

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEW MEXICO

Clerk's Minutes

Before the Honorable James Starzynski

James Burke, Law Clerk
Jill Peterson, Courtroom Deputy

Joe Jameson Court Reporters
(505) 242-2809

Sara Edmonds X

Date:
Thursday, November 29, 2001

Re:
FURRS
No. 11-01-10779 SA

FH on Motion to Reject Sublease w/Pinnacle, etc. #777

Attorney for Debtor: David Thuma
Attorney for UCC: Chris Pierce
Attorney for Pinnacle: Richard Downing and Deborah Gille

Summary of Proceedings:

Exhibits X

Testimony X

MOTION GRANTED - THUMA WILL SUBMIT ORDER

Thuma: Going to be relatively easy matter on facts and law. Not a lot of controversy about facts. Will argue about what I am proposing. Look beyond document.

Ct: Issue is whet. this is a true lease or not. 365 (h) protection. IF not, not entitled to 365 (h) protection.

T: My understanding of the law.

Ct: Different understanding?

D: No.

T: The evid. will show that for some years Furrs had a supply contract w/Fleming. Fleming bought distrib. center from Furrs in 1991. Part of transaction where Fleming became sole supplier. In 1997 Furrs sold Fleming saying that they overcharged. Agreement was terminated. Furrs got back lease. Furrs decided that the best course of action would be to do own buying of groceries. Have somebody else manage the distrib. center. Talked to a # of people. Simul. w/closing of settlement Furrs entered into contract w/Pinnacle to manage the distrib. center. On 75 acres of land. Lease rental is \$260k a yr. Furrs contracted w/Pinnacle to manage it. Trucked into center and Pinnacle unloads trucks and put it on shelf. As stores need it, put order in and Pinnacle would ship it out. Furrs would reimb. Pinnacle for all costs. Paid a management fee. Management fee plus reimb. of all costs. Transparent agmt where a budget would be negot. Furrs thought mgmt fee would be cheaper. As part of that arrangement Furrs agreed to sign a sublease. Req. under mgmt contract. Signed later. An exh. to an orig. contract. Sublease req. rent of \$100 a mo. Evid. will show it is a nominal amt at best. \$100 a mo. was chg'd back to Furrs. Economic reality is the amt was zero. Never paid. Transparent agmt where Furrs paid all costs. Will argue the econom. subst. test. Case law will supp. what we've got is not an econom. subst. Paid good money to get back lease. Doesn't make any sense at all. Did not convey prop. rights. Assign lease and get a lot of money for it. Sublease to Pinnacle for little or no money. If Pinnacle prevails today, cannot benef. econom. Only be used in connect. w/performance under mgmt agmt. W/o breaching sublease don't think Pinnacle can do anything. Equip. that is there is either owned by Furrs or Heller Leasing. That equip. would not remain w/Pinnacle. Furrs would not cont. to pay lease pymts. End up w/right under sublease. No abil. to use center w/o viol. sublease. Only value is hostage value. When court hears evid., court will have no trouble deciding it was a mgmt agmt. No inditia of a typical lease. Argue law in closing. Case law is pretty good.

Ct: Good idea and already read cases you cited.

D: Let me thank court for accomod. us. Looking at parties for over 3 yrs have understood there was an agmt. Separ. sublease was negot. Arms length trans. Parties always understood a sublease existed. Valuable consider. for entering into a sublease. Econom. realities. Prov. Pinnacle and affiliate Countrywide

w/valuable protection in event Furrs failed to reimb. for costs they incurred. Risk of util. and costs of building and hiring employees will show the relationship was structured to insulate Furrs. Risk taken by Pinnacle factors into the consideration in negot. sublease. Will present a witness and will demons. how the rates were described. Dtr now seeks to meld these agmts into one. Pinnacle was oblig. to negot. a separ. and distinct sublease. In breach of warehousing agmt. Master lease Furrs entered into permits it to sublease. Economic reality test is inapplicable. Test is used in a leaseback transaction. No option for Furrs to ever purch. If were to impose econom. reality test would side w/Pinnacle. Oper. costs of warehouse. Were to hire and maintain insur. w/Pinnacle as primary insured and Furrs as secondary. Evid. will show a sublease exists. Under 365 (d) (4). Pinnacle is to be charged back pursuant to budget.

Ct: Based on comments I was trying to figure out - one of the sect. of sublease - parag. 5. Is a provision for reimb. for those taxes and util. Handled thru mgmt agmt. Just curious. Did Pinnacle pay those and Furrs reimb.?

