Franchise Securitization Financings

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Engaging in the successful securitization financing of a franchisor’s royalty stream and/or other sources of revenue can be a complex endeavor. It requires a particularly sophisticated skill set to enable the franchisor to take advantage of the markedly lower finance costs (versus conventional bank financing) typically associated with this type of financing transaction.

Although securitizing receivables is hardly a novel concept—the technique has been used over the past thirty years to collateralize mortgage, credit card, health care, and automobile lease receivables, among others—no successful securitization of a franchisor’s royalty stream had ever been achieved until 2000, when Arby’s, Inc. (now Arby’s Restaurant Group) raised $290 million through the securitization of the Arby’s royalty stream (a securitization subsequently, and successfully, closed out through repayment of the securitization notes).

Since then, securitization has proven more and more integral to the financing plans of many of our nation’s largest franchisors. In the past seven years alone, the following companies have turned to securitization as a means of raising funds for any of a number of strategic reasons (system expansion; acquisitions; or retirement of existing, expensive debt):¹

- The Blackstone Group/Hilton Hotels Corporation ($21 billion) (planned for 2008)
- Dunkin’ Brands, Inc. ($1.6 billion)
- IHOP Franchising, LLC ($245 million)
- Applebee’s Enterprises LLC ($1.794 billion)
- Sonic Corporation ($600 million)
- Quizno’s (confidential)
- Domino’s Pizza LLC ($1.7 billion)

What is driving the explosive growth of securitization in the franchise arena? The answer is simple: economics. A franchisor seeking to borrow funds can typically save upwards of 200 basis points a year by going the securitization route instead of establishing bank credit facilities or engaging in a traditional debt offering. The first year’s savings are not truly savings at all; they typically will be offset by the significant legal, underwriting, rating agency, insurance, and other credit enhancement fees required to consummate the securitization transaction. After the first year, however, the savings to be enjoyed by a franchisor engaging in a royalty securitization versus conventional bank financing can prove compelling.

Since the first successful franchise securitization involving Arby’s in 2000, securitization transactions have evolved and feature yet additional benefits for franchisors, such as favorable amortization terms, limited covenants, and a high level of marketability.

These finance savings reflect the lower interest rates typically associated with securitization debt as opposed to either conventional bank financing or the franchisor’s issuance of new debt instruments. Why? The answer is relatively straightforward. In the conventional bank financing or new-debt-offering scenario, the amount that can be raised by a franchisor—and the interest rate payable thereon—is wholly dependent on that franchisor’s balance sheet and income statement and the rating agency’s view of the franchisor’s overall financial position. In a securitization financing, these elements are simply inapposite. As will be detailed below, the very essence of a securitization—in which a franchisor’s revenue stream is “securitized” (that is, turned into securities)—relies upon the structural isolation of that revenue stream in an entity that is legally independent and bankruptcy-remote from the franchisor itself.

Thus, in the securitization setting, the franchisor’s overall creditworthiness is no longer of consequence, leaving only the predictability of the royalty and/or other revenue stream at issue. The rating assigned by one of the nation’s recognized rating agencies to a securitization offering will almost always be superior to that assigned to a debt or equity offering of the franchisor itself because in the latter scenario, the franchisor’s overall creditworthiness (including operating and nonoperating liabilities) and bankruptcy exposure must be taken into account. Finally, and critically, in those many instances in which the franchisor’s revenue stream is deemed so safe and so predictable as to qualify, bond insurers will fully insure both principal and

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interest on the securitization notes offered to investors, a circumstance that can quickly qualify a securitization debt offering for an AAA rating, driving down even further the interest rate associated with such notes.

In this article, we identify the participants in a securitization transaction, detail how a securitization typically is structured and accomplished, and address the key issues of law governing securitization financing activity.

**Participants in a Securitization Financing**

A securitization financing features its own lexicon of participants. In securitization parlance, the franchisor whose revenue stream will be securitized is known as the *originator, contributor, or transferor*. The newly created, structurally isolated, and bankruptcy-remote entity that will acquire, by means of a “true sale,” the franchisor’s revenue-generating assets (its franchise and other revenue-generating agreements) and offer notes secured by those assets in a *special purpose entity* (SPE) (sometimes known as a *special purpose vehicle* or *SPE*) is known as the *issuer*. Frequently, an *insurance company* (frequently referred to as a *monoline or wrapper*) will participate to irrevocably guarantee repayment of the principal and/or interest due on the asset-backed notes issued by the issuer. Sometimes, a *credit enhancer*—typically a bank, financial assurance company, or insurance company—may be brought in to enhance the creditworthiness of the securitization offering by means of letters of credit, surety bonds, and/or guarantees.

To retain its bankruptcy-remote standing—critical from an asset isolation perspective and to conform to the legal principles underlying a securitization, as detailed below—the issuer typically will have few, if any, employees of its own. Accordingly, vital to a franchise securitization is the *servicer*, an entity that, under contract with the issuer, undertakes to administer the revenue-generating franchise and other agreements that are the subject of the securitization (and, almost always, administer the entirety of the network as well); ensures that collection of royalties and other receivables due the issuer is properly accomplished; oversees the proper distribution of cash once received; and, at all times, performs its activities so that it remains legally distinct from the franchisor-originator itself (lest the securitization structure collapse upon a judicial determination that “substantive consolidation” of the issuer, the originator, and the servicer should be accomplished because they improperly blurred distinctions among them).

In a franchise royalty securitization, the servicer is usually the originating franchisor itself whose contracts are sold or contributed, by true sale, to the issuer (which, in securitization parlance, makes the originating franchisor a *seller-servicer*).

The notes sold by the issuer, as secured by subject franchise agreement revenue streams, may be publicly offered or privately placed; but under either circumstance, the sale almost always will involve the services of an *investment bank* or other *underwriter*. Those securities will have to secure a rating from one of the nation’s widely recognized *credit rating agencies*, such as Moody’s Investor Services, Inc. (Moody’s) or Standard & Poor’s Ratings Services (a division of the McGraw-Hill Companies, Inc.) (Standard & Poor’s).

Finally, but certainly most critically, are the *investors* that acquire the securitization notes issued by the issuer. Under ideal conditions, these investors are qualified institutional buyers or other qualified purchasers such that registration of the issuer’s offering need not be accomplished under either the Securities Act of 1933 or any applicable state securities laws.2

**Methodology**

The sine qua non of a securitization financing is the isolation of revenue-generating assets, whose cash flow and liquidation value are predictable, into a new entity, the SPE, which is wholly legally independent of the transferor of those assets and bankruptcy-remote from that transferor.

Franchise agreements (and the right to receive royalties thereunder) are the most common type of revenue-generating assets underlying a franchise securitization financing. Note, however, that a franchisor can also elect to engage in a “whole business securitization,” in which the franchisor enjoys a multiplicity of revenue streams that it desires to monetize, such as construction, equipment, or FF&E (furniture, fixtures, and equipment) loan receivables from franchisees whose build-out costs are financed by the franchisor; for product-based franchisors, receivables from product sales to franchisees; for those franchisors that routinely lease the real estate upon which franchised units will be situated, lease/sublease payments; and, in the guest lodging sector, management fees under management agreements, reservation fees, and technology payments.

