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Bankruptcy Recipe

By David M. Posner, Gianfranco Finizio, and Kelly E. Moynihan

The post-COVID-19 restaurant renaissance has rapidly turned into a restaurant recession. Over the past year, a smorgasbord of notable restaurant chains and franchisees have filed for bankruptcy relief, including Red Lobster, TGI Friday's, Rubio's Coastal Grill, Buca di Beppo, Tijuana Flats, On the Border, EYM Pizza (Pizza Hut franchisee), River Subs (Subway franchisee), and BurgerFi/Anthony's Coal Fire Pizza, to name a few.

Recently, GPS Hospitality (GPS), a leading restaurant franchisee operating over 400 Burger King, Pizza Hut, and Popeye's locations across 12 states and owned by former Arby's Chief Executive Officer Tom Garrett, reportedly retained counsel and a financial advisor to manage its debt load and the alleged risk of breaching some of its debt terms. A group of GPS' creditors have reportedly also retained counsel.

Like many other restaurant chains, GPS has suffered from declining revenue

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J&J Pivots Back to Tort System

By Carlo Fernandez and Christopher Patalinghug

"Rather than pursue a protracted appeal, the Company will return to the tort system to litigate and defeat these meritless talc claims." This was Johnson & Johnson's declaration after the United States Bankruptcy Court for the Southern District of Texas denied confirmation of the prepackaged bankruptcy plan proposed by its subsidiary Red River Talc LLC and dismissed the unit's Chapter 11 case. "Notwithstanding that [the Plan] offered one of the largest settlements ever proposed in a mass tort bankruptcy and was supported by the overwhelming majority of claimants," J&J continues.

"[The] Company has prevailed in 16 of 17 ovarian cases tried in the last 11 years. [The] Company will reverse approximately $7 billion from amounts previously reserved for the bankruptcy resolution," according to J&J.

J&J adds, "The disclosures made under oath in the Red River bankruptcy

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brought about by lower foot traffic and a significant rise in food costs. Following the restaurant closures imposed during the COVID-19 pandemic, restaurants experienced a revitalization in 2022 and early 2023 driven by pent-up consumer demand. Now, inflationary pressures, the trend in consumer confidence, continued labor shortages, increased minimum wage, and real property lease burdens, among other things, have battered the restaurant industry just five years after it faced the seismic impacts of the pandemic. GPS is no exception to this unfortunate reality.

The financial distress currently affecting GPS and the quick-service restaurant (QSR), fast-casual restaurant (FCR), and casual restaurant industry in general can be attributed to several interconnected components. Simply put, the confluence of factors described below has caused the already slim margins of restaurants to be razor-thin, if they even exist at all.

Inflation. Inflationary pressures have increased the cost of ingredients, requiring restaurants to increase their menu prices. Not only has inflation resulted in the increased cost of ingredients and food generally, but it has eroded consumer confidence and the disposable income of the consumers targeted by QSRs and FCRs. Just this past month, consumer confidence plunged to its lowest

2024 & 2025 Restaurant Bankruptcies

(Min. $1M Assets)

Debtor	Date Filed	Assets	Liabilities
Tijuana Flats Restaurants LLC	4/19/2024	$1-10M	$10-50M
Pinnacle Foods of California LLC dba Popeyes	4/22/2024	2,077,748	$4,509,986
Red Lobster Management LLC	5/19/2024	$358,252,000	$398,983,000
MRRC Hold Co. dba Rubio's Coastal Grill	6/5/2024	$10-50M	$100-500M
Miracle Restaurant Group, LLC	6/20/2024	$1-$10M	$1-$10M
One Table Restaurant Brands LLC dba Tender Greens and Tocaya	7/17/2024	$10-50M	$10-50M
Amergent Hospitality Group Inc.	7/18/2024	$1-10M	$1-10M
EYM Pizza LP dba Pizza Hut	7/22/2024	$2,250,000	>$21,000,000
BUCA Texas Restaurants LP dba Buca di Beppo	8/4/2024	$10-50M	$50-100M
N Apple Central KC LLC dba Applebee's	10/30/2024	$1-10M	$10-50M
TGI Friday's Inc.	11/2/2024	$155,721,000	$223,468,000
Eegee's LLC	12/6/2024	$10-50M	$10-50M
The Little Mint Inc. dba Hwy 55 Burger Shakes & Fries	12/31/2024	$1,901,728	$19,448,164
Rock N Concepts, LLC and Lava Cantina The Colony, LLC	2/18/2025	$1-$10M	$1-$10M
OTB Holding LLC dba On The Border Mexican Grill & Cantina	3/4/2025	$10-50M	$10-50M
BLH TopCo, LLC dba Bar Louie	3/26/2025	$1-$10M	$50-$100M
Hooters of America, LLC	3/31/2025	$50-100M	$50-100M
Global Concessions Inc.	4/2/2025	$10-$50M	$10-$50M
Ronbon LLC dba The Ainsworth Hoboken	4/8/2025	$1,227,446	$7,122,070
Consolidated Burger Holdings LLC dba Burger King	4/14/2025	$50-100M	$50-100M