D: Correct. Prov. Pinnacle would be responsible. Had the real estate taxes not been paid would come after us seeking reimb. Liable as if it was the lessee.

Ct: Will need to look at mgmt agmt.

TESTIMONY OF STEVEN CROWTHER (sworn)

CROSS EXAMINATION

REDIRECT

T: Call Steve Mortensen to stand.

TESTIMONY OF STEVEN MORTENSEN (sworn)

Ct: Exh. 1, 2 and 3 are admitted w/o obj.

CROSS EXAMINATION

T: I rest.

D: Pinnacle rests.

Ct: Take a break and will give you time. Want to review the evid. and the two docs so I can be better prepared.

Recess

Ct: After closing argum. will take a recess and figure out whet. I can make a decis. this morning. Prefer. would be to make a decis. If an iss. is floating around that I can noodle thru satisfactorily w/in a short period of time, I will let you know that.

T: The main ques. under the case law whet. A lease is a true lease or not is economic subst. Intent, whet. they intended to create a landlord relationship. Govern by 365. Evid. is clear. What Pinnacle and Furrs intended to do and what they did was differ. than typical tenant relationship. Real prop. is a val. of \$265k a year for no consideration. I think if that was what Pinnacle's argument. If intended to give addit. security, no evid. to support that. Didn't say anything about that. Said we want the sublease so we can oper. that center. Show Pinnacle and Furrs are differ. entities. Not a fraud. Not a convey. of prop. right that was intended to be covered by 365. Do contend the economic subst. of entire trans. is joined at hip and sublease was never intended to. Not legally terminated. Law about what happens when it rejects a contract. Tantamount to a subst. breach. Don't think that gets Pinnacle all the way home. Iss. is econom. subst. and bonafide lease. To say Pinnacle would owe no rent - didn't think that would happen. Nothing in docs that sugg. that was the intent of parties. Part of unfairness of Pinnacle's position is that they don't have to pay rent. Owe them money post-pet. Offset. Iss. that it is a below market lease doesn't fly either. Everybody knew what didn't matter. Kind of like peppercorn theory. Nominal amt. Transfer a ranch. Lease like any other. Way below market. Mr. Crowther test. is right on. Idea was independence. Idea was not to convey a leasehold estate. Agreed to idea of independence. Not trying to go around that. Call a sublease. Argument they make is Pinnacle is taking some risk. Became sublessee. They have right to either term. the mgmt agmt and thereby the sublease bec. Furrs is in breach. Took no risks to sign on the sublease. Can term. it anytime. Their final argum. is to collect back. Bring a lawsuit ag. Pinnacle to recover. Is not right. Assert setoff. All of those amts are owed back under open book contract. Not see any situation where they would prevail. Furrs always pays everything and doesn't get rent. Mr. C. doesn't dispute that. If apply a lot of the facts, Furrs has abil. to say this is not a true lease. Are other cases referred to. Fair to say the bonafide lease test and true lease test were generated from differ. between a true lease and the financing. If ct looks at a transaction and says not a true lease, not kind of trans. under 365. Cases I cited aren't under 365 (h). I don't think there is no case on point should be a problem. Are cases that don't go off. Isn't enough like a lease. Cited 3 - re: Morregia and Sons case. City of San Francisco. Not a lease. Like an estate for a term of yrs. Looked to the judge that the debtor wasn't a lessee. Ct said is not a true lease. Won't apply 365. PCH Assoc. Case ct said isn't a lease. Didn't apply 365. Final case was Intl. Trade Assoc. Hybrid of a lease and a sale. Mr. D. opening implied they think it is a true lease or financing. Bound to apply 365. Case law really gives the court discretion. In two of the cases the ct looked at the equity. Can apply and exercise power if looks like someone will get a raw deal. If ct enforced sublease as true lease, would be a catastrophe to the bankr. estate. Two cases that looked at eq. were Luna Family Restaurants and Morregia. Eq. power under 105. Not hold to 365. For these reas. the ct should allow our motion and find a buyer.

D: Sublease is a lease that is a matter of fact and a matter of law. Reach outside four corners of sublease. Relied on \$ val. and treatment of pymt of rent under warehouse agmt. Don't see where Mr. T. argum. would chg. Back here saying that is not a sublease. Below market. Reject. of sublease is governed by 365(h). Evid. is shown that purs. to the terms of sublease has not been terminated. Unable to avoid remedies prov. under 365 (h). Seeks to fashion a new remedy.

Ct: Said whet. trustee can reject it is governed by 365 (h)? Simply the conseq. of what happens if a trustee rejects a lease?

