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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: DEWEY RANCH HOCKEY, LLC, COYOTES HOLDINGS, LLC, COYOTES HOCKEY, LLC and ARENA MANAGEMENT GROUP, LLC, Debtors.	Case No. 2:09-bk-09488 (Jointly Administered) Chapter 11 **CITY OF GLENDALE'S REPLY TO MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEBTORS' MOTION FOR AN ORDER APPROVING REJECTION OF THE ARENA LEASE UNDER BANKRUPTCY CODE § 365(a) EFFECTIVE AS OF THE CLOSING DATE OF A RELOCATION SALE** **Hearing Date:** September 2, 2009 **Hearing Time:** 9:00 A.M. **Hearing Location:** 230 N. First Ave. Courtroom 703 Phoenix, Arizona
This filing applies to: ■ All Debtors □ Specified Debtors	

The City of Glendale, an Arizona municipal corporation (the "City"), by its undersigned counsel, hereby submits this Reply to the Debtors' Motion for an Order Approving Rejection of the Arena Lease under Bankruptcy Code § 365(a) Effective as of

the Closing Date of a Relocation Sale [Docket No. 611] (the "Rejection Motion") and the Debtors' Memorandum of Points and Authorities in support thereof [Docket No. 685] (the "Rejection Memorandum"). This Reply also applies to the legal and factual matters addressed in pending Adversary Proceeding No. 2:09-ap-00540-RTBP. In support of this Reply, the City respectfully states as follows:

INTRODUCTION

On November 29, 2001, the City, Arena Management Group, LLC ("Arena Management" or the "Arena Manager"), Coyotes Hockey, LLC ("Coyotes Hockey" or the "Team"), Glendale-101 Development, LLC and Coyote Center Development, LLC entered into the Arena Management, Use and Lease Agreement (the "Agreement").[1] As described in more detail below, the Agreement, while admittedly an "executory contract" subject to rejection under proper circumstances, memorializes a complex set of business arrangements, and the document is comprised of multiple parts, with those provisions in the nature of a "lease" being, from both an economic and legal perspective, relatively minor components of the overall Agreement.

The Debtors have now requested, in the Rejection Motion, guidance to the effect that, if certain events occur, the Debtors would be permitted to then obtain orders allowing rejection of the Agreement and limiting the allowable amount of claims that the City may elect to assert. As set forth here, the Rejection Motion should be disallowed on any one or more of the following eight bases:

1. Great and disproportionate harm would be caused to creditors by rejection of the Agreement, and rejection should therefore be denied.

2. Rejection of the Agreement would be sought by the Debtors only in the context of an approved so-called "relocation" sale. However, given the high degree of misconduct committed before and during these cases by Jerry Moyes ("Mr. Moyes") and those reporting to him in an effort to preclude any result other than a relocation sale to PSE, which has destroyed the integrity of the sale process here, no relocation sale can be approved, and so rejection would not be in the best interests of the Debtors' creditors.

[1] Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the Agreement.

3. Even if the Agreement were rejected, the City's contractual right of specific performance is not a dischargeable "claim" and would thus survive rejection. Accordingly rejection of the Agreement would not provide the benefits desired by, and for, the Debtors' owners.

4. Even if the Agreement were rejected, the great bulk of the City's rejection damages would not be subject to any cap. Accordingly, rejection of the Agreement would not permit the Debtors' owners to avoid the application of the absolute priority rule and have sales proceeds skip over the City's compensation for admittedly great harm and instead be devoted to return on owner capital.

5. Under all of the facts and circumstances of these cases, and especially the systemic commission of misconduct and dereliction of duty by Mr. Moyes and his enablers that has destroyed the integrity of the sale process here, the Debtors' attempted use of their extraordinary rejection and "claims cap" powers to benefit owners at the expense of valid creditors would cause inexcusable injustice and is prohibited by the Bankruptcy Code.

6. Even, arguendo, if all or most of the City's claims for damages were to be capped upon rejection of the Agreement, the "capping" of rejection claims would not of course relieve the harm suffered by creditors upon rejection. Rejection of the Agreement would, accordingly, still be improper here and should not be approved.

7. Rejection of the Agreement is sought only in the context of a proposed Section 363 sale free and clear of the City's interests in the assets of these Debtors. As any sale by the Debtors here to PSE would be in bad faith and wrongful, and as those assets cannot be sold free and clear of the City's interests under Section 363 (f), rejection would serve no purpose and should be denied.

8. In any event, as it seeks rejection only if a later "auction" were to produce an acceptable "relocation" bid, and further seeks limitations on claims that have not yet arisen, the Rejection Motion is at best premature and seeks advisory opinions that Federal courts are not constitutionally permitted to render.

FACTUAL BACKGROUND

1. THERE WOULD BE TREMENDOUS HARM CAUSED TO CREDITORS BY REJECTION OF THE AGREEMENT

As this Court has already recognized, if the Agreement is permitted to be rejected, the City will suffer tremendous harm. See Minute Entry/Order Denying the Debtors' Sale Motion entered on June 15, 2009 [Docket No. 341] (the "Order Denying the Sale") at pp. 16-17. In support further thereof, the City incorporates by reference its Supplemental Objection to the Debtors' Sale Motion [Docket No. 281] (the "Supplemental Objection") and filed in support thereof, the Declaration of Arthur Lynch [Docket No. 282] (the

"Lynch Declaration"), the Declaration of Tom Hocking [Docket No. 283] (the "Hocking Declaration"), and the Declaration of Gerald Sheehan [Docket No. 284] (collectively with the Lynch Declaration and the Hocking Declaration, the "Supporting Declarations"). The Debtors have admitted the tremendous harm the City will suffer in the event the Agreement is rejected, and this issue need not be re-litigated.[2]

