

IN THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

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In re: : Chapter 11
FURRS SUPERMARKETS, INC., : Case No. 01-11-10779-SA
Debtor. :

U.S. BANKRUPTCY COURT
ALBUQUERQUE, NM

**OBJECTION OF PINNACLE LOGISTICS, INC. TO DEBTOR'S MOTION
TO REJECT SUBLEASE WITH PINNACLE LOGISTICS AND FOR AN
ORDER DECLARING THAT THE DEBTOR'S LEASEHOLD RIGHTS IN
THE EL PASO DISTRIBUTION CENTER ARE FREE AND CLEAR OF
ANY CLAIMS OF PINNACLE LOGISTICS, INC.**

Pinnacle Logistics, Inc. ("Pinnacle"), through its attorneys, hereby submits its objection to the motion by Furr's Supermarket, Inc. ("Furrs" or "Debtor") to reject the sublease with Pinnacle and for an order declaring that the Debtor's leasehold rights in the El Paso Distribution Center are free and clear of any claims of Pinnacle (the "Motion"). Through its motion, the Debtor seeks to deprive Pinnacle of the statutory right accorded to Pinnacle under Bankruptcy Code section 365(h) which permits a lessee of a Debtor to remain in possession of leased property subsequent to the rejection of the lease by the Debtor. In opposition of the Motion, Pinnacle represents and states as follows:

Facts

1. Furrs is a regional supermarket chain with operations in New Mexico and Western Texas. On or about February 8, 2001 (the "Petition Date"), the Debtor filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") with this Court.

2. Pinnacle subleases and operates a warehouse and distribution center in El Paso,

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Texas (the "El Paso Warehouse") and provided warehousing and related operation services to the Debtor pursuant to a Warehousing and Distribution Agreement executed by the parties on or about September 23, 1998 (the "Warehousing Agreement"). The Debtor previously rejected the Warehousing Agreement, such rejection approved by an order of this Court on August 6, 2001, retroactive to July 21, 2001. A copy of the Warehousing Agreement has previously been provided to the Court.

3. As provided for in the Warehousing Agreement, on or about October 19, 1998, the parties negotiated a separate and distinct agreement whereby the Debtor transferred to Pinnacle the Debtor's leasehold interest in the El Paso Warehouse as memorialized in a sublease (the "Sublease"). A copy of the Sublease is attached to the Motion as Exhibit A. The property subleased by Pinnacle that comprises the El Paso Warehouse represented a portion of a larger food distribution center which the Debtor lease pursuant to a long term leasehold.

4. Paragraph 2 of the Sublease provides that Pinnacle's sub-leasehold interest in the El Paso Warehouse shall commence on October 19, 1998 and terminate on the earlier of: (i) the date the [Warehousing] Agreement terminates; (ii) the date [Furrs] leasehold interest in the [El Paso Warehouse] terminates; or (iii) the date the Sublease is terminated pursuant to paragraph 10 [of the Sublease].

5. Paragraph 10 of the Sublease provides that the Debtor may terminate the Sublease if Pinnacle is in default under the Sublease and fails to cure such default or if the Warehousing Agreement is terminated.

6. As represented in the Motion, the Debtor's leasehold interest in the El Paso Warehouse has not terminated.

7. While previously rejected, the Warehousing Agreement has not terminated pursuant to its term nor has the Debtor ever terminated the Warehousing Agreement.

8. Pinnacle has at all times and continues to timely performed under the terms of the Sublease and has never been in default under the terms of the Sublease.

ARGUMENT

9. Pinnacle asserts that the Debtor is attempting to deprive Pinnacle of its rights conferred under Bankruptcy Code section 365(h) to remain in possession of the El Paso Warehouse upon the rejection of the Sublease by the Debtor. Pinnacle asserts that the Sublease is in fact and as a matter of law a true lease of real property and upon the rejection of the Sublease by the Debtor, the only determination to be made is whether Pinnacle will exercise its rights under Section 365(h) to terminate the Sublease or to remain in possession; such determination left solely in the hands of Pinnacle.