Critical to a successful securitization—and the reason why a more favorable rating and lower interest rate may be forthcoming for the same as opposed to a conventional debt offering or bank financing—is that the subject revenue-generating assets, once properly isolated, are now wholly distinct from the balance sheet, overall creditworthiness, and bankruptcy possibilities of the transferring franchisor. Thus isolated and distinct, these revenue-generating assets secure the notes issued by the SPE issuer, to the exclusion of claims against them that may be advanced by the transferring franchisor’s other creditors (and, not coincidentally, isolation removes such assets from any possible bankruptcy estate of the transferring franchisor).

Indeed, frequently two or more SPEs are utilized in a franchise royalty stream securitization to further achieve the goal of isolating the issuer’s assets from those of the contributing franchisor. Typically, the revenue-generating franchise agreements are sold or contributed to the issuer SPE (or to another SPE that guarantees the issuer’s debt). Another SPE will typically receive, by means of sale or contribution, the intellectual property rights of the contributing franchisor (including the franchisor’s trademarks, service marks, trade name, patents, proprietary and/or confidential information, trade dress, copyrights, software, computer programs, and all other pertinent know-how). In turn, these assets are licensed back to the issuer SPE so that it (and its affiliates and subsidiaries) can offer and sell franchises conveying rights to such intellectual property. By following this protocol, the transferring franchisor’s intellectual property, key to the administration of its network and ability to sell additional franchises, is potentially shielded, not just from the bankruptcy claims of the franchisor’s creditors, but from those of the issuer as well.
Other SPEs may be formed to accommodate a franchise securitization financing that goes beyond the monetization of royalties. For example, if the franchisor typically leases real estate to its franchisees, then a separate SPE may be formed to hold those leases, receive payments thereunder, and forward the same to the issuer. In the guest lodging arena, if reservations system or technology payments will be securitized, then another SPE may be formed to hold and administer the reservation system.

Yet additional entities may be formed to accomplish a franchise-related securitization, depending on the circumstances. For example, an SPE that is a subsidiary or affiliate (and, in each instance, a guarantor) of the issuer may be formed to hold franchise agreements entered into prior to the securitization. In addition, because the issuer itself typically will not serve as the franchisor under post-securitization franchise agreements, it will form one or more subsidiaries, which will serve as co-guarantors for the issuer’s debt, to fulfill this function. (There are two principal reasons not to have the issuer serve as the franchisor under post-securitization franchise agreements: first, to shield the issuer from claims advanced by franchisees and others; and second, the issuer’s balance sheet may render it incapable of securing state franchise registrations absent disruptive escrow, surety bond, or fee deferral preconditions because by definition the issuer’s balance sheet will typically reflect either a nominal positive or substantial negative net worth.)

As noted earlier, the critical and absolutely indispensable structural feature of a franchise securitization is the isolation of the revenue-generating assets (typically the franchisor’s franchise agreements) at issue. Accordingly, the legal norms governing absolute transfer of assets must be strictly followed. Therefore, a franchisor undertaking a securitization must transfer its assets to an SPE in such a way that constitutes, legally speaking, a true sale. This is typically done in one of two ways: either the franchisor’s outright sale of its franchise agreements to the issuer SPE or the franchisor’s capital contribution of the same to the issuer SPE. In either event, the legal norms governing a true sale must be strictly observed so that, upon the bankruptcy of (or other creditor proceeding involving) the originating franchisor, the assets of the issuer SPE (and all other SPEs) are deemed bankruptcy-remote and are not affected by the franchisor’s bankruptcy and certainly are not “substantively consolidated” with the originating franchisor. Substantive consolidation is an equitable judicial doctrine pursuant to which a bankruptcy court has the power to consolidate entities not sufficiently legally distinct, whether under a corporate “alter ego” theory or because the entity’s affairs are “hopelessly obscured” (see discussion below).

Legally speaking, a true sale is a transaction in which the risk of loss associated with the subject assets is entirely transferred (in this case from the originating franchisor to the issuer SPE); the transferring franchisor retains no benefits of ownership with regard to the assets being transferred; the originating franchisor maintains no continuing control over the transferred assets; the originating franchisor’s financial statements do not treat the transferred assets as being owned by the franchisor, but rather sold or contributed; and the transfer agreements reflect a true sale (as opposed to, say, a secured transaction in which the franchisor maintains an interest in the transferred franchise agreements).

To accomplish the type of legal division necessary to withstand subsequent judicial inquiry, to enjoy bankruptcy-remote status, and to avoid substantive consolidation with the originating franchisor, the SPE (recall that there may be more than one) should be a newly created entity with no prior business activities; no prior creditors; few, if any, employees; and no actual or potential claims that a third party could assert against it. The SPE’s activities should be narrowly confined, its ability to issue debt severely restricted (usually confined solely to the ability to issue the subject asset-backed notes and, perhaps, subsequent subordinated debt). Furthermore, the franchise agreements and other assets transferred to the SPE must be free of all liens and other security interests; and the ability of the SPE to file for voluntary bankruptcy (or to have an involuntary bankruptcy proceeding commenced against it) must be negated to the greatest extent legally possible.

To maintain its bankruptcy remoteness and avoid a subsequent judicial finding that substantive consolidation should be had, it is critical that the SPE have a corporate governance structure separate and distinct from the originating franchisor (and, for that matter, from any other entity) such that no alter ego or other attack to pierce the corporate veil may succeed or even be credibly advanced. It is vital that, at a minimum, the following formalities be observed:

- The SPE must conduct its business solely in its own name or through its own agents (including any servicer, as discussed below).
- The SPE’s funds and assets must at all times be separately maintained.
- The SPE must maintain its own set of complete and correct books and records. If the SPE is a wholly owned subsidiary of the originating franchisor, as is permitted and customary, and the franchisor issues consolidated financial statements, then notes to those consolidated statements should clearly reveal the SPE’s ownership of the transferred assets.
- The SPE must use its own stationery, invoices, checks, and other business forms and instruments, distinct from those of any other entity (including, most certainly, the originating franchisor).
- All of the SPE’s liabilities must be paid out of its own funds (except for its initial organizational expenses).
- The SPE may never hold itself out as being liable for, or assume or guarantee, the debts of any other party.
- The SPE must fairly and reasonably allocate overhead

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The critical structural feature of a franchise securitization is the isolation of the revenue-generating assets.

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expenses that are shared with a related entity, including payments for office space and employees.