To summarize briefly, and as further detailed in the Lynch Declaration, the City of Glendale spent $183 million dollars to acquire land for, and then to design, develop, finance and construct, the Arena. The City made this investment, in connection with the development of the Westgate City Center, to provide additional employment opportunities, increase the City's tax base, create a venue for other entertainment and

[2] Here, the magnitude of economic and intangible harm that the City will suffer upon breach of the Team Use Covenant is undisputed. Using the Debtors' own pleadings and numbers, the City's resulting harm would exceed $700 million. See Rejection Motion at ¶¶ 14, 15 and 34. The Debtors attempt to side-step around this harm in their most recent Rejection Memorandum, see ¶ 16, but that is flatly disingenuous and belied by their repeated judicial admissions at the June 9, 2009 hearing ("June 9 Hearing"). During that hearing the Debtors admitted that "If that lease were rejected, all of what Glendale says it would be owed – and I acknowledge the – how compelling their declaration was on this point. Look at all of the hundreds of millions of dollars of damages that we can count on what would happen as a result of the rejection of this lease. I have no qualms with that." Transcript of June 9 Hearing , 192: 3-8. The Debtors further admitted that the City has "declarations in page after page of their brief describing how the economic and cultural and intangible benefits are being mounted upon Glendale and all of its citizens. Again …we don't quibble with that…. [They spent $180 million] on the expectation that there would be returns of multiples of that value in every way possible. Commercial returns, economic returns, cultural returns, reputational returns. Don't quibble with any of it." Id. at 198: 6-22. "There is a huge economic loss. And we don't even have to talk about the psychic losses. Which may be real; I acknowledge they are." Id. at 203: 22-25; 204: 1-3.

The law here is similarly straightforward. "Judicial admissions are formal, deliberate declarations which a party or his attorney makes in a judicial proceeding for the purpose of dispensing with proof of formal matters or of facts about which there is no real dispute." Smith v. Argent Mort. Co., LLC, 2009 U.S. App. LEXIS 10702, *15-17 (10th Cir. May 19, 2009) (*affirming* the district court's refusal to consider explained error in pleadings as a binding judicial admission) (*quoting* U.S. Energy Corp. v. Nukem, Inc., 400 F.3d 822, 833 n.4 (10th Cir. 2005)); see also United States v. Bentson, 947 F.2d 1353, 1356 (9th Cir. 1991) (defense counsel said during his closing statement that defendant had not submitted valid tax returns for the years in question. This was a "straightforward judicial admission, not merely a concession for the sake of argument," and therefore was a "binding concession") (*citing* United States v. Wilmer, 799 F.2d 495, 502 (9th Cir. 1986) (attorney's statement during oral argument constitutes judicial admission), cert. denied, 481 U.S. 1004 (1987)).

The City has, in the months since these admissions were made, relied upon them in not taking discovery on these issues and in not retaining experts to prove up uncontested facts.

sporting events, and stimulate the development of additional properties in the vicinity of the Arena.

To date, its investment has been a success. A recent Economic Impact Study commissioned by the Team conservatively estimated the Arena's impact on the City as 540 new jobs, $199 million in industry output, $38 million "value added" in labor income, property tax income and business taxes, and $1.2 million in sales tax revenue. In addition, the City expanded its jurisdiction by annexing the land in the vicinity of the Arena, which annexation obligated the City, among other things, to extend public services to the annexed area. Moreover, in the past decade, the Glendale/Phoenix area has established itself as a premiere sports community. The Team represents the final cornerstone of the foundation, giving the Glendale/Phoenix area franchises from all four major American professional sports. As such, the Team is a community asset that is a major and unique source of economic return, entertainment, pride and civic spirit which cannot be replaced. If permitted to prematurely relocate, the City would also suffer immeasurable harm to its goodwill, reputation and standing in the tourism, sporting and entertainment communities. Lynch Decl., ¶¶ 6, 8, 14, 17, 26, 29, 30. Clearly, rejection of the Agreement would cause tremendous harm to the City.

Rejection of the Agreement, and relocation of the Team from the City, would also cause great harm to other creditors. For example, ARAMARK has asserted a $5 million liquidated damage loss if the Team were to vacate the Arena. Presumably, hundreds of current employees, season ticket holders and local vendors would also have claims arising from relocation and, on top of those claims, the City would suffer the loss of a valuable employer, source of recreational enjoyment and future business, respectively.

The Debtors have made no showing that anyone other than owner investors would benefit from a relocation of the Team or rejection of the Agreement.

2. THESE CASES WERE FILED IN BAD FAITH TO TRY TO USE THE SECTION 502(b)(6) CLAIMS CAP TO SHIFT SALE PROCEEDS FROM INJURED CREDITORS TO SHAREHOLDERS

At trial on September 10, the evidence will show that these cases were not filed because the Team had no cash to fund operations (it did; the National Hockey League ("NHL") had been funding the Team for more than six months, and still does), and not because a chapter 11 proceeding was needed to effect a sale to pay all creditors in full (as a sale could have been achieved then without any harm to creditors, no proceedings, no administrative accruals and full payment of all valid claims).