Sources: Troubled Company Reporter, Octus, others

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level in more than four years, with fears of a recession and higher inflation. These trends and rising costs have contributed to significant foot traffic decline in QSRs, FCRs, and casual restaurants as consumers tighten their belts and seek to stretch their dollars while cutting back on discretionary spending, including dining out. Inflation has also resulted in significant interest rate increases with respect to debt, increasing the cost of debt service and making additional financing more difficult to obtain.

Wages. Restaurants across the board have suffered from labor shortages and increased minimum wage as mandated by several states. The industry has always faced high employee turnover due in part to low wages and limited career growth opportunities. Labor shortages following the COVID-19 pandemic have hit QSRs and FCRs hard over the past several years, making it difficult to maintain sufficient staff for daily operations. Further, the costs of hourly wages have outpaced the industry's ability to increase prices. In addition to noting increased food costs and labor shortages, Rubio's, which filed for Chapter 11 relief for the second time in June 2024, cited the increased minimum wage in California, one of its largest markets, as having a significant detrimental impact on the business. On April 1, 2024, California's minimum wage increased to $20 per hour for fast-food restaurant employees.

Leases. Many QSR, FCR, and casual restaurant chains are burdened with long-term leases at underperforming locations and are facing rent increases in prime locations. Nearly 33% of the top 500 restaurant chains, based on United States systemwide sales, experienced a net decrease in locations in 2023. Recently, Hooters, Pizza Hut, Applebee's, Outback Steakhouse, Cracker Barrell, Denny's, and MOD Pizza have all closed underperforming stores in order to rightsize their footprint. Moreover, certain chains have been impacted by the expiration of rent deferral agreements that were entered into during the pandemic. For example, Roti Restaurants, a Mediterranean FCR chain, filed for Chapter 11 relief in August 2024 largely due to the expiration of rent deferral agreements made during the pandemic.

Technology. Restaurants have been further impacted by the rise of third-party delivery services like Uber Eats and DoorDash. Both Rubio's and One Table Restaurants, which owned the Tocaya and Tender Greens brands, pointed to the increased popularity of delivery services as applying additional pressure on their margins and cash flows. Since the pandemic, food delivery services have increased in popularity with consumers, but restaurants are often required to pay commissions and fees as high as 30% on these third-party orders, eroding already thin profit margins. As third-party delivery services continue to be prevalent, QSRs and FCRs are left paying for long-term leases designed to provide the square footage for eat-in customers notwithstanding the decrease in foot traffic in the restaurant space.

As liquidity runs out and debt maturities near, QSRs, FCRs, and casual restaurants facing these industry headwinds are seeking in- and out-of-court restructurings to address their capital structures and operational challenges. Such restructurings require adequate funding. A company's existing lenders are typically the only party (begrudgingly) prepared to finance any out-of-court workouts and in-court processes in order to, among other things, (i) restructure and extend additional credit to effectuate a turnaround of the business, (ii) credit bid for the assets and attempt a turnaround with a reduced footprint through a Section 363 sale in a Chapter 11 case, or (iii) find a strategic buyer willing to pay enough for the assets to provide some recovery for the prepetition lenders through a Section 363 sale in a Chapter 11 case. For example, California Pizza Kitchen, BurgerFi, Tender Greens, Tocaya, and Red Lobster were all recently sold

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to certain of their prepetition lenders through their respective Chapter 11 bankruptcy cases.