- The SPE must hold itself out as a separate entity, correct any known misunderstandings regarding its separate identity, and not identify itself as a division of any other entity.
- The SPE must maintain adequate capital in light of its contemplated business operations.
- The SPE’s organizational documents must forbid it from dissolving, liquidating, merging, consolidating, or selling substantially all of its assets.
- The SPE must at all times maintain bank accounts separate from those of any other entity and not permit any other entity independent access to such bank accounts.
- The SPE must observe all corporate or trust (as the case may be) formalities.
- All SPE transactions with the originating franchisor and other affiliates must be strictly arm’s-length in nature.

In nonfranchise securitizations, where the subject revenue-generating assets are relatively dormant in nature (such as mortgages, credit card receivables, equipment leases, health care receivables, and other commercial trade receivables), the issuer SPE may engage its own officers and employees to carry out its responsibilities and affairs. More typically, however, and certainly at all times in the franchise arena, a servicer will be engaged to administer the subject assets (typically franchise agreements), collect receivables therefrom, and disperse such receivables to the issuer for distribution to noteholders (either directly or indirectly through a third-party paying agent).

Accordingly, in franchise securitizations (in which franchise and related agreements, and the right to receive royalties and other payments thereunder, are the subject of the securitization and thus transferred to the issuer SPE or an affiliate or subsidiary thereof), the SPE will need to engage a servicer to administer those franchise agreements and, indeed, the franchise network to which they relate. If separate SPEs from the issuer SPE are established, one to receive and administer preexisting franchise agreements and another to offer and enter into new franchise agreements, then each will enter into a separate contract with the servicer and both will guarantee the issuer’s debt. The practical result is that the servicer will administer the subject franchise network and fulfill all of the functions of the originating (now former) franchisor.

But who should be the servicer? Logic dictates, and the law affirms the propriety of, engaging the originating franchisor itself to be the SPE’s servicer. In this setting, the originating (former) franchisor is now known as a seller-servicer. Recalling once more the need to keep all SPEs legally and financially distinct from all other parties (most certainly the original transferring franchisor), the franchisor, when acting as a seller-servicer, must deal with such SPEs on an arm’s-length basis and should be paid a fee equivalent to that paid to a wholly independent third-party servicer; and the authority of the originating franchisor to act as servicer should be revocable by the SPEs on terms and conditions that normally would attach to an independent third-party servicer.

Accordingly, the servicing agreement between the originating franchisor (which will act as a seller-servicer) and the one or more SPEs involved must precisely delineate just what standards the servicer must adhere to when administering the subject franchise network, when selling franchises on behalf of the issuer SPE or one of its subsidiaries, and when collecting franchisee payments (and paying such payments over to the issuer). These contracts must also delineate events of termination. Sometimes, it is prudent to engage an industry consultant, paid for by the issuer, to monitor the performance of the servicer and, upon the occurrence of certain events, terminate the servicer and advise and assist the issuer in seeking a replacement servicer.

Frequently, an insurance policy will guarantee the timely payment of principal and/or interest in order to obtain the highest possible credit rating for the issuer SPE’s notes or other debt instruments. This is known as credit enhancement. Other forms of credit enhancement are letters of credit, surety bonds, guarantees, subordinated loans and the issuance of “senior-subordinated” debt by the issuer SPE.

Sometimes the collection of franchise or other agreement receivables will not precisely correlate with the timing of payments to noteholders. In such circumstances, one or more “liquidity facilities” may be required. As opposed to credit enhancement, however, liquidity providers undertake no risk; they are only advancing cash against receivables certain to be collected.

Finally, but indelibly, the issuer SPE must obtain the highest credit ratings possible from Moody’s and/or Standard & Poor’s necessary when selling to the public, or to institutional investors, the subject notes, debt instruments, preferred stock, or other certificates of beneficial interest. Without obtaining optimal ratings from these rating agencies, not only will higher interest rates result, but it may be difficult for the SPE to find investors altogether. Certain categories of institutional investors, financial institutions, and others purchasing such asset-backed securities require ratings of a certain caliber to satisfy regulatory requirements, investment guidelines, restrictive covenants, or internal policies.3

It is most important, when effecting a securitization, to bring the rating agencies into the picture relatively early on to get them comfortable with the transaction and its legal structure and, if need be, to modify the transaction and its structure so that the optimal ratings necessary will be forthcoming.

Set forth below is a diagram of a prototypical (simplified for this purpose) franchise securitization. The transaction involves a franchisor’s transfer to the issuer SPE of its existing franchise agreements and the right to grant future franchises; the franchisor’s transfer to a separate SPE of its intellectual property (as broadly defined above); the issuer SPE’s contribution of preexisting franchise agreements to a separate SPE and the licensing, on a long-term basis, of its franchising and intellectual property rights (which the issuer receives from the original franchisor) to a subsidiary that, in turn, assigns them to its own subsidiary, the franchisor SPE (which will offer and enter into new franchise agreements); all SPEs appointing the originating transferring franchisor as their servicer; and procurement of an insurance policy guaranteeing repayment of the principal and interest of the issuer SPE’s notes.

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The Post-Securitization Franchisor

Following the securitization financing transaction, and as detailed above, either the issuer itself or, more commonly, another SPE that guarantees the issuer’s obligations will receive all preexisting franchise agreements of the subject franchisor. With regard to new franchise agreements to be entered following the closing of the securitization transaction, either the SPE or, again more commonly, one of its subsidiaries or affiliates will serve in all respects as the franchisor under franchise agreements thereafter entered into (and will likewise guarantee the issuer’s debt). Also as detailed above, all applicable entities will contract with the servicer to fulfill their obligations by administering the subject franchise network and selling new franchises as well (as a registered “franchise broker”).

Let us focus on the SPE entity that will serve as the network’s franchisor under new or renewed post-securitization franchise agreements. As a brand-new entity, that new franchisor will have to secure initial franchise registrations in each of the fourteen states requiring registration. In addition, and as is most common, if the former franchisor is contracted as the new franchisor’s servicer, then that entity will have to register itself as a franchise broker (in New York, a “franchise sales agent”) in those jurisdictions requiring the registration of independent third-party entities that offer and sell franchises on behalf of a franchisor.

Clearly, if the franchise agreements scheduled to be transferred to the issuer SPE (or its subsidiary or affiliate) explicitly bar their sale, assignment, or transfer by the franchisor, then it will be impossible to utilize the securitization protocol. On the other hand, if the subject franchise agreements are silent on the subject (in which case, under the common law, they generally may be freely transferred or assigned) or if such agreements explicitly permit the franchisor to transfer, sell, or assign the same, then no impediment to their transfer exists.

Finally, it must be remembered that all franchise solicitation advertising to be utilized by the new franchisor (whether it be the issuer SPE itself or one of its subsidiaries or affiliates) must be filed in the new franchisor’s name in those franchise registration states that require such filings be effected prior to the use of such advertising. Recall that pertinent state franchise laws define advertising to include not only print and broadcast advertisements but also promotional brochures, certain form letters, CD-ROMs, DVDs, and nonexempt website solicitation content.