Rather, after many months of planning, Mr. Moyes bought into a scheme hatched by James Balsillie and Richard Rodier to buy an NHL team by the admitted "side door" and to try to use the Code's "cap" on certain lease termination claims to shift tens of millions of dollars of sales proceeds away from compensating the City's taxpayers for a portion of the harm that would be occasioned by rejection of the Agreement and directly to Mr. Moyes himself. As of this filing, the proof of such facts would require the disclosure of documents and testimony that Mr. Moyes and the Debtors have requested be kept under seal.[3] When brought to the light of day, those facts will lead to the inescapable conclusion that these cases have been prosecuted in bad faith and for purposes (and, even more strikingly, in a manner) not permitted under the Bankruptcy Code and other applicable law.[4]

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[3] The City's motion to unseal the proof of wrongdoing is pending. The law presumes that bankruptcy cases should be administered in public. "Under §107(b)(2), an interested party must show more than injury to reputation to withhold papers filed in a bankruptcy case from public access. *** Negative publicity to [particular] creditors is regrettable but not a basis for sealing [the record] … injury or potential injury to reputation is not enough to deny public access to court documents." In re Neal, 461 F.3d 1048, 1053-4 (8th Cir. 2006).

[4] For a preliminary recitation of relevant facts, the City incorporates by reference the facts set forth in (i) the City's Reply to Glendale Sale Objections And Summary of Newly Discovered Evidence [Docket No. 556] (the "Reply to Glendale Sale Objections"), (ii) the Complaint filed in the adversary proceeding commenced against Mr. Moyes [See Adv. Proc. No. 2:09-ap-00952-RTBP] (the "Moyes Complaint"), (iii) the City's Application for Issuance of an Order to Show Cause Against Moyes and his Counsel Jennings, Strouss & Salmon, PLC [Docket No. 540] (the "Application for Order to Show Cause"), and (iv) the National Hockey League's (A) Renewed Motion for Determination of (I) Authority to Manage the Business and Affairs of the Debtors, and (II) that William Daly is Representative of the Estates, or (B) in the Alternative, Motion for Appointment of a

ARGUMENT

1. AS A RESULT OF THE DISPROPORTIONATE HARM TO CREDITORS THAT WOULD BE CAUSED BY ANY REJECTION OF THE AGREEMENT, THE TEAM CANNOT SATISFY THE BEST INTERESTS OF CREDITORS TEST UNDER SECTION 365 OF THE BANKRUPTCY CODE

Contrary to the Debtors' assertion, bankruptcy courts, at least in this District, do not rubber-stamp rejection motions. Indeed, courts in the Ninth Circuit carefully scrutinize a debtor's business judgment as to the possible rejection of a contract to ensure that its decision is in the best interests of the unsecured creditors of the bankruptcy estate, and will not result in disproportionate harm to the non-debtor party to the contract. See Agarwal v. Pomona Valley Med. Group (In re Pomona Valley Med. Group), 476 F.3d 665, 670-71 (9th Cir. 2007); In re Chi-Feng Huang, 23 B.R. 798, 801 (B.A.P. 9th Cir. 1982); In re Circle K Corp., Nos. B-90-5052-PHX-GBN – B-90-5075-PHX-GBN, 1991 WL 349900, at *11 (Bankr. D. Ariz. April 5, 1991); In re Turbowind, Inc., 42 B.R. 579, 584 (Bankr. S.D. Cal. 1984); In re Aslan, 65 B.R. 826, 831 (Bankr. C.D. Cal. 1986). Yet here, the Debtors offer no credible business justification to reject the Agreement. The only business justification for rejection of the Agreement is to permit the relocation of the Team to Hamilton, Canada - which relocation would be for the benefit of Mr. Moyes individually, not for the benefit of creditors. In fact, rejection of the Agreement and relocation of the Team would cause tremendous harm to many of the estates' creditors.

What Mr. Moyes and PSE continue to fail to recognize is that "[o]ne of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors." Commodity Futures Trading Com. v. Weintraub, 471 U.S. 343, 355 (1985). "It is true that a debtor in possession owes a fiduciary duty to both creditors and equity holders. ... This does not allow a debtor in possession to favor equity holders

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Trustee filed under seal on August 18, 2009 [Docket No. 682] (the "NHL Renewed Motion") (collectively, the "Moyes Misconduct Pleadings"). The City expects that these pleadings and facts will be supplemented materially at or before trial, as documents only now being produced in response to weeks-old discovery requests continue to reveal additional materially wrongful conduct.

over creditors, however, or to engage in conduct that essentially amounts to concealing assets and self-dealing. To the contrary, the hierarchy of the Bankruptcy Code provides that the interests of creditors are paramount to the interests of the equity holders, and a trustee must act in accordance with this hierarchy." Tenn-Fla Partners v. First Union Nat. Bank of Fla., 229 B.R. 720, 726, 736 (W.D. Tenn. 1999) (citations omitted) (finding the debtor-in-possession violated its fiduciary duty and harmed creditors when it failed to disclose information related to asset valuation and intentionally discouraged purchase offers so that its proposed self-dealing plan would be confirmed, thereby denying creditors the full recovery they would have received). In determining whether a debtor is fulfilling its fiduciary duties, "the interest of creditors is said to be of 'paramount' importance and entitled to deference." See Simantob v.Claims Prosecutor, L.L.C. (In re Lahijani), 325 B.R. 282, 290 (B.A.P. 9th Cir. 2005).

Recognizing this principle, Ninth Circuit courts acknowledge that "it is proper for the court to refuse to authorize rejection of a lease or executory contract where the party whose contract is to be rejected would be damaged disproportionately to any benefit to be derived by the general creditors of the estate . . . ." Huang, 23 B.R. at 801; Pomona Valley, 476 F.3d at 670-71; Turbowind, 42 B.R. at 584; Aslan, 65 B.R. at 831; see also In re Petur U.S.A. Instrument Co., 35 B.R. 561, 563-64 (Bankr. W.D. Wash. 1983) (the court, holding that even though rejection of an executory contract was a proper exercise of the debtor's business judgment, would not authorize rejection due to the tremendous harm to be suffered by the creditor whose contract was to be rejected); In re Midwest Polychem, Ltd., 61 B.R. 559, 562-563 (Bankr. N.D. Ill. 1986) (court balanced equities when assessing debtor's business judgment and disallowed rejection when debtor did not prove that enforcement of covenant not to compete would be a detriment to the debtor's unsecured creditors and rejection could have "mortally wounded" the counterparty). In assessing whether rejection is appropriate, debtors "cannot become the primary beneficiaries of rejection." Huang, 23 B.R. at 803. Thus, in cases where the resulting damages to the non-debtor contract counterparty are shown to be disproportionate, a court

should hold that the debtor's decision to reject an executory contract or lease was not based on sound business judgment and, therefore, the court should deny the debtor's motion to reject. Pomona Valley, 476 F.3d at 670-71.

