

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO
ALBUQUERQUE

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U.S. BANKRUPTCY COURT
ALBUQUERQUE, N.M.

In re) Chapter 11
)
FURR'S SUPERMARKETS, INC.,)
)
) Case No. 11 01-10779 SA
Debtor.)
)

MEMORANDUM OF LAW IN SUPPORT OF FINOVA CAPITAL CORPORATION'S OBJECTION TO THE DEBTOR'S STORE-BY-STORE TREATMENT OF CERTAIN EQUIPMENT LEASES

FINOVA Capital Corporation ("FINOVA"), respectfully submits this Memorandum of Law in Support of FINOVA's Objection to the Debtor's Store-by-Store Treatment of Certain Equipment Leases, and states as follows:

A. Introduction

FINOVA objects to the Debtor's proposed store-by-store treatment of FINOVA's multi-store Lease as an improper attempt to assume or reject a portion of a single Lease. The Debtor argues that FINOVA's Lease consists of several distinct contracts which may be independently assumed or rejected. FINOVA asserts that the Debtor's position is an impermissible form of "cherry picking" which robs FINOVA of an essential part of its bargain with the Debtor and provides a windfall for the Debtor. Therefore, this Court should find that the FINOVA Lease constitutes a single unitary contract which the Debtor must assume or reject in its entirety.

B. Background

FINOVA leased certain store equipment to the Debtor pursuant to the terms and conditions of a single unexpired lease of personal property entitled Equipment Lease No. 5645900 dated December 29, 1995 (the "Master Lease") together with all addenda, amendments, schedules and other ancillary documents. Specifically, the Lease includes Master Lease

936

Schedule No. 5645900 dated as of December 29, 1995¹, Master Equipment Lease Schedule No. C060700101 dated as of December 4, 1997, Master Equipment Lease Schedule No. C022200301 dated as of November 1, 1999 and Master Equipment Lease Schedule No. C022200101 dated as of August 29, 1998. The Master Lease, addenda, amendments, schedules and other ancillary documents are collectively referred to as the "Lease". (See Exhibit A to the Declaration of Anthony Holland in Support of FINOVA Capital Corporation's Objection to Debtor's Notice Relating to § 365(f)(2) Adequate Assurance Requirements For Assignment of Equipment Leases, Lease Estoppel, and Final Hearing filed on August 14, 2001 (hereinafter, "Ex. A"). The Lease is an unexpired true lease subject to §365 of the Bankruptcy Code.

On June 29, 2001, the Court granted the Debtor's motion to sell substantially all of its assets to Flemming Companies, Inc. ("Flemming"). Under the sale agreement with Flemming, certain stores will be assigned to third parties while other stores will be closed. Pursuant to Flemming's notices, Flemming has indicated that it does not desire to purchase several of the stores in which FINOVA's equipment is located. As a result, the Debtor seeks to assume only that portion of the Lease where the stores will be assigned and reject the remainder of the Lease. The Debtor asserts that it has the right to assume or reject the Lease on a store-by-store basis because the Lease is allegedly made up of several individual leases. FINOVA believes that the terms of the Lease dictate that the Lease constitutes a single indivisible agreement which cannot be separately assumed or rejected.

¹ On December 29, 2000, pursuant to Agreement No. R5645900, the Debtor financed the purchase of the equipment originally subject to Master Lease Schedule No. 5645900. FINOVA acknowledges that Agreement No. R5645900 is a secured financing arrangement and is not part of the Lease.

C. Argument

The Debtor claims that the Lease is not a single unexpired lease of personal property which must be assumed or rejected in whole. The Debtor argues that right to use a portion of the leased equipment can be severed on a store-by-store or a schedule-by-schedule basis and that each schedule constitutes a separate agreement. The Debtor is simply attempting to “cherry pick” from a single Lease the beneficial provisions while rejecting the more burdensome terms. This is a right not granted to a Debtor under the Bankruptcy Code. Leslie Fay Companies, Inc. v. Corporate Property Assocs. 3 (In re Leslie Fay Companies, Inc.), 166 B.R. 802, 808 (Bankr. S.D.N.Y. 1994) (an executory contract or unexpired lease must be assumed or rejected “*cum onere*, with all of its benefits or burdens” and “cannot be assumed in part and rejected in part.”).

Any right to assume or reject portions of the Lease provides the Debtor with an opportunity to use FINOVA’s equipment on a basis contrary to the terms of the Lease. Whether a single agreement is divisible is a matter of state law. See In re Quintex Enters., Inc., 950 F.2d 1492, 1496-97 (9th Cir. 1991); In re T & H Diner, Inc., 108 B.R. 448, 453 (D. N.J. 1989). Under Arizona law, which governs the construction of the Lease, “[w]hether a contract is entire or severable is a question of intention to be determined by the language the parties have used and the subject matter of their agreement.” Temp-Right Eng’g Co. v. Chesin Const. Co., 372 P.2d 701 (Ariz. 1962). As explained further:

A contract may both in its nature and by its terms be severable, and yet rendered entire by the intention of the parties. We think that perhaps the best test is whether all of the things, as a whole, are of the essence of the contract. That is, it appeared that the purpose was to take the whole or none, then the contract would be entire; otherwise it would be severable. (Citation)

O’Malley Investment & Realty Co. v. Trimble, 422 P.2d 740, 747 (Ariz. App. Ct. 1967) quoting Waddle v. White, 78 P.2d 490 (Ariz. 1938).