Where a strategic buyer has indicated an interest in purchasing the company's assets and the company's lenders do not have an appetite to credit bid for the assets, the strategic buyer may also fund the company's Chapter 11 case, including an often-truncated Section 363 sale process. For example, On the Border recently filed for Chapter 11 with debtor-in-possession financing provided by an affiliate of Pappas Restaurants Inc., the proposed stalking horse bidder for On the Border's assets. Prior to the bankruptcy filing, said affiliate also provided bridge financing to ensure that On the Border had sufficient capital to continue operations while the parties negotiated a potential stalking horse bid from Pappas Restaurants after On the Border defaulted under its prepetition credit agreement and faced liquidity constraints.

Despite some recent innovation with liability management exercises (discussed below), restaurant restructurings have largely stuck to the same recipe: in-court restructurings. This trend is likely to continue for a number of reasons. Most notably, in-court restructurings afford debtors powerful tools to reject unprofitable leases pursuant to Section 365 of the Bankruptcy Code. Given the extensive lease footprint of many restaurant chains, Chapter 11 provides the most efficient path to allow a QSR, FCR, or casual restaurant debtor to either (i) reorganize around a slimmed-down lease portfolio (e.g., Red Lobster) or (ii) reject unprofitable leases and sell the balance of its assets to a third party (e.g., BurgerFi, Tender Greens, and Tocaya). Absent the benefits of Section 365 of the Bankruptcy Code, restaurant chain debtors would have little leverage in negotiating with landlords and, as a result, would not be able to address the substantial debt burdens associated with underperforming leases. For these reasons and others, in-court proceedings are the restructuring *du jour* for the distressed restaurant industry.

But to say that in-court proceedings for the restaurant industry are challenging is an understatement. Due to a combination of highly overleveraged capital structures, *de minimis* unencumbered assets, and little appetite for third-party acquisitions, restaurant chain debtors and their stakeholders are in a tough spot. As a result, and more often than not, unsecured creditors are left holding the bag in QSR, FCR, and casual restaurant Chapter 11 cases. These creditors include landlords for rejected leases (of which there are many), vendors and service providers whose contracts are not assumed during the bankruptcy process, and litigation creditors that have outstanding claims prior to the commencement of the bankruptcy.

The Chapter 11 plans filed in the restaurant industry paint a bleak picture for unsecured creditor recoveries. Take, for example, BurgerFi. According to BurgerFi's Chapter 11 plan, unsecured creditor recoveries are projected to be "0% - unknown" and will depend on, among other things, the ability to monetize certain liquidating trust assets. A similar "unknown" recovery is projected for unsecured creditors in Red Lobster's Chapter 11 plan. The Chapter 11 plan filed by Tijuana Flats is no better; it provides that unsecured creditors will share pro rata in a lump sum distribution of only $200,000, resulting in a "pennies on the dollar" recovery. The Subchapter V plan of reorganization filed by Sticky Fingers projects unsecured creditor recoveries to be 0.1%. A diamond in the rough in terms of unsecured creditor recoveries is Taco Bueno, which was purchased by Sun Holdings as part of Taco Bueno's Chapter 11 bankruptcy in 2019. In that case, unsecured creditors recovered approximately 10% of their claims and had a continuing customer under new ownership. Compared to the restaurant chain industry in general, the recovery ranges from these cases are, unfortunately, on the high end.

In many recent restaurant bankruptcies, QSR, FCR, and casual

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restaurant debtors do not have the financial wherewithal to confirm a Chapter 11 plan, and as a result, their Chapter 11 cases either convert to Chapter 7 or are dismissed. This means that the recovery prospect for millions of dollars of unsecured claims is likely zero. And the list of converted or dismissed cases keeps on growing. For example, on February 5, 2025, Buca di Beppo's Chapter 11 cases were converted to cases under Chapter 7. On March 25, 2025, Rubio's Chapter 11 cases were converted to cases under Chapter 7. On June 26, 2024, the Chapter 11 cases of Meridian, one of the then-largest franchisees of Burger King restaurants, were converted to cases under Chapter 7. On May 2, 2023, TOMS King, another large Burger King franchisee, had its Chapter 11 cases dismissed. Given the challenges these Chapter 11 cases present, there is no shortage of case dismissals or conversions, and we expect that trend to continue.