For example, the Petur court denied a debtor's request to reject an executory contract because the resulting damages to the affected party would be grossly disproportionate to any benefit derived by the general creditors. Petur, 35 B.R. at 563. In that case, the non-debtor contract counterparty had founded its business, and derived all of its income, in reliance on an exclusive license to use, manufacture and sell certain patented technology pursuant to twenty-year license agreement with the debtor-licensor. Id. at 562. The debtor moved to reject the license agreement as an allegedly burdensome executory contract, arguing that by rejecting the agreement it could enter a larger, more profitable market, thereby allowing it to fully satisfy the claims of its creditors. Id. Relying on its equitable powers, the court denied rejection of the agreement because, in balancing the equities, the harm to the affected party's business outweighed the potential recovery to all creditors. Id. at 563.

Likewise, in Midwest Polychem, the court denied a debtor's attempt to reject a contract to rid itself of a covenant not to compete so it could expand its business services. 61 B.R. at 563. The court recognized that expansion of the debtor's services "could very well mortally wound" the non-debtor counterparty to the contract and that rejection would only provide a speculative benefit to the debtor. Id. The court also recognized that damages arising out of rejection would be substantial enough that general unsecured creditors may suffer as a result thereof. Id.

Similarly, the Debtors here offer no evidence of particularized benefits of relocation to the Debtors' general unsecured creditors - only that relocation (and thus rejection) would benefit Mr. Moyes personally. While the PSE bid (if it survives at all, given the misconduct here in which it has participated and the heavy litigation risks it bears on the so-called "NHL issues") may appear to be in some sense the 'highest' bid, it is not the "highest and best bid." The decided cases recognize that not all bids for "more"

dollars are in fact better. See, e.g., In re Bakalis, 220 B.R. 525, 532 (Bankr. E.D.N.Y. 1998) (court stated that "[o]veremphasis on the 'highest' bid overlooks a fundamental truism, i.e., the 'highest' bid is not always the 'highest and best' bid – the inclusion of 'best' in that conjunction is not mere surplusage."); In re Landscape Properties, Inc., 100 B.R. 445 (Bankr. E.D. Ark.1988) (while the recommended purchaser was "obviously not making the highest offer on the property, it may be the better offer"). Thus, courts have authorized the acceptance of the lower of competing bids because the lower bid provides a greater net benefit to creditors. See In re Broadmoor Place Invs., L.P., 994 F.2d 744, 745 (10th Cir.1993) (approving a sale to an alternate bidder that was not recommended by the trustee because it was the better bid). Here, any bids that keep the Team in Glendale (the "Stay Bids") provide a significant benefit to unsecured creditors – a factor strongly militating in favor of such a sale's approval. See In re New Era Resorts, LLC, 238 B.R. 381, 387 (Bankr. E.D. Tenn. 1999) (approving sale when it provided a benefit to creditors). Also, an asset sale that eliminates or mitigates litigation risk (like any Stay Bids do here) adds tremendous value to creditors in the form of certainty and expediency. See In re Nicole Energy Services, Inc., 385 B.R. 201, 215 (Bankr. S.D. Ohio 2008) (sale of assets was in the best interest of creditors because it eliminated the substantial litigation risk faced by the estate).

2. IN LIGHT OF MR. MOYES'S PATTERN OF CONDUCT IN THESE BANKRUPTCY CASES, INSTIGATED AND ABETTED BY THE SOLE RELOCATION BIDDER, FAIRNESS TO CREDITORS DICTATES DISAPPROVAL OF ANY RELOCATION BID AND DISAPPROVAL OF THE REJECTION MOTION

As the evidence will show at trial, the Debtors' Rejection Motion, and these chapter 11 cases more generally, are indelibly stamped with the self-dealing of insiders and equity holders (both current and aspiring) and demonstrate an utter disregard for fairness to creditors.

A. The Debtors Owe a Fiduciary Duty to Creditors That Outweighs Any Interests of Mr. Moyes and Other Owner Affiliates

Chapter 11 debtors in possession are "fiduciaries of their own estate owing a duty of care and loyalty to the estate's creditors." Thompson v. Margen (In re McConville), 110 F.3d 47, 50 (9th Cir. 1997). Thus, Mr. Moyes, as an insider and helmsman of the debtor in possession, is unquestionably a fiduciary to all creditors. See Holta v. Zerbetz (In re Anchorage Nautical Tours, Inc.), 145 B.R. 637, 643 (B.A.P. 9th Cir. 1992); Collins v. Kohlbert & Co. (In re Southwest Supermarkets, LLC), 325 B.R. 417, 423 (Bankr. D. Ariz. 2005).

Mr. Moyes's fiduciary duties prohibit him from managing the bankruptcy process to his own self interest; rather, he must administer the estate in trust for the benefit of creditors. See Anchorage, 145 B.R. at 643 (*citing* In re Woodson, 839 F.2d 610, 614 (9th Cir.1988)). Further, Mr. Moyes must be mindful not to destroy or devalue the assets of the estates. See In re Rigden, 795 F.2d 727, 730 (9th Cir. 1986).