D: Apologize if I misspoke. Two agmts cannot be used to equal up. Reject. of a contract certain covenants will survive. If adopt dtrs position now, undermine the intent of 365(h). Cited Dooms Hotel. Similar facts. Parties had exec. what the dtrs fashioned to be a mgmt agmt. Lessee resp. for paying taxes. Insure oper. of bus.

Ct: Decis. go off in large part that the dtr that was trying to recharacterize mgmt agmt. Records and corresp. said this is a lease until it became important to treat as something else. Then said this is not a lease. Where judge went off in Dunes case?

D: He did. Pinnacle failed to enter into that sublease. Is clear. Defined as a sublease. Subleases premises to Pinnacle. Parties until recently said this is not a sublease. Similar to Dunes case. Most of the cases cited are used to evaluate true selves. PCH case where judge deter. it is not a lease. No joint venture. No financing. No sales leaseback. Disting. from PCH. Benef. both Pinnacle and Furrs. Negot. and arrived at the value of the rent. Other value consideration. If Furrs was paid a market rent by Pinnacle, would not be here. What Furrs hired Pinnacle to do. Manage the warehouse. Had the failure to pay taxes and a default occurred. Agmt reached on side by parties. Fact remains Pinnacle was resp. Furrs would have right to seek reimb. of any damages that resulted as a failure to pay real estate taxes.

Ct: Ultimately real estate taxes get paid by Furrs?

D: Correct. Pinnacle was resp. for all the oblig. under master lease.

Ct: Open book concept sounds like it doesn't make a differ. Made sense for Furrs to make sure the real estate taxes get paid. Make sure it gets done.

D: Hard to contemplate that Furrs would sit idly by and not seek reimbursement. We bel. at the end when you look at the docs notwithstanding is well below market rent they belong to Pinnacle.

T: Can I comment on Dunes case?

Ct: Entitled to rebuttal.

T: Dunes case the tenant paid over \$1mil in rent. Rented some property. Negot. lease and had to pay a ton of rent. Looked to judge why would you say this is nothing other than a true lease.

Ct: Hyatt or SC Hyatt who ran Hyatt Regency paid extra rent that turned out to be almost like a lending arrangement. Added improvements to hotel and rents fell below req. Seemed there was more to it than just we rent this from you and only relat. we have.

T: True. Doesn't seem like that is the core of the trans. I thought Dunes case was disting. from what we've got.

Ct: Let me go thru my notes. This is - I have juris. under 28 USC 1334. Are

oral findings of fact deliv. on record. I did find Mr. C. and Mr. M. credible. Their test. dovetails. Bottom line I do find this partic. sublease that is listed as exh. 1 is not a true lease as is contemplated by prov. of 11 USC 365. Therefore, it is not entitled to protections that follow from it being declared a true lease. Let me tell you the basis for that ruling. Don't think the sublease was signed by Pinnacle. Take Mr. C. at his word. First time in history that such a doc. wasn't signed. I suspect it wasn't signed. Led me to think this sublease was in nature of detail than overall mgmt of agmt. Mgmt agmt was effective Sept. 23, 1998. Sublease refers to mgmt agmt as effect. on Oct. 18, 1998. Effect. date of sublease. Seems to me to effectively tie in sublease w/mgmt agmt. There are innumerable refer. to mgmt agmt. Exh. 3. Throughout this sublease it is tied in and part of mgmt agmt. Cannot be used for any other reas. than carrying out mgmt agmt. Continues to run when FSI lease when the underlying lease ends. Purs. to parag. 10. Says FSA can terminate the sublease if P. defaults and gives written ntc. Sublease still has not been term. No written ntc. Says FSI can term. the sublease if P. defaults and Furrs prov. written ntc. Or, when the warehouse and distrib. agmt ends. Agree the mgmt agmt itself has not been term. What this sublease is saying in subsec. 3 the sublease doesn't have a purpose w/o mgmt agmt being in effect. Ample test. about the util., taxes, etc. Parag. 5 makes it clear those items are to be paid by Furrs. Test. from Mr. C. about open book arrangement is consistent w/Mr. M. agmt. A cost plus agmt. That is somewhat differ. than Dunes case. The reimb. of util. and taxes are handled thru mgmt agmt. Says Pinnacle can't make alter. Says Pinnacle cannot assign w/o discret. of Furrs. Further evid. that Pinnacle was in there has a hired manager. FSI can renew underlying lease in accord. w/mgmt agmt. Dunes case. Ques. I asked Mr. D. was the matter that governed the judge's decis. in the Dunes case. A situation where the dtr referred to the doc. at iss. between the two parties throughout. When began to chg. it the corresp. talked about chging this agmt from a lease to a mgmt agmt. Get rid of lots of extra lang. Appears in leases. There was virtually a plethora of additions. Had SC Hyatt had made a # of loans in form of rent. Had a situation where doc was still a lease. Mr. C. testif. that the reason the separ. sublease was entered was to allow Pinnacle to operate from facility. Describes intent of sublease. Pay \$100 a mo. No way would a real lease have a low rent amt. Test. from Mr. C. was there wasn't any intent to negot. a fair market rent. Said Furrs said that is the amt that was offered and the amt we took. Seems the parties when negot. didn't treat as a true sublease. Economic behavior is not what you expect to negot. Negot. a true lease agmt. Have some signif. beyond more than a clause of the mgmt agmt. T and B. did not show val. of lease. May not have been req. to list it. Furrs said they carried this lease on books. \$5mil amorit. of 5 yr. period. Further conduct that these bus. people recog. the underlying value of that trans. belonged to Furrs. Wasn't a true lease at all. Seems that the property has a much higher lease value. Based on those #'s is possible to apply equity test. Go on basis of sect. 105. Won't do that. Not necess. Use 105 sparingly. Don't know why I would want to use 105. I do think based on case law presented and based on facts of this trans. this is not a true lease that Congress anticipated. Including amend. to 365. I will find the sublease which is in the record as exh. 1 is not a sublease and not entitled to protections that would follow 365 (h). Will ask Mr. T. to prepare of order and run by Mr. Downing. Order should say the ct make finding of fact w/o attempt. to summarize. No need to do that.