To make matters worse for unsecured creditors, several restaurant chains have been in and out of bankruptcy multiple times. Again, the aforementioned Rubio's Chapter 11 case was its second Chapter 11 filing (the first occurred in October 2020), or as it is commonly referred to in the bankruptcy industry, a "Chapter 22." On March 26, 2025, Bar Louie filed its second Chapter 11 case (its first was in January 2020). Buffets Restaurants is a rare "Chapter 33" filer, having filed Chapter 11 three times (most recently in April 2021). Unfortunately, there are several distressed restaurant chains that may serve up their own "Chapter 22" in the near term due to unsustainable capital structures, unrelenting interest rates, and an inability to bounce back from the COVID-19 pandemic.

While Chapter 11 can be a challenging environment for unsecured creditors and other stakeholders, it can also provide an opportunistic landscape for distressed investors that want to acquire restaurant assets out of bankruptcy. For example, as noted above, Sun Holdings acquired the secured debt of Taco Bueno prior to bankruptcy and then used that debt to acquire Taco Bueno's assets pursuant to a Chapter 11 plan of reorganization.

A similar playbook was deployed by TREW Capital in two recent Chapter 11 cases. In both the Rubio's and BurgerFi cases, TREW Capital acquired secured debt prior to bankruptcy and used that debt to credit bid for assets. The strategy worked. TREW Capital is now the owner of BurgerFi and Rubio's pursuant to a court-approved sale process. A similar scheme seems to be unfolding in the recently filed Chapter 11 case of Bar Louie, where the existing secured debt was acquired by a seemingly opportunistic lender approximately one month prior to the bankruptcy filing.

The restaurant industry is also dipping its toes into liability management exercises (LMEs). In April 2024, City Brewing was the subject of a non-pro rata uptier debt exchange with certain of its lenders. The LME deal included a $115 million liquidity boost from a new first-lien, first-out loan and moved certain assets to a new entity as collateral for the newly minted credit facility.

While the restaurant industry has been plagued by Chapter 11 filings of notable brand names, there have been some distressed opportunities outside Chapter 11, including certain strategic acquisitions.

In March 2024, The One Group, parent company of STK Steakhouse, acquired Benihana restaurants in a transaction valued at $365 million. The One Group had previously purchased Kona Grill through its Chapter 11 case in 2019.

In July 2024, amid reports that MOD Pizza was contemplating a Chapter 11 filing and following the closure of 44 locations, Elite Restaurant Group, known for acquiring struggling restaurant chains, acquired 100% of MOD Pizza's equity (and its more than 500 locations across the United States and Canada). Elite Restaurant Group previously purchased the GiGi's Cupcake chain through its bankruptcy case in 2019 and Marie Callender's following

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the conclusion of that company's bankruptcy in 2019.

In October 2024, Darden Restaurants Inc., parent company of the Olive Garden, Ruth's Chris, The Capital Grille, and LongHorn Steakhouse, among others, acquired Chuy's restaurants in an all-cash transaction with an enterprise value of approximately $605 million.

In December 2024, Sun Holdings acquired Uncle Julio's through a foreclosure auction.

The current financial distress and rising bankruptcy filings in the restaurant industry highlight the profound challenges facing these businesses today. The combination of inflation, labor shortages, increases in minimum wage, consumer habit shifts, and overleveraged balance sheets has caused restaurants to struggle to maintain profitability. As noted, GPS and many others are facing this difficult reality. In the immediate future, restaurant bankruptcy filings do not appear to be slowing down, but they present an opening for opportunistic parties to breathe new life into the chains we all know and love by focusing on best-performing stores and new innovations while shedding burdensome debt and underperforming leases.

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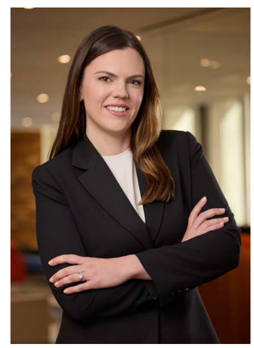

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