As described in the Moyes Misconduct Pleadings, Mr. Moyes cannot be allowed to be the individual decision-maker and to enter into a relocation sale triggering a rejection of the Agreement that would materially injure creditors. See Slater v. Smith (In re Albion Disposal, Inc.), 152 B.R. 794, 822-23 (Bankr. W.D.N.Y. 1993). That is especially so where Mr. Moyes and the only relocation bidder have (unfortunately, successfully) conspired to harm the Team's value in place to improve the chances it would be moved.

Bankruptcy courts have, in other situations of insider and bidder misconduct, called a halt to the infected process. For example, in the Embrace Systems case, a bidder's offer was found unfair and the sale was not in the estate's best interests because the sale had been arranged by the debtor's president, who had a financial interest in the bidder. See In re Embrace Systems Corp., 178 B.R. 112, 123 (Bankr. W.D. Mich.1995). Moreover, the court in Embrace Systems appointed a independent disinterested person as trustee after it made an explicit finding of good faith lacking on the part of both the debtor's president and prospective purchaser. Id. at 128-29. The court found the debtor's president had an

adverse interest and should "not be permitted to continue to exercise the Debtor's fiduciary obligations." Id. at 129. Like the debtor's president in Embrace Systems, Mr. Moyes's bad faith support of a sale that would require rejection of the Agreement that would be harmful to the creditor body violates his fiduciary duty to creditors. See also Tenn-Fla Partners, 229 B.R. at 736 (holding that while a debtor in possession owes a fiduciary duty to both creditors and equity holders, it cannot favor equity holders over creditors or engage in conduct that essentially amounts to concealing assets and self-dealing).

B. Rejection of the Agreement in the Context of a Sale Process That Lacks Integrity Cannot Be Approved

Mr. Moyes's fiduciary position, and his serial appointments of his personal lawyers to be the chief executives of these businesses, immediately gives cause for close scrutiny of the Debtors' decision-making. See In re KDI Holdings, Inc., 277 B.R. 493, 511 (Bankr. S.D.N.Y. 1999) (controlling equity holders of the debtors having a sufficiently close relationship with the debtor were subject to closer scrutiny than those dealing at arms length with the debtor). "The federal courts have long been concerned with the integrity of the bankruptcy sale process." C&J Clark America, Inc. v. Carol Ruth, Inc. (In re Wingspread Corp.), 92 B.R. 87, 92-93 (Bankr. S.D.N.Y. 1988). As a result, courts must be "[m]indful of the need to engender stability and integrity of the sale process." Id.; see Wine Group v. Diamante (In re Hat), 310 B.R. 752, 758-759 (Bankr. E.D. Cal. 2004) (ordering a new sale process where collusion between named purchaser and two potential bidders chilled the bidding process).

For example, in Hat, the ex-debtor in possession, a collusive bidder and a party holding a right of first refusal colluded to chill the sale process of a winery and "ice-out" another serious bidder. 310 B.R. at 756. The three colluding parties orchestrated a plan where the ex-debtor in possession and collusive bidder would buy the winery from the party exercising her rights of first refusal for a commission. Id. The Hat court found the bidding was impermissibly chilled by the collusion and dictated that a new sale be

conducted, noting that the collusion directly and negatively affected the "integrity of the sale" and the "preservation of the best interests of the estate." Id. at 758. In its decision, the court highlighted the remedies set forth in section 363(n) of the Bankruptcy Code with respect to policing collusive sales and punitive damages in favor of the estate. Id. at 761.

Mr. Moyes "cannot by the use of the corporate device avail himself of privileges normally permitted outsiders in a race of creditors. He cannot utilize his inside information and his strategic position for his own preferment. . . .Where there is a violation of those principals, equity will undo the wrong or intervene to prevent its consummation." Pepper v. Litton, 308 U.S. 295, 311 (1939). Here, Mr. Moyes caused the Debtors to file for bankruptcy for his own personal benefit, and has conferred upon himself, and PSE, unfair advantages in this sale process. As a result, Mr. Moyes has harmed the Debtors and their creditors through his self dealing, as detailed in the Moyes Misconduct Pleadings and evidence to be introduced at trial.

Therefore, the utter lack of integrity of the sale process here, caused solely by the actions of Mr. Moyes and PSE, should foreclose any relocation sale and, in turn, any rejection of the Agreement in the context of the present process.

3. REJECTION WOULD NOT NEGATE THE CITY'S RIGHT TO SPECIFIC PERFORMANCE

A. The City Does Not Have An Adequate Remedy At Law

As recognized by the Debtors, the City is entitled to specific performance if, as is the case here, it has no adequate remedy at law. The Debtors accordingly try to persuade this Court that an adequate remedy at law exists because the Agreement contains a liquidated damages provision, setting forth a formula for its calculation, and therefore urges this Court to conclude that the City's damages can be easily quantified with reasonable certainty and satisfied by money damages alone. The Debtors are just plain wrong.

As set out to some extent in its Supplemental Objection (and the City respectfully incorporates the arguments and points of authority contained therein at pages 23-31 in

support of this Reply), the mere presence of a liquidated damages provision in an underlying contract does not preclude a creditor's right to injunctive relief. In re Oseen, 133 B.R. 527, 531 (Bankr. D. Idaho. 1991); Phoenix Orthopaedic Surgeons v. Peairs, 164 Ariz. 54, 59 (Ariz. App. 1989), *disapproved on other grounds by* Valley Med. Specialists v. Farber, 194 Ariz. 363 (Ariz. 1999). As stated by the Arizona Court of Appeals:

> A contract provision for payment of a sum of money as damages may not afford an adequate remedy even though it is valid as one for liquidated damages and not a penalty. Merely by providing for liquidated damages, the parties are not taken to have fixed a price to be paid for the privilege not to perform. The same uncertainty as to the loss caused that argues for the enforceability of the provision may also argue for the inadequacy of the remedy that it provides. Such a provision does not, therefore, preclude the granting of specific performance or an injunction if that relief would otherwise be granted.