A: MetLife has some concern. Combine ntc of m/to conv. w/ntc of admin. clm bar date. Try to split cost of direct mail ntc. I would much prefer direct mail ntc.

Ct: Admin. clm bar date?

A: Prefer direct mail ntc. Combine two and reduce cost. Only have auth. for expenditure involved for public. of ntc. Get auth. for several hundred more.

Ct: For what?

A: Splitting costs of admin. clms. One one side of ntc having m/to conv. and other side have admin. clm bar date.

Ct: Goes out in envelope?

A: Yes. Cost if we use a local company would be in neighborhood of \$10k to \$12k. Trying to share costs and send a combined ntc out. More than the ntc by publication of m/to convert. Have to go back and get auth. for expenditure of additional monies.

Ct: M/convert would be \$2k - \$3k?

A: Would be \$1400.

B: Expressed concern about public. ntc was calculated to where it needed to go. So many natl. creds in this case...

Ct: Lubbock Avalanche Journal?

B: Yes. Not natl. Publish in Wall Street Journal. More natl. publication. IF combine ntc w/dtrs on bar date would be about what that kind of ntc would be. Publication ntc is iffy anyway.

Ct: Balancing test. Have to tell you this iss. came up about a month ago in chambers. Someone from clerk's office came up and someone wanted to do public. by ntc. Talked to Margaret Gay and said talking about \$20k to use those folks. That was where she and I talked about ntc for public. Don't know if Mr. Andazola came up w/those #'s. If drew a triangle from Albuquerque to Lubbock and El Paso reached just about everyone. Get majority of folks. Agree public. is not the best form of ntc. Wall Street Journal would prov. better ntc. If we look at it from practical point of view and get more bang

for our buck I think newspaper ntc would work. Iss. of admin. clms is more complex. Ques. is is what is liklihood of people who have admin. clms being missed. Not thought about admin. clm aspect until I walked in here today. More up in air. Already been talk about conversion in this case. Month and a half ago dtr was talking about converting. I don't know who would argue that. Admin. clms could be some little tortilla factory down in Chamborino, NM. Mr. Fish that is a little town in So. NM.

F: Is a winery there, I know where that is.

J: W/respect to sending out a ntc of admin. clm bar date to do it by mail and not public. I think there would be due process iss. Estates w/mil. of \$. Cost of sending ntc locally is \$6800 for postage and \$200 for every pg. inserted in envelope. \$8800 approx. Dtr thinks it is a good idea to send out that ntc. Ntc will need to be sent on m/convert. No reas. to wait. From estates aspect the cost is less. Don't think dtr is asking court to approve ntc by publication. Cost is not overwhelming.

Ct: Take care of your concern Ms. Behles.

B: Yes.

Ct: Sounds like a better way to proceed. What do you propose we do at this point. Have a m/to set a bar date?