10. The Debtor's rejection of the Sublease is governed solely by section 365(h) of the Bankruptcy Code. Section 365(h) of the Bankruptcy Code addresses the effect on the rights of a non-debtor tenant when the debtor-landlord seeks to reject a lease of real property. Section 365(h) of the Bankruptcy Code was enacted to afford the lessee the option of selecting the parameters of its claim. See In re Chestnut Ridge Plaza Assoc., L.P., 156 B.R. 477 (Bankr. W.D. Pa. 1993).

11. Section 365(h) provides in relevant part that if a debtor seeks to reject an unexpired lease of real property under which the debtor is the lessor after the terms of such lease has commenced then:

the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other

amounts payable by the lessee . . .) that are in or appurtenant to the real property for the balance of the term of such lease.

11 U.S.C. § 365(h)(1)(A)(ii). Alternatively, the lessee may treat such lease as terminated if the rejection amounts to a breach.

12. As one court observed, the legislative history reveals that “Congress sought to protect both the lessee so as to preserve expectations in real estate transactions.” In re Churchill Properties III, L.P., 197 B.R. 283 (Bankr. N.D. Ill 1996). Thus, the court continued, rejection of a lease does not divest the lessee of its interest in the lease. Id. at 288 (citation omitted). The lessee’s interest in a leasehold cannot be modified or changed because of a pending bankruptcy. Id. (citing In re Wood Comm. Fund I, Inc., 116 B.R. 817, 818 (Bankr. N.D. Okla. 1990)).

13. Section 365(h) is clear and specific in providing for certain rights and remedies available to the lessee after rejection or its lease

14. Unable to avoid the applicability of section 365(h) to the rejection of the Sublease, the Debtor posits that the earlier rejection of the Warehousing Agreement coupled with the rejection of the Sublease now somehow serves to fashion a new “remedy” contrary to the provisions of the Bankruptcy Code. In effect, the Debtor requests this Court to adopt a new mathematical formula that “One rejection plus One rejection equals One Termination” to eviscerate Pinnacle’s rights under the Bankruptcy Code. Unfortunately, it is well-settled that the rejection of a lease or an executory contract does not equal rejection.

15. Courts have consistently held that a rejection of an executory contract does not result in the termination of the contract. In In re Drexell Burnham Lambert Group, Inc. 138 B.R. 687, 697 (Bankr. S.D.N.Y. 1992), the court held that “[r]ejection merely frees the estate from the

obligation to perform: it does not make the contract disappear.” Consistent with this approach, in reviewing the term “rejection” contained in Bankruptcy Code section 365, the Court of Appeals for the Fifth Circuit in Austin Dev. Co. v. Sowashee Venture, 19 F.3d 1077 (5th Cir. 1994) stated that “[t]his language does not mean that the executory contract or lease has been terminated, but only that a breach has been deemed to occur.” See also In re Continental Airlines, 981 F.2d 1450, 1459 (5th Cir. 1993)(“[T]o assert that a contract effectively does not exist as of the date of rejection is inconsistent with deeming the contract breached.”); In re Modern Textile, Inc., 900 F.2d 1184, 1191 (8th Cir. 1990); Leasing Serv. Corp. v. First Tennessee Bank, 826 F.2d 434, 436-37 (6th Cir. 1987).

16. As section 365(h) solely governs the Debtor’s rejection of the Sublease, the Debtor’s request of this Court to fashion an alternative remedy is wholly inappropriate. Congress did not provide a vehicle for the Court to fashion the relief as suggested by the Debtor. If the Court was to adopt the Debtor’s proposal to treat the two rejections as the equivalent of a termination of the Sublease, it would render section 365(h) meaningless. Clearly, the Debtor’s request for a determination that the Sublease based on the rejection of both the Sublease and Warehousing Agreement is effectively terminated must be denied.