Peairs, 164 Ariz. at 59 (*quoting* The Restatement (Second) of Contracts § 361, Comment a (1982)).

Despite having already acknowledged that the damage to the City includes non-economic damages in addition to the great financial harm to taxpayers, which non-economic damages are by their very nature impossible to quantify with any certainty, the Debtors selectively quote from the liquidated damages provision of the Agreement to try to suggest that the parties have agreed to an express quantification of damages. The Debtors, in their zealous advocacy, however, exclude from their quotations the parties' express agreement that the liquidated damages calculation was merely an "**attempt** to compensate the City for its loss (which the City and the Team acknowledge **cannot** be fully compensated for by the payment of damages, including liquidated damages) that will result from a Team Use Covenant Default." See Agreement, § 14.7.2 (emphasis added).

In light of the unique and incalculable harm resulting from the complex nature of the relationships between the City and the Team, the Debtors' continued reliance on simple commercial landlord/tenant cases is misplaced. As explained in detail in Section III.C. below, the Agreement is not a traditional landlord/tenant lease. Accordingly, as discussed in the Supplemental Objection, the In re Pittsburgh Sports Assoc. Holding Co.,

1999 Bankr. LEXIS *1870 (W.D. Pa. 1999) ("Penguins I") decision remains the most apt analogy here.[5] The Debtors' attempt to factually distinguish Penguins I by citing to bad faith actions of the Penguins owner in disregard of the team's contractual obligations. In fact, the Penguins case and these cases unfortunately share that characteristic as well. As described more fully in the Moyes Misconduct Pleadings, this case is replete with bad faith on the part of this Team's owner, most notably the commencement of these cases to secure a personal financial gain for owners by causing admitted harm to creditors.

Further, the Debtors' assertion that, because the liquidated damages provision in Penguins I was only $15.5 million, as compared to the $794 million of stipulated harm here, the City somehow has a 'more' adequate remedy at law, is illogical at best. The dollar amount which parties to two separate contracts negotiated and agreed to set for liquidated damages is entirely fact-specific and, frankly, meaningless. Moreover, it is insincere for the Debtors to claim in one breath that the City has an adequate remedy at law because it is theoretically entitled to such a large award of monetary damages, and then claim in the next breath that these very same damages should be capped at no more than $7 million under section 502(b)(6) of the Bankruptcy Code. Assuming, *arguendo,* that the Debtors succeed in capping the City's claim at $7 million, or less than 1% of its liquidated damages, then, the Debtors' own logic leads inescapably to the conclusion that the City does not have an adequate remedy at law and is entitled to specific performance.

B. The City's Right to Specific Performance Is Not a Dischargeable "Claim" Negated by Rejection

As noted by this Court in its Order Denying the Sale, the case law regarding the extent to which specific performance claims can survive rejection is mixed. The Debtors rely almost exclusively on the case of In re Ward, 194 B.R. 703 (D. Mass. 1996), to support their assertion that the City's right to specific performance is a claim under section 101(5)(B) of the Bankruptcy Code. This reliance, however, is misplaced for two

[5] While the Debtors continue to urge reliance instead on Penguins II, they fail to address the fact that the Penguins II decision was vacated and, in any event, the language they suggest as relevant here was merely dicta.

reasons. First, Ward is in the minority and contradicted by precedent in other circuits. Second, Ward is clearly distinguishable from the case at hand.

In Ward, a franchise agreement provided that, upon a violation of the covenant not to compete, the franchisor had the right to injunctive relief in addition to any other remedies to which he was entitled. 194 B.R. at 706. The court determined that, since the breach of the covenant not to compete gave rise to a right to the payment of damages as well as the right to injunctive relief, money damages were an alternative to the equitable remedy and thereby fit the definition of a "claim" under §101(5)(B). Id. at 712 ("[Debtor's counterparty] therefore has the right to obtain either [compensatory lost profits] damages . . . or an injunction . . . As an alternative remedy, this right to payment permits a dollar sign to be placed on the equitable remedy, as is done with other claims."). Similarly, in In re Kilpatrick, 160 B.R. 560, 567 (Bankr. E.D. Mich. 1993), also relied on by the Debtors, the Court found it dispositive that the beneficiary of the covenant not to compete had the right to **elect** to receive either damages or an injunction.

Here, however, the Agreement expressly states that the City's right to specific performance is the City's sole and exclusive remedy with respect to any breach of the Team Use Covenant. See Agreement, § 14.7. The City is not entitled to any compensatory, consequential or punitive damages, nor does it have the right to elect a monetary remedy. Id. The City is entitled to liquidated damages "only in the event that the [specific performance remedy] is not available to the City and (ii) if the City seeks, but fails to obtain [specific performance]." Accordingly, pursuant to the plain language of the Agreement, the City has no election of remedies and therefore its right to specific performance is not a claim even under the minority line of cases led by Ward.