Selected Legal Issues

Numerous bodies of law will govern and impact the structure and administration of a franchise securitization financing, including the law governing commercial transactions (most pointedly, the true sale doctrines addressed above), corporate law (bearing in mind the extreme importance in a securitization of isolating, and rendering bankruptcy-remote, the revenue-generating assets possessed by the subject SPEs, in part by strictly adhering to corporate law governance and procedural requirements so as to avoid any attempt to pierce the corporate veil of any SPE as part of an effort to substantially consolidate the SPE’s assets with those of either the originating franchisor or any other SPE), trademark law (so
that assignments of the franchisor’s intellectual property to one or more SPEs is properly accomplished, filings with the U.S. Patent and Trademark Office reflecting such assignments are timely and properly effectuated, and the resultant licenses are properly documented, debtor-creditor law, and securities law (which may govern the issuer SPE’s offer and sale of its notes, asset-backed debt, and/or securities, assuming that not all will be sold to qualified sophisticated investors exempt from statutory coverage).

However, the most critical body of law pertinent to a securitization transaction is that of bankruptcy law. Two branches of that body of law are of vital importance to a securitization transaction: substantive consolidation, as defined above, and the exclusion of the originating franchisor’s transferred assets from the bankruptcy estate of the franchisor.

**Substantive Consolidation: An Overview**

In order to satisfy the policies of reorganization, equality of distribution, and equitable treatment of creditors, bankruptcy courts historically have exercised their equitable powers in appropriate circumstances, subject to appropriate exceptions, to treat separate and distinct entities as a single entity for bankruptcy purposes, i.e., to substantively consolidate them. Bankruptcy courts have broad discretion in the exercise of their equity powers. In the course of applying these equitable powers under the rubric of substantive consolidation, courts have looked to a number of factual indicia of separateness and to the relative fairness of separate versus consolidated treatment of the assets and liabilities of related entities.

The reported decisions under the Bankruptcy Act of 1898 and cases decided shortly after the 1978 enactment of the Bankruptcy Code rely principally on the presence or absence of certain elements that are identical or similar to factors relevant to piercing the corporate veil or alter ego theories. Most subsequent cases take such factors into account within the context of a test that more heavily emphasizes a balancing of the benefits offered by substantive consolidation against the interests of parties objecting to consolidation. Such decisions examine the impact of consolidation on creditors of the entities at issue and the degree of their reasonable reliance on the separate credit of their debtor, instead of cataloging the mere presence of the substantive consolidation elements.

Although most reported decisions involve attempts to substantively consolidate debtors under the Bankruptcy Code, courts have, on occasion, consolidated the assets and liabilities of nondebtors with those of debtors. Some, but not all, of those courts have held that proponents of the substantive consolidation of a nondebtor and a debtor have a heavier burden to satisfy due process, among other, concerns. In addition, substantive consolidation of a nondebtor’s assets with those of a debtor may be viewed as violating the Bankruptcy Code’s strict requirements for the commencement of an involuntary bankruptcy case.

**Factors Considered**

Regardless of which variant of the standard for substantive consolidation is applied, the elements enumerated in several cases remain relevant. Two sets of substantive consolidation elements are often cited. In the cases that depend primarily on the alter ego analogy, the following factors are often cited as relevant:

- **(a)** parent corporation owns all or a majority of the capital stock of the subsidiary;
- **(b)** parent and subsidiary have common officers and directors;
- **(c)** parent finances subsidiary;
- **(d)** parent is responsible for incorporation of subsidiary;
- **(e)** subsidiary has grossly inadequate capital;
- **(f)** parent pays salaries, expenses, or losses of subsidiary;
- **(g)** subsidiary has substantially no business except with parent;
- **(h)** subsidiary essentially has no assets except for those conveyed by parent;
- **(i)** parent refers to subsidiary as a department or division of parent;
- **(j)** directors or officers of subsidiary do not act in the interest of subsidiary but take directions from parent;
- **(k)** formal legal requirements of the subsidiary as a separate and independent corporation are not observed;
- **(l)** parent assumes contractual obligations of subsidiary;
- **(m)** parent shifts people on and off subsidiary’s board of directors;
- **(n)** parent misuses corporate form, and parties engage in non-arm’s-length dealings and transfers; and
- **(o)** parent and its affiliates and subsidiary act from the same business location.

A second statement of substantive consolidation elements appears in *In re Vecco Construction Industries*: 14

- **(a)** the degree of difficulty in segregating and ascertaining individual assets and liabilities,
- **(b)** the presence or absence of consolidated financial statements,
- **(c)** profitability of consolidation at a single physical location,
- **(d)** the commingling of assets and business functions,
- **(e)** the unity of interests and ownership between the various corporate entities,
- **(f)** the existence of parent or intercorporate guarantees or loans, and
- **(g)** the transfer of assets without formal observance of corporate formalities.

The presence or absence of some or all of these elements does not necessarily lead to a determination that substantive consolidation is or is not appropriate. Indeed, many of the elements are present in most bankruptcy cases involving affiliated companies or a holding company structure but do not necessarily lead to substantive consolidation.

In addition to the foregoing factors, poor or nonexistent record keeping of intercompany transactions and of purportedly separate assets (particularly cash and other liquid assets) and liabilities, whether by design or otherwise, is a common reason for imposing substantive consolidation. Particularly when affiliates’ assets, liabilities, and business affairs are so hopelessly entangled that segregation is prohibitively expensive.
or impossible, courts are more likely to grant substantive consolidation.24 The degree of entanglement is important, however, because the potentially prejudicial effect of substantive consolidation is not likely to be justified based on contentions of mere administrative inconvenience.17 Strict adherence to maintaining corporate or other organizational formalities and separate books and records, as well as avoidance of commingling of assets, should make it more likely that a court would not order substantive consolidation either for reasons of administrative convenience or on equitable grounds.

More recent substantive consolidation decisions continue to rely at least to some degree on the elements described above.19 However, the balancing test, discussed below, appears to be at least an equally important analysis undertaken in these decisions. For example, in In re Creditors Service Corp., the court cited Vecco Construction Industries and the factors appearing therein.19 Nevertheless, in determining whether to order the substantive consolidation of a nondebtor individual and several nondebtor entities with the debtor, the court also noted thus:

The factors merely provide the framework to assist the Court’s inquiry whether harm will result in the absence of consolidation. After a court has decided it has the factual justification to substantially consolidate entities, the ultimate inquiry involves a balancing of the equities based on the bankruptcy court’s inherent powers pursuant to § 105. [The] Court must be convinced that a harm or prejudice to creditors will occur in the absence of substantive consolidation by weighing the equities favoring consolidation against the equities favoring the debtor remaining separate from the entities and the individual.20

In In re Circle Land & Cattle Corp., the court noted that although these factors are relevant, the focus has shifted from “alter ego factors to the effect of the consolidation on general unsecured creditors of the two entities.”21 The court continued by noting thus:

An applicant must allege equitable grounds for substantive consolidation such as: that general creditors have dealt with the entities as a single economic unit to their detriment; that a necessity exists for consolidation to protect creditors; that a harm to the creditors could be avoided by the remedy; or that the benefits of consolidation outweigh any resulting harm to general creditors of the entities.22