17. Finally, the Debtor’s assertions that the Sublease is in fact not a lease, but instead a management agreement or, alternatively, part of the Warehousing Agreement are meritless and should not serve the basis for this Court to fashion the relief requested by the Debtor. Interestingly, the Debtor refers to an “economic substance” test in the Motion in support of its position that the Sublease is not a lease. Pinnacle offers, however, that such an “economic substance” test further bolsters its position that the Sublease is a true lease.

18. First, the legal relationship of the parties, as provided for in paragraph 13.8 of the Warehousing Agreement, is one of independent contractor, and neither party shall be the agent or legal representative of the other for any purpose. Second, the Sublease clearly states that the Debtor agrees to sublease to Pinnacle its leasehold interest in the El Paso Warehouse. Third, Pinnacle is responsible for paying all utilities, real estate taxes and other charges that come due under the Sublease. Finally, the agreement cannot be classified as a sales/leaseback as Pinnacle is not accorded any opportunity to purchase at the termination of the Sublease. Clearly, the terms and conditions of the Sublease and Warehousing Agreement support Pinnacle's position that the Sublease is in fact a true lease.

19. The facts of this case are strikingly similar to the facts in In re Dune Hotel Assocs., 212 B.R. 110 (Bankr. D.S.C. 1997) where the bankruptcy court found that a lease existed in spite of the Debtor's assertion that the "lease" was in fact a management agreement. Under the agreement, the Dune Hotel court observed that the agreement provided, among other things, that 1) Debtor leased the property to lessee; 2) the lessee was responsible for paying all taxes, operating expenses and insurance; and 3) and was to ensure the uninterrupted and efficient operations of the hotel during the terms of the lease. *Id.* at 125. Looking to state law, the court therefore concluded that a true lease did in fact exist.

20. In contrast, the cases relied upon by the Debtor to "defeat" the Sublease as a true lease subject to the "economic substance" test are readily distinguishable here. Two of the primary cases relied upon by the Debtor, In re Lunan Family Rest. and In re PCH Assoc., were decided in the context of sales/leaseback transactions; transactions that are not present here. The other primary case, International Trade Admin. v. Rensselaer Polytechnic Instit., was decided

Debtor are inapposite to the issue before the Court.

21. Pinnacle merely seeks to remain in possession of the leasehold as provided for by Section 365(h)(1)(A)(ii). Pinnacle's election to remain in possession is entirely consistent with the plain language of section 365(h) and the underlying intent of Congress. The Debtor's attempt to fashion some termination remedy is entirely unsupported by authority. Accordingly, the Debtor's motion for an order declaring that the Debtor's leasehold rights in the El Paso Warehouse free and clear of and claims should be denied.

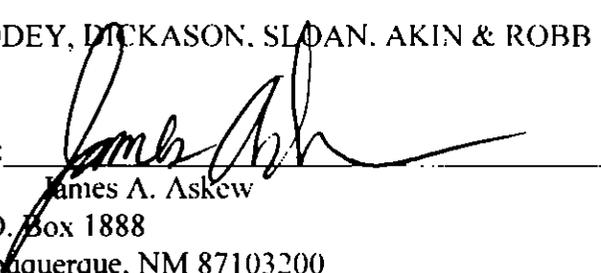
CONCLUSION

WHEREFORE, Pinnacle respectfully requests that this Court enter an Order denying the Debtor's motion.

Respectfully submitted,

RODEY, DICKASON, SLDAN, AKIN & ROBB

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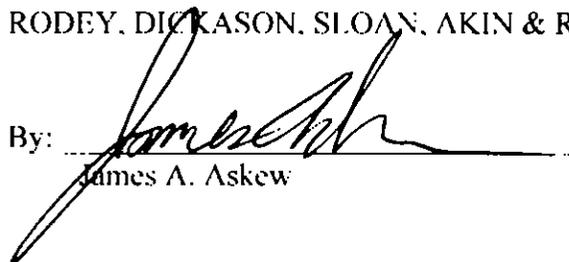
CERTIFICATE OF MAILING:

I hereby certify that I mailed a true and correct copy of the foregoing pleading, by U.S. Mail, first class, postage prepaid, on this 15th day of October 2001 to the following:

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