In addition to the inapplicability of Ward to the instant facts, the holding does not comport with the holdings of bankruptcy courts in the Ninth Circuit and other jurisdictions,[6] precedent the Debtors simply ignore. For example, in Oseen, the court was

[6] For a discussion of cases in other jurisdictions, the City hereby incorporates by reference the arguments and authorities set forth in Glendale's Supplemental Objection, p. 24-25.

faced with a claim for injunctive relief in which the contract also contained a liquidated damages provision. 133 B.R. at 528. The court held that the presence of the liquidated damages provision signaled that the parties anticipated the obvious difficulty of calculating any actual damages associated with a breach of the noncompetition provision and held that, where the defendant met the state law standard for injunctive relief, the right to the injunction was not a claim dischargeable in bankruptcy. Id. at 531. Similarly, in the case of In re Brown, the court held that where the state law standard for injunctive relief was met (that is, there was no adequate remedy at law), a right to injunctive relief "cannot be said to give rise to payment." 237 B.R. 740, 745 (Bankr. C.D. Cal. 1999). In addition, the Brown court specifically rejected the implication in Ward that courts should ignore concerns regarding a debtor's improper use of bankruptcy law to escape the consequences of his or her wrongdoing in deciding whether or not to discharge a claim.

Further, while the Debtors would like to minimize its applicability, they cannot deny that Penguins I is a decision directly on point. There, the court interpreted a liquidated damages provision virtually identical to the one in the Agreement here and held that the city of Pittsburgh's ability to seek monetary damages was not an alternative to seeking equitable relief because, under the applicable agreement, Pittsburgh had the right to liquidated damages for breach of the covenant **only** in the event that injunctive relief was not available and further that the City did not have an adequate remedy at law. 1999 Bankr. LEXIS 1870 at *20-21, 29-31. It would be odd, in the least, if the same hockey arena use agreement, under attack in similar proceedings (not coincidentally, both involving the same "relocation bidder" trying to buy the NHL team over the strenuous objections of the NHL and the City), produced opposite results on the most important issue in the case.[7]

[7] The Debtors also attempt to distinguish Penguins I by trying to undermine the case law upon which the Penguins I court relied. First, In re Torwico Elecs., 8 F.3d 146 (3d Cir. 1993) remains good law for the proposition that where a party has no right to payment, but only a right to equitable relief, such right to equitable relief is not a dischargeable claim in bankruptcy. Moreover, In re Continental Airlines, 125 F.3d 120 (3d Cir. 1997) does not depart from the reasoning of Torwico, but in applying it to the specific facts of that case finds that the right to seniority integration was a vehicle to provide compensation

C. The City's Specific Performance Covenant is Not An Unenforceable Waiver

Contrary to the Debtors' assertion, the City's right to specific performance is not some sort of prepetition "waiver" of the benefits of bankruptcy, nor does it violate public policy considerations. See Supplemental Objection, p. 24, n. 10. As stated by this Court in its Order Denying the Sale, the obligation in the Agreement for the Team to play all of its home games in Glendale cannot be excised from the "contract because it violates some portion of 365 [anti-assignment or other term]," and the very same reasoning applies to the provision granting the City a right to specific performance for violation of the Team Use Covenant.

The Debtors' reliance on In re TWA, 261 B.R. 103 (Bankr. D. Del. 2001), is no better. Contrary to the Agreement here, the agreement at issue in TWA contained a provision whereby the debtor expressly waived its right to seek rejection of the agreement in the event it later filed for bankruptcy. Id. at 108. That, obviously, was an attempted waiver. As soon as TWA filed its chapter 11 petition, the creditor sought to have TWA assume its agreement and to oppose any attempts to reject the agreement based on this express waiver. Id. at 108-109. Here, the City does not assert that the Team has waived its right to seek rejection of the Agreement; rather, it submits that the Team has failed to satisfy the conditions of section 365 of the Bankruptcy Code and, alternatively, that the Team's right to specific performance of the Team Use Covenant is a right that survives rejection. TWA is simply inapplicable to this Court's rejection analysis.

4. IF THE AGREEMENT WERE REJECTED, THE GREAT BULK OF THE CITY'S REJECTION DAMAGES WOULD NOT BE SUBJECT TO ANY CAP

Contrary to the Debtors' overly simplistic characterization, while the Agreement is an executory contract, the Agreement is not entirely a lease. The Agreement is a complex agreement consisting of three primary components: (i) provisions relating to the

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to covered employees and therefore there was in fact a viable monetary alternative to the equitable remedy. Here, however, as discussed above, the City has no right to payment, and no one could seriously suggest here that the City has a viable alternative to its right to specific performance.

management of the Arena on a year-round basis by Arena Management, (ii) a covenant requiring the Team to play its games only at the Arena, and (iii) provisions relating to the Team's lease of specific rooms and parking spaces located at the Arena. Notably, the Agreement does not include any lease provisions which relate to the Arena as a whole. Rather, and as described in greater detail below, the lease provisions set forth in the Agreement relate only to a physically small portion of the Arena and represent, economically, only a minor aspect of the Agreement. The Debtors' characterization, for present litigation purposes, of the Agreement as only a "lease" is wholly inconsistent with both the plain language and economic substance of the Agreement when carefully examined. As shown herein, each of the three components of the Agreement have stand-alone significance and their own respective damage components in the event of rejection.

A. Management Component[8]

Pursuant to the Agreement, the Arena Manager is engaged by the City and the Team to be the sole and exclusive manager of the Arena. Under certain circumstances, the City could replace the manager of the Arena. Agreement, § 14.11. The manager of the Arena is charged "with the responsibility for the operation, direction, management and supervision of the Arena and its staff . . . ." Agreement, § 4.1. Those responsibilities are not limited to hockey games or to the hockey season - but to all types of events at the Arena on a year-round basis. See, e.g., Agreement, § 5.16 (City Sponsored Events); § 5.17 (Community Events). In return for its services, the Arena Manager is entitled to receive a management fee equal to a fixed fee plus a percentage of operating revenues. Agreement, §§ 1.1 and 7.2. The Arena Manager pays all expenses relating to the operation of the Arena from operating revenues that it generates and collects or, to the extent there is a deficiency, monies required to be funded by the Team. Agreement, §§ 7.2 and 7.4. Thus, one important part of the Agreement is a fairly customary

[8] The provisions of the Agreement relating to Arena Management's provision of management services to the City are collectively referred to hereinafter as the "Management Component."

management agreement.