In In re Eagle-Picher Industries, Inc., the court noted that “the lists presented by the several courts in their decisions, of factors which must be present in order to determine the issue of substantive consolidation, are of limited use.”23 Instead, the court adopted the analyses applied by courts within the D.C. Circuit (the so-called Auto-Train test) and the Second Circuit, which it said “are not materially different.”24 Nevertheless, the court in Eagle-Picher, applying the foregoing analyses, did consider many of the substantive consolidation factors described in the earlier decisions, noting, for example, that the subsidiary was referred to as a division of the parent on checks paid to vendors, the subsidiary’s office and stationery displayed the parent’s name and logo, the parent selected the subsidiary’s board members, the subsidiary’s board did not hold formal meetings, the parent paid the salaries of the subsidiary’s employees, the parent paid the subsidiary’s share of general office charges, and the parent routinely guaranteed obligations of the subsidiary.25

Balancing Benefits and Harm
Under the balancing analysis appearing in a majority of the decisions, proponents of substantive consolidation must not only demonstrate the existence of substantive consolidation elements, such as the failure to observe corporate formalities, but also establish the harm suffered as a result of the existence of the elements, as well as the overall benefits to be derived from substantive consolidation.

Balancing the harm and benefit to creditors that would result from substantive consolidation, the court in In re Snider Bros., Inc.,26 stated the following principles: the proponent must demonstrate a “necessity for consolidation, or a harm to be avoided by use of the equitable remedy of consolidation”; supporting evidence must go beyond a mere showing of commingling or unity of interest and must demonstrate the harm caused thereby or prejudice without consolidation; elements are only one factor in the proof of necessity; and even if the proponent can demonstrate the necessity for consolidation, objecting creditors can argue the defense that the benefits of consolidation do not counterbalance the harm to the objectors.27

The balancing test formulated in Snider Bros. has been adopted by many courts, either expressly28 or impliedly.29

In another often-cited decision, the Second Circuit in In re Augie/Restivo Baking Co., Ltd., reduced the considerations pertinent to the balancing test to two “critical factors,” namely, “whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, . . . or whether the affairs of the debtors are so entangled that consolidation will benefit all creditors.”30 The Second Circuit later affirmed the vitality of this test.31

A decision from the U.S. District Court for the Southern District of New York interprets the Second Circuit test as requiring a court to consider Augie/Restivo’s two critical factors as separate bases for substantive consolidation.32 In particular, the court noted that “[t]he Second Circuit’s use of the conjunction ‘or’ suggests that the two cited factors are alternatively sufficient criteria.”33 Moreover, in addressing the first of the Second Circuit tests—whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit—the court clarified that the test “must be applied from the creditors’ perspective.”34 The inquiry is whether creditors treated the debtors as a single entity, not whether the managers of the debtors themselves, or consumers, viewed the four stores as one enterprise.”35 Consistent with its earlier statement, the court in that case found that creditors in fact knew that they were dealing with separate entities, but then noted thus:

A finding that creditors knew they were dealing with separate entities does not necessarily preclude substantive consolidation on the ground that it is impossible or prohibitively expensive to
unravel the debtors’ commingled finances. Consolidation may still benefit all creditors under those circumstances because “the time and expense necessary even to attempt to unscramble [the debtors’ separate finances may be] so substantial as to threaten the realization of any net assets for all the creditors.”35

In In re Bonham, the Ninth Circuit explicitly adopted the two-factor test from Augie/Restivo and acknowledged that “[t]he presence of either factor is a sufficient basis to order substantive consolidation.”37

The Eighth Circuit has held that “[f]actors to consider when deciding whether substantive consolidation is appropriate include 1) the necessity of consolidation due to the interrelationship among the debtors; 2) whether the benefits of consolidation outweigh the harm to creditors; and 3) prejudice resulting from not consolidating the debtors.”38

The District of Columbia Circuit in In Re Auto-Train required a proponent of substantive consolidation to show “a substantial identity between the entities to be consolidated. . . .”39 Even after such a showing, however, under Auto-Train’s test the proponent must still demonstrate that the benefits of substantive consolidation outweigh any harm to be caused thereby.40

The “benefits and burdens” test perhaps has been applied most clearly and consistently to secured creditors whose rights in specific, clearly identifiable collateral would be impaired or destroyed as a result of substantive consolidation. It is a general rule that absent a compelling reason, such as fraud, substantive consolidation may not reduce a creditor that is secured by specific, identifiable assets to the status of an unsecured creditor.41 As a corollary, it is generally agreed that secured creditors’ specific, identifiable collateral should not be enhanced, absent unusual circumstances, as a result of substantive consolidation.42

Finally, in a recent decision, the Third Circuit significantly restricted the circumstances under which a court may order substantive consolidation.43 In reversing the district court’s consolidation of a parent company and a number of its subsidiary guarantors, the Third Circuit, favoring the Augie/Restivo test but unwilling to endorse any specific set of factors, articulated a number of principles to guide the court in its analysis.44 These principles include the following: (i) absent compelling circumstances, courts must respect entity separateness; (ii) recognition that substantive consolidation nearly always addresses harms caused by debtors disregarding separateness; (iii) mere benefit of administration is “hardly a harm calling substantive consolidation into play”; (iv) substantive consolidation should be used rarely and as a last resort after alternative remedies have been considered and rejected; and (v) substantive consolidation may not be used as a “sword.”45

Using these principles, the Third Circuit set forth the standard by which courts in its jurisdiction must weigh requests for substantive consolidation. Specifically, in ordering substantive consolidation, courts must find, with respect to the entities in question, that either (a) prepetition, they disregarded their separateness “so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity,” or (b) postpetition, “their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.”46 It remains to be seen whether other courts will follow the Third Circuit’s lead in circumscribing the use of this equitable doctrine.

Therefore, and notwithstanding the widespread acceptance of the balancing analysis first articulated in Snider Bros., several issues remain unsettled: (a) the continued importance of the substantive consolidation elements, (b) the appropriate standard for assessing the benefits to creditors of a proposed substantive consolidation, and (c) the appropriate standard for assessing harm to creditors objecting to a proposed substantive consolidation. In light of the lack of a detailed, clearly prescribed standard for determining the appropriateness of substantive consolidation under existing case law, and given the equitable basis for the remedy, any opinion regarding substantive consolidation must, of necessity, be a reasoned opinion based on the various elements and the balancing test. As courts have noted, substantive consolidation is decided on a case-by-case basis in light of the unique facts as determined by the bankruptcy court in the case at hand.47

**Franchisor’s Bankruptcy Estate**

Subject to certain exceptions, § 541(a)(1) of the Bankruptcy Code provides that the commencement of a bankruptcy case creates an estate, the property of which includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” A bankruptcy trustee of the transferee, or the transferee as a debtor in possession under the Bankruptcy Code, might assert that the transferee retained an interest in the transferred assets, arguing that the transferee did not sell or contribute them to the transferee but rather pledged them to the transferee to secure an obligation. Under this theory, the bankruptcy trustee of the transferee’s estate, or the transferee as the debtor in possession under the Bankruptcy Code, might seek (1) a court order requiring turnover of the transferred assets to the transferee (or the bankruptcy trustee) as provided by § 542 of the Bankruptcy Code; or (2) an order enforcing § 362(a) of the Bankruptcy Code, the automatic stay provision, in order to prevent payment to the transferee of the income generated by the transferred assets.

