreements. Houston ultimately prevailed in the arbitration action, and the bankruptcy court ordered Regis to pay Houston over \$300,000 in damages plus attorneys' fees and costs. Regis appealed, arguing that the bankruptcy court misinterpreted the dismissal order when it held that Regis was the "purchaser" liable for Houston's damages and that the bankruptcy court abused its discretion in granting attorneys' fees and costs to Houston.

The Third Circuit held that the bankruptcy court did not abuse its discretion in finding Regis liable for Houston's arbitration award. The plain terms of the dismissal order, when read together with Trade Secret's dismissal motion, indicated that Regis, as the purchaser of Trade Secret's franchise system, was liable for any and all amounts awarded to Houston in the arbitration proceeding. The court further concluded that Regis assumed the franchise agreements and was subject to their terms, including the provision that entitled Houston to recover the attorneys' fees and costs it incurred in the arbitration proceeding and in trying to collect its award. The court also upheld the bankruptcy court's determination that the fees and expenses requested by Houston were reasonable, necessary, and appropriate.

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