The Master Lease makes clear that the parties intended all lease schedules to constitute a single Lease by and between the Debtor and FINOVA. Numerous provisions of the Lease incorporate and refer to the terms of the Master Lease and each lease schedule as part of one unitary contract between FINOVA and the Debtor. Specifically, paragraph 19 of the Master Lease provides: “This Lease and all schedules attached hereto contain the entire agreement between Lessor and Lessee, and no modifications of this Lease shall be effective unless in writing and executed by an executive officer of Lessor”. (Ex. A p.6 ¶19). Additionally, each schedule expressly references the Master Lease by stating: “Lessor agrees to lease to Lessee, and Lessee hereby agrees to lease and rent from Lessor the Equipment listed above, or on any Schedule attached hereto, for the term and the rental payments provided herein, all subject to the terms and conditions of the Lease.” (Ex. A ¶1 of each schedule).

Moreover, the cross-default provision in the Master Lease provides that a default under any schedule allows FINOVA to, *inter alia*, declare the remaining rent due under any and all schedules immediately due and payable. (Ex. A p.4 ¶13). The cross-default provision in the Lease is further evidence of the parties’ intent to treat the Master Lease and all the schedules as a single indivisible, integrated Lease. Since the parties intended to enter into a single agreement, the Debtor’s intentions to sever the Lease and “cherry pick” the most beneficial equipment while rejecting the remainder of the Lease should not be sanctioned by this Court.

Further, In re Gardinier, Inc., as relied on by the Debtor, is factually distinguishable from the instant case. Byrd v. Gardinier, Inc. (In re Gardinier, Inc.), 831 F. 3d 974 (11th Cir. 1987). There the court determined that the terms of the instrument at issue “demonstrated that the parties intended to make two separate contracts.” Id. at 976. In the present case, as explained above, the language contained in the Lease makes clear that the parties intended to have only one

Lease. Additionally, in In re Gardinier, Inc., the issue was whether two promises, each with a different promisor and promisee, constituted one or more contracts. The court found no support for the theory that promises between different parties, even if dependent on each other, evidenced that the parties intended the agreements to actually form one contract. Id. 977-78. In the present case, unlike in In re Gardinier, Inc., the only parties to the Lease are FINOVA and the Debtor. Therefore, In re Gardinier, Inc. is factually inapplicable to the present case.

Finally, while bankruptcy courts may allow assumption of a Lease without curing cross-defaults in a related transaction, the enforcement of cross-default provisions should not be refused where to do so would thwart the non-debtor party's bargain. See, e.g. In re Kopel, 232 B.R. 57, 65 (E.D.N.Y. 1999); In re T & H Diner, Inc., 108 B.R. at 454-55. Courts also have found that there is "no federal policy which requires severance of a lease condition solely because it makes a debtor's reorganization more feasible." In re Kopel, 232 B.R. 57, 65 (E.D.N.Y. 1999) *quoting In re Easthampton Sand & Gravel Co.*, 25 B.R. 193 (Bankr. E.D.N.Y., 1982). Here, allowing assumption without curing all defaults under the Lease would completely undermine the basis by which FINOVA leased equipment to the Debtor.

Upon information and belief, the Debtor intends to assume all of the equipment subject to Schedule Nos. C060700101 and C022200101 while rejecting certain equipment located in stores subject to Schedule C022200301. FINOVA leased the equipment under schedule C022200301 in November, 1999 over one year after entering into Schedule No. C22200101 and approximately two years after Schedule No. C0607001. FINOVA would not have leased additional equipment to such a highly leveraged corporation without the cross-default protection afforded to FINOVA under the Lease. To refuse to enforce the cross-default provision of the Lease would completely undermine FINOVA's rights and thwart FINOVA's bargain. In

essence, the Debtor would receive an unjustified windfall at FINOVA's expense. Further, there is no possibility that enforcement of the cross-default provision would contravene an overriding federal bankruptcy policy and thus impermissibly hamper the Debtor's reorganization. The Debtor is nearing the final stages of winding down its operations and attempting to completely liquidate its assets. The Court has already approved Flemming's asset purchase agreement and the transaction will close irrespective of whether or not the Debtor assumes or rejects the Lease. Therefore, the cross-default provision of the Lease should be enforced and the Debtor should not be able to assume the Lease without curing all defaults thereunder.

D. Conclusion

This Court should prohibit the Debtor from assuming or rejecting the Lease on a store-by-store or schedule-by-schedule basis. Since FINOVA and the Debtor intended to enter into one Lease agreement, the Debtor's attempt to "cherry pick" the most beneficial terms of the Lease while rejecting the more burdensome ones should not be allowed. Further, the cross-default provision of the Lease is a material and integral part of FINOVA's bargain without which FINOVA would not have continued to lease additional equipment to the Debtor. Therefore, the Debtor should be directed to either assume or reject the Lease in its entirety.

Dated: August 21, 2001

FINOVA CAPITAL CORPORATION

By:  _____

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CERTIFICATE OF SERVICE

I, Allen J. Guon, hereby certify that I served a copy of the foregoing Memorandum of Law In Support of FINOVA Capital Corporation's Objection to the Debtor's Store-by-Store Treatment of Certain Equipment Leases on the following:

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via facsimile at the telephone numbers listed above on this 21st day of August, 2001.



Allen J. Guon