Whether a bankruptcy court would determine the transferred assets to be property of the transferee’s bankruptcy estate turns on whether the transferee’s conveyance of the transferred assets constitutes a true sale or other absolute transfer, or only the grant of a security interest to secure a purported obligation of the transferee to repay money borrowed from the transferee. The Bankruptcy Code does not give guidance, however, on whether a debtor has an interest in property or whether it owes a debt.48

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*Securitization may prove a remarkably advantageous alternative to conventional debt offerings.*

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Generally, state law dealing with property rights determines the nature and extent of a debtor’s interest in property.50 “In the absence of any controlling federal law, ‘property’ and ‘interests in property’ are creatures of state law.”51 Thus, although bankruptcy law defines what property of the debtor constitutes property of the bankruptcy estate, a bankruptcy court generally will apply state law to determine a debtor’s interest in particular property.51

A critical factor in resolving the pledge-versus-sale issue is the level and nature of recourse present in a particular transaction. For example, an owner of receivables or goods is expected to bear the risk that the receivables may be uncollectible or that the goods will diminish in value. Conversely, where a transferee of receivables has full recourse to the transferor for a deficiency in the collectibility of the receivables or the value of the goods transferred and bears none of the risks generally associated with ownership, the transaction has the characteristics of a secured borrowing.52

The presence of some recourse, however, does not require the conclusion that the transfer is a pledge to secure a loan.53 Case law generally permits limited recourse to a seller while still treating the transfer as a true sale. In Major’s Furniture Mart, Inc. v. Castle Credit Corp., Inc., the court stated that

“[t]he presence of recourse in a sale agreement without more will not automatically convert a sale into a security interest. . . . The question for the court then is whether the Nature [sic] of the recourse, and the true nature of the transaction, are such that the legal rights and economic consequences of the agreement bear a greater similarity to a financing transaction or to a sale.”54

A second factor in determining whether a transfer of assets is a pledge or a true sale relates to whether the transferor has a right to redeem the transferred assets. For example, if the transaction is in fact a secured loan, a transferor would be permitted to redeem the pledged collateral. In this case, the transferor retains no right to repurchase or redeem the transferred assets after the applicable closing date.

A number of other factors, in addition to the degree of recourse to the transferor and whether the transferor maintains a residual interest, are relevant in determining whether the sale/assignment/contribution will result in a true sale or other absolute transfer of the transferred assets. Whether the transferor or the transferee undertakes to collect on the accounts and notifies the account debtor of the transfer may influence the characterization of the transaction. Direct collection by a transferee, with notice to the account debtor, usually indicates a sale.55 However, it has been observed that, depending on the circumstances, indirect collection from and nonnotification of account debtors do not prevent sale treatment.56 Regardless, a lack of actual awareness by any account debtor of the contribution and/or sale in light of the entire transaction should not be persuasive evidence that the transfer is a secured loan.57

(We note that this factor may not be directly applicable to many of the transferred assets because the account debtor for such assets generally makes centralized payments to either an administrative or paying agent without direct knowledge of who the ultimate beneficial owner of such assets may be.)

Although courts typically give effect to the expressed intent of the parties, from time to time courts have either ignored or given only perfunctory attention to such expressed intent where necessary to prevent an inequitable result or where the stated intent is manifestly at variance with the actual purpose of the transaction.58 In connection with the contribution and assignment of the transferred assets, however, it would be inequitable to permit creditors of the transferor to recover the assigned assets (or an interest therein) to the detriment of the transferee where the transferee and the transferee’s creditors had only limited recourse to the transferor, i.e., where the transferee will provide value to the transferor and the underlying documents require the transferor to (i) note on its financial statements and in its books, records, and computer files that the transferred assets have been sold, contributed, or transferred to the transferee; and (ii) respond to any inquiries as to the ownership of the transferred assets that the transferred assets have been contributed or transferred to the transferee. Moreover, where the parties are sophisticated business entities that have deliberately structured a transaction to achieve certain legal consequences, the parties’ expressed intention should be taken into account.59

**Current Credit Market Crisis**

It would be more than disingenuous for the authors not to note that, as this article is being written, the U.S. credit markets are experiencing a crisis that may serve as a barrier to all but the very strongest securitization financing transactions.

Ironically, it is securitization activity that triggered the current credit market crisis. However, the trigger was not securitization activity involving franchisors. To the contrary, those securitizations have uniformly proven extraordinarily creditworthy and successful, suffering not even a hiccup along the way.

No, the type of securitization activity responsible for the credit market crisis that began unfolding in the last quarter of 2007 and reached crisis mode in January to February of 2008 related to subprime mortgages. What happened is simple. As noted throughout this article, the very essence of a securitization involves isolating dependable, revenue-generating assets in an SPE that is bankruptcy-remote and structured to be beyond the reach of any other entity’s creditors. The key word here is “revenue-generating.” Obviously, if the assets being securitized do not generate revenues, then the securitization will collapse. And that is precisely what happened with subprime mortgage securitizations. Pools of subprime mortgages were securitized. Many of these mortgages were all too freely granted by banks and other financial institutions to less-than-creditworthy individuals during the real estate boom of the past decade and, to make matters worse, featured adjustable rates; when interest rates began dramatically escalating in 2006 and 2007, rates payable under these mortgages increased as well, leading to widespread defaults and home foreclosures. (In this context, the authors truly believe that the use of the phrase “subprime mortgages” is a mere euphemism for “mortgages aggressively marketed to individuals who were not creditworthy and who, given the slightest economic downturn or rise in adjustable rates, would prove unable to fulfill their mortgage payment obligations.”)
Widespread subprime mortgage defaults swiftly escalated into a credit market crisis, as follows. First, a great many subprime mortgages were sold to investment banks and other financial institutions, which packaged and securitized them (recall that securitizations involving pooled mortgages were among the first to be accomplished in this country). Because mortgage pool securitizations have for nearly forty years proven so remarkably safe and dependable, insurance companies—evidently unaware that the subprime mortgages at issue carried critically greater risk than the conventional mortgages traditionally securitized—elected to fully insure principal and/or interest payments to noteholders of the subprime mortgage securitizations. Once widespread subprime mortgage default ensued, these insurance companies were placed in great peril. Indeed, as of February 2008, the scope of these insurance companies’ exposure could not even be quantified.