J: Ask ct to set a bar date and go ahead and ntc it out. Propose 40 days after we send the ntc. Specify a date certain.

Ct: So no ques. about calculating 3 days. More user friendly.

J: Other thought is that if the unions are in a position on severance clms to assert the emp. is not req. to file a separ. clm. so unions won't get thous. of calls.

Ct: Not get lots of calls. Sounding better all the time. Gets into iss. of class proofs of claim.

J: 10th circ. has a case. Under collected bargaining unit - clm for sever. is collected under collect. bargaining. Ask ct to allow the sever. clms on behalf of work force. Under collective bargaining unit. Union emp. would be bound by result. If ltd, the dtr doesn't obj. to union filing that particular clm. Guess court is right if any iss., not approp. to put in ntc.

Ct: Sheffelman case was a - Standard Metals filed bankr. while one or two fraud causes pending in NJ. Organized a couple of suits or lead pltf in one of them. Mass proof of claims. Distinction between that kind of circum. - not sure if they had ntc or had Mr. S. repres. them. Where the union is a desig. agent here that really works. Don't want to think about getting admin. clms that have to be processed.

F: On the union iss. the court could order that the union members not need file clms under collect. bargaining agent. Given a time to file a clm. The other thing is under rule 2002 (a) (7). 303 (c). Concerned that were are extending ntc to Dec. 2001. Not sure it will cont. in

Dec. Have deadline during ch. 11 rather than being conv. Have deadline run during this next cc period. Gotten that done during cc. Give people two weeks to get ntc in mail. I think it would be useful to have bar date.

Ct: W/respect to appt. of a trustee and ques. whet. it overlaps.

B: Other reas. it would be handy to get ntc out is some ques. between UCC and sec. lenders about way to do a consensual plan. Might help us to get a deal cut. Nice if we could do it.

Ct: Saw mention of a plan. I had been thinking really talking about conv. and only real iss.is when.

D: Unfairness about sending out ntc. Texas emp. have to go thru some set of procedures. W/regard to union not sure on the fly if there oesn't become a conflict w/positions the unions have taken. Union has been in here askin gfor pymts of trust fund. Trust is not the individual clms. Health fund repres. those people w/health clms. Differ. in amt and differ. than those w/severance clms. Seems to me on the fly when some conflict iss. might come about. It would have to be clear if union recovered money have to go to individuals.

Ct: Assumed latter would be the case. W/respect to those people repres. by a union, not sure req. those folks to file - sense of equalitarianism. Like thought for practical aspect the notion of allowing union to file on behalf of a lot of these folks. Keep paperwork down. Help people who are admin. this. Benef. individuals. If someone has clm for sever. benef. rather have someone deal w/it for them.

D: If repres. by a union, shouldn't they contact union. Talking about opt in vs. opt out. May not want to pursue an admin. clm. W/o indication of admin. clm. Have to call up union or send postcard to union saying please repres. me in this. Sugg. at least the people should notify the union that they want the union to repres. them.

P: We don't want to approve something that would prejudice someone. Collect. bargain. agmt is between dtr and union. Emp. are not typically in a class. Rights between parties. In position that it will show we are in a position to bring these clms on behalf of members. Don't have immed. comment on trusts.

Ct: Trusts are differ. than unions.

P: Yes. Little less knowl. about Texas situation.

Ct: Not going to make a decis. today. Will be gone next Wed., Thurs. and Fri. Following week I will have court for a couple of days. Thurs. morn. Nov. 8 want to see some of the stuff we do. Be an ideal time. Designed to deal w/things like this.

F: I had another suggest. Dtr has power to file poc for people. Makes no sense if severance - no clue what rights people in Texas would have had. If the same - say Union would file a poc. Perhaps the dtr could file these clms that the union has asserted as admin. clms. Court could hold hrgs and resolve them. Throw that out as a way to cut admin. burden. Whet. they win or lose that is a separ. iss.

Ct: Based on records of who was working when.

J: Dtr disputes the severance clms so dtr wouldn't want to file clm.

F: If clm valid, is amt. Deemed their poc. Before court w/o this nightmare of filing or not filing poc.

J: Like oppor. to talk to unions to work out a solution. File clms for constituency. Rule on filing tax clms. May req. they file w/in so many days. Dtr would prob. prefer not getting into bus. of filing admin. clms. Hope we can work something out w/unions.

Ct: Local 1564 and 540 for West Texas and parts of NM the major. of emp. are repres. by those two unions.

P: Correct.

J: Non-union employees and four stores that weren't part of a union.