In turn, the credit rating agencies either downgraded or threatened to downgrade the credit ratings of these insurance companies below the AAA critical for them to qualify for one of their main activities, i.e., insuring bonds issued by states, cities, towns, counties, and quasi-governmental agencies. Naturally, an inability to engage in such core activity (or even the threat of such an inability) further weakened their credit ratings and public perception of safety. Without insurance, securitized notes bear greater risk and, accordingly, far greater interest rates, making securitization financing activity less attractive than it had been (or even impossible to accomplish altogether, given investor wariness of any securitization financing not accompanied by fully insured securitization notes).

However, the authors believe that, as happened following significant credit market crises in decades past, the current crisis, too, will pass. U.S. financial markets cannot survive, let alone thrive, without insurance companies insuring a plethora of debt offerings (including securitization notes). Without such insured asset-backed securities, the ability of federal, state, city, town, county, and other government entities to issue bonds to pay for schools, roads, airports, bridges, and other public projects will be severely constrained. Further, critical securitization activity involving creditworthy mortgages, health care receivables, credit card receivables, automobile lease receivables, and so forth—activity vital to this nation’s economy—will likewise prove difficult to accomplish.

It is thus not surprising that even as this article is being written, various efforts are under way to put the credit market crisis behind us. The subject insurance companies are engaging in secondary offerings of securities to raise capital in an effort to maintain their crucial AAA financial strength ratings. The Insurance Commissioner of New York revealed that he is working with Wall Street’s major investment banks in an effort to have them make similar investments in those insurance companies whose participation in securitization financings is so critical. And the federal government, in addition to its February 2008 $150 billion economic stimulus package, has established various means through which holders of subprime mortgages with adjustable rates can refinance at a low fixed-interest rate made possible by the Federal Reserve’s dramatic January 2008 core interest rate cuts.

Accordingly, although as of this writing securitization activity across the board has dramatically decreased due to the current credit market crisis, the authors believe that, as with past credit market crises, this crisis will abate over the relative short term such that the vibrancy and breadth of securitization activity is not only restored to former levels but, in the franchise arena, surpassed.

**Conclusion**

The structured financing technique known as securitization may prove a remarkably advantageous alternative to conventional debt offerings, bank credit facilities, and public or private placements of equity to franchisors seeking to raise cash for strategic reasons. The 200-plus basis point savings in finance costs versus traditional financing activity have proven sufficiently compelling such that at least $4.4 billion of securitization financings have been undertaken in the last seven years alone by some of our nation’s foremost franchisors, with a single $21 billion franchisor whole business securitization planned for this year. So it is that the time-tested technique of securitization may join the initial public offering, the follow-up offering, the debt offering, the private placement of securities, and the bank credit facility as a prime source of financing for large franchisors.

**Endnotes**

1. Authors David Kaufmann and David Oppenheim served as franchise counsel either to the securitizing franchisor, the investment bank/underwriter, or the securitization note insurer in all of the securitization transactions referenced in this article except Quizno’s; and author Jordan Yaretz served in similar capacities in all of the securitization transactions referenced except Blackstone/Hilton.


5. California has in the past sometimes required that the servicer register as a subfranchisor (California’s Franchise Investment Law does not require the registration of franchise sales agents or brokers).

corporate veil, nondebtor affiliates cannot argue that there is no personal jurisdiction as to them; see also In re Amco Inc., 444 F.3d 690, 695 n.3 (5th Cir. 2005), cert. denied, 127 S. Ct. 389 (2006) (noting concerns regarding consolidating a nondebtor with a debtor and that courts should be more cautious when granting such requests).

11. See In re Colfor, Inc., 1997 WL 605100, at *3–4 (if committee seeks to bring nondebtor into bankruptcy, it should file involuntary petition against the nondebtor under 11 U.S.C. § 303); In re Circle Land & Cattle Corp., 213 B.R. 870, 877 (Bankr. D. Kan. 1997) (agreeing with decisions that “reason that consolidation of a non-debtor is contrary to the Code limitations for involuntary bankruptcy petitions’’); In re Ira S. Davis, Inc., No. 92-142595, 1993 WL 384501, at *7 (E.D. Pa. 1993) (citing 11 U.S.C. § 303). But see In re United Stairs Corp., 176 B.R. 359, 369–70 (Bankr. D.N.J. 1995) (where the nondebtor entities are alter egos of the debtor, requirements for filing an involuntary case do not apply to prevent substantive consolidation). See also In re Bonham, 226 B.R. 56, 75 (Bankr. D. Alaska 1998), aff’d, 229 F.3d 750 (9th Cir. 2000) (noting that in “a slight majority of the cases which have decided the issue, courts have held that the estate of a non-debtor can be consolidated into that of a debtor under the appropriate circumstances”).

12. See In re Tureaud, 45 B.R. at 662, aff’d, 59 B.R. 973 (N.D. Okla. 1986) (citing Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940)); In re Gulfo, 593 F.2d at 921; see also In re Gilder, 962 F.2d at 798–99; In re Affiliated Foods, Inc., 249 B.R. 770, 776–84 (Bankr. W.D. Mo. 2000); In re Apex Oil, 118 B.R. at 692–93 (relying, in part, on such factors but also considering fairness of substantive consolidation to creditors).

13. See Lease-A-Fleet, 141 B.R. at 877 (noting that in that particular case, “the more important factors” had not been alleged or asserted “with any degree of particularity”).


15. See In re Donut Queen, Ltd., 41 B.R. 706, 709–10 (Bankr. E.D.N.Y. 1984) (criteria should not be mechanically applied in determining consolidation; rather, factors should be evaluated within the larger context of balancing the prejudice resulting from the proposed order of consolidation with the prejudice alleged by creditor from the debtor’s separateness); see also In re Drexel Burnham Lambert Group Inc., 138 B.R. 723, 764–65 (Bankr. E.D.N.Y. 1992) (the consolidation factors must be “evaluated within the larger context of balancing the prejudice resulting from the proposed consolidation against the effect of preserving separate debtor entities”).


17. See In re Bonham, 226 B.R. 56, 76 (Bankr. D. Alaska), aff’d, 229 F.3d 750 (9th Cir. 2000) (“Substantive consolidation should not be used as a mere device of convenience, e.g., to overcome accounting difficulties, where it would unfairly impair the vested rights of some of the creditors.”). Compare In re Jeter, 171 B.R. 1015, 1020 (Bankr. W.D. Mo. 1994) (evidence of financial commingling sufficient to support substantive consolidation), aff’d, 178 B.R. 787 (W.D. Mo. 1995), aff’d, 73 F.3d 205 (8th Cir. 1996), and In re Standard Brands Paint Co., 154 B.R. 563, 572 (Bankr. C.D. Cal. 1993) (although debtors were not entangled in a “records sense,” court ordered substantive consolidation, finding that “in a functional sense the affairs of all five debtors are so entangled that consolidation will benefit all creditors, because the effect/validity of the intercompany debts and guarantees will not have to be sorted out”), and In re Vecho Constr. Indus., 4 B.R. at 410–11 (substantive consolidation granted without opposition when
debtor's single operating account and consolidated financials; had made no attempt to segregate receivables, disbursements, or income; had inaccurately allocated affiliate expenses through intercompany accounts; and had filed bankruptcy schedules on a consolidated basis), and In re Baker & Getty Fin. Servs., Inc., 78 B.R. 139, 142 (Bankr. N.D. Ohio 1987) (substantive consolidation ordered when corporate funds were extensively commingled and used for principal's personal purposes, segregation of assets could not accurately be accomplished, funds were transferred without adherence to corporate formalities, and corporate entities were alter egos of principal that exercised pervasive control over debtors' financial affairs), and In re Tureaud, 45 B.R. at 661 (extensive commingling of personal and corporate assets, numerous undocumented intercorporate transfers, lack of distinction between intercompany transactions despite separateness of books and records, indiscriminate use of different corporate names within single transaction, and impossibility of accurately tracing all transfers), with In re Reider, 31 F.3d 1102, 1109–11 (11th Cir. 1994) (erroneous listing of both entities’ land on debtor’s schedules and some evidence of commingling of funds is not sufficient for substantive consolidation where proper allocation of funds can be readily made and harm to creditors resulting from substantive consolidation outweighs benefits), and In re Ford, 54 B.R. 145, 147–50 n.6 (Bankr. W.D. Mo. 1984) (evidence of commingled corporate and personal funds in corporate bank account, common use of funds, and common responsibility for loans held insufficient to blur the distinction between the entities and inadequate for substantive consolidation).


22. Id.

23. 192 B.R. at 905.

24. Id.

25. Id. at 906–07.


27. Id.


30. 860 F.2d 515, 518 (2d Cir. 1988) (citations omitted).


33. In re 599 Consumer Elecs., Inc., 195 B.R. at 248; see also In re Bonham, 229 F.3d 750, 766 (9th Cir. 2000) (the presence of either Augie/Restivo factor is sufficient to order substantive consolidation).


35. Id. at 249.

36. Id. at 250 (quoting In re Augie/Restivo, 860 F.2d 515, 519 (2nd Cir. 1988)).

37. 229 F.3d at 766.

38. In re Giller, 962 F.2d 796, 799 (8th Cir. 1992); see also In re Affiliated Foods, Inc., 249 B.R. 770, 784 (Bankr. W.D. Mo. 2000) (Giller analysis here supports consolidation of three bankruptcy estates that have been so intertwined in their business and corporate relations as to be practically indistinguishable; consolidation will benefit all creditors while nonconsolidation will benefit only one creditor); In re Apex Oil Co., 118 B.R. 683, 692–93 (Bankr. E.D. Mo. 1990) (substantive consolidation supported by analysis of interrelationship among the debtors; basic fairness to creditors; and prejudice to creditors and the debtors resulting from not consolidating the debtors, including the substantial cost of untangling the debtors’ affairs).

39. In re Auto-Train Corp., Inc., 810 F.2d 270, 276 (D.C. Cir. 1987); see also In re Standard Brands Paint Co., 154 B.R. 563, 572–73 (Bankr. C.D. Cal. 1993) (discussing the Auto-Train test, the court found that a parent and four debtor subsidiaries did not meet the substantial identity test in the old alter ego / piercing the corporate veil sense, but rather in “functional terms” because they functioned as a single consolidated entity and there were multiple interdebtor guarantees and interdebtor debts).

40. In re Standard Brands Paint, 154 B.R. at 572; see also In re Reider, 31 F.3d 1102, 1107–08 (11th Cir. 1994) (reaffirming the adoption of the Auto-Train test in the Eleventh Circuit and emphasizing the impact of substantive consolidation on creditors of the entities at issue, and the degree of their reasonable reliance on the separate credit of their debtor, instead of cataloging the mere presence of the substantive consolidation elements).


44. In re Owens Corning, 419 F.3d at 211.

45. Id.

46. Id.

are of little value, thereby making each analysis on a case-by-case basis.”); \textit{In re} Tureaud, 59 B.R. 973, 975 (N.D. Okla. 1986) (“[Substantive consolidation cases are to a great degree sui generis.”) (quoting 5 \textsc{Collier on Bankruptcy} ¶ 1100.06, at 1100–33 (15th ed. 1984)).

48. 5 \textsc{Collier on Bankruptcy} ¶ 541.07[1], at 541–30 (L. King ed., 15th ed. 2003).


52. \textit{See} \textit{In re} Commercial Money Ctr., 350 B.R. 465, 483–84 (9th Cir. B.A.P. 2006).

53. \textit{See} Major’s Furniture Mart, Inc. v. Castle Credit Corp., Inc., 602 F.2d 538, 544 (3d Cir. 1979); \textit{see also} U.C.C. § 9-608 (“If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes, the debtor is not entitled to any surplus and the obligor is not liable for any deficiency.”).

54. \textit{Major’s Furniture Mart}, 602 F.2d at 544 (footnote omitted).

55. \textit{See} Milana v. Credit Discount Co., 27 Cal. 2d 335, 342, 163 P.2d 869, 872 (1945) (although alleged buyer collected accounts and customers were notified of assignment, these facts did not render the transaction a sale where payment of accounts was guaranteed).

56. \textit{See} A.B. Lewis Co. v. Nat’l Inv. Corp. of Houston, 421 S.W.2d 723, 728 (Tex. Civ. App. 1967) (the fact that customers were not notified of assignment and did not make payments directly to purchaser but to seller of contracts would, in absence of other factors, indicate a loan secured by such contracts rather than a sale of the contracts); \textit{Milana}, 163 P.2d at 872; \textit{see also} \textit{In re} Federated Dep’t Stores, Inc., 1990 Bankr. LEXIS 2453, at *6–9 (1990) (approving debtor’s motion for authority to enter into a receivables purchase agreement, which provided for the debtor’s servicing of accounts, and holding that neither the debtor nor its estate retained any interest in the receivables sold under § 541 of the Bankruptcy Code where valid business reasons existed for not notifying account obligors of the sale of the debtor’s account and the majority of collections would be made through lockbox arrangements).

57. \textit{See} A.B. Lewis, 421 S.W.2d at 728 (where assigned contracts themselves provided that payment could only be made to assignee, fact that contract obligors were not notified of the assignment and did not make payments directly to assignee did not prevent transaction between assigner and assignee from being deemed a sale).

58. \textit{See}, e.g., \textit{Major’s Furniture Mart}, 602 F.2d at 543, and cases cited therein; \textit{In re} Commercial Money Ctr., Inc., 350 B.R. 465, 481 (9th Cir. B.A.P. 2006) (holding that the characterizations by the parties in the documents would carry little weight where the parties attempted to characterize the transaction in different ways for different purposes and the labels were in direct conflict with each other); \textit{In re} Alda Commercial Corp., 327 F. Supp. 1315, 1316–17 (S.D.N.Y. 1971).