B. Mandatory Use Covenant[9]

Pursuant to the Agreement, the Team has the right, and indeed the obligation, to use the Arena to play all of home games and any all-star games for 30 hockey seasons and to conduct four hockey related events per year. Agreement, §§ 9.1 and 9.5. The requirement that the Team play its games in the Arena, and the right to do so, is separate and distinct from the Team's lease of Team Exclusive Spaces (described below). Agreement, § 9.1.

The Mandatory Use Covenant is the most critical provision of the Agreement. The City's decision to spend more than $180 million to build the Arena, and to devote countless other funds and resources to build the surrounding retail community, was premised solely on this Covenant. As discussed below, the rental income for the Team Exclusive Spaces is minimal. The City's benefits from being the home of an NHL franchise, however, are not, as this Covenant essentially ensures that hundreds of thousands of good, paying customers flow through the Westgate Center's many restaurants, shops and other establishments. In other words, the primary economic terms of the Agreement relate to the dollars generated outside the Arena, and not to the relatively minor amounts of rent payable by the Team for the use of Arena space.

Thus, in order for the City to recoup its monetary investment in the Arena and to capitalize on the good will that the Team brings to the City, the City required the Team to play 30 hockey seasons at the Arena. As expressly set forth in the Agreement, and as the Team acknowledged in executing the Agreement, no amount of money damages could adequately compensate the City for the loss of its NHL hockey team, and the parties agreed to specific performance to remedy any breach of the Mandatory Use Covenant (and not, of course, the "lease" provisions). Agreement, § 14.7.1.

[9] The provisions of the Agreement relating to the Team's right and obligation to use the Arena and the City's related right to specific performance are collectively referred to hereinafter as the "Mandatory Use Covenant."

C. Lease Component[10]

Pursuant to the Agreement, the City also leases to Coyotes Hockey the "Exclusive Team Spaces," which are comprised exclusively of: (i) the Team Box Office, (ii) the Team Locker Room, (iii) the Team Office and Storage Space, (iv) the Team Retail Stores, and (v) the Team Parking Spaces. Agreement, § 9.2. This is the only provision in the Agreement that is, or uses the term, "lease."

D. The Agreement's Lease Provisions Are Not a Predominant Part of the Agreement

In the context of a 660,000 square foot facility, the Exclusive Team Spaces, consisting of only approximately 50,000 square feet, represent a very small portion of the Arena (less than 8%). The Team's lease of the Exclusive Team Spaces has no effect whatsoever on its ability to perform the Mandatory Use Covenant or on Arena Management's performance of its management services (for example, rather than use the office space at the Arena, the Team has for the last few years leased new office space from an entity owned by Mr. Moyes.). Additionally, the Arena Manager can still operate its business as manager of the Arena whether or not the Team leases the Exclusive Team Spaces.

Financially, the lease of the Exclusive Team Spaces is a very small part of the consideration to which the City is entitled under the Agreement. As discussed in greater detail in the Rejection Memorandum, both the "Base Team Fee" and the "Additional Team Fee" could be characterized as rent owed by the Team for the Exclusive Team Spaces because they compensate the City for the lease of those spaces. Agreement, § 9.3.1. These payments pale in comparison to the consideration paid to the Team under the Agreement and the investments made by the City in reliance on the Mandatory Use Covenant - most notably its agreement to build a state of the art hockey facility. Even on a gross (non-discounted) basis, the total Base Team Fee and Additional Team Fees over

[10] The provisions of the Agreement relating to the Team's lease of the Exclusive Team Spaces are collectively referred to hereinafter as the "Lease Component."

the course of the entire 30 year contract term equals $36,075,660, an amount equal to less than 5% of the cost of the Arena.

These "lease" payments are dwarfed by the City's reasonable expectation of other income streams arising from the Agreement, such as parking fees (Agreement, § 8.1.2) and the tax revenues generated over the life of the Agreement (again, primarily having nothing to do with the actual use of the Arena, but from sales at the adjoining Westgate City Center). Under the Agreement, the City ensured that it had the right to specifically enforce the Mandatory Use Covenant and the parties acknowledged that the damages the City would suffer following a breach of the Mandatory Use Covenant are "incapable of estimation due, to a substantial extent, to the adverse consequences [such breach] will have on development of properties in the vicinity of the Arena" and that an award of damages "will not be an adequate remedy." Agreement, §§ 9.5 and 14.7.1. These critical agreements and acknowledgements do not relate to any other components of the Agreement. Moreover, the liquidated damages clause in the Agreement, which is available only if the City is not able to obtain specific performance (such as a result of a "lock-out" that occurred during the 2003-2004 season), calculates the City's damages based primarily on lost tax revenues; it does not include the Base Team Fee or the Additional Team Fees in the calculation. Agreement, § 14.7.2 and Exhibit A. No amount of "rent," then, would begin to compensate the City for a breach of the Mandatory Use Covenant.

If this Court approves a rejection of the Agreement, the Debtors will have breached the Agreement, triggering distinct damages and remedies arising under each of the three components of the Agreement. See 11 U.S.C. § 365(g). First, under the Mandatory Use Covenant, the City's damages are not quantifiable and, as a result, the sole and exclusive remedy of the City is specific performance; and if the City is unable to obtain specific performance, the City's liquidated damages claim would be $697,502,176 (collectively, the "Use Damages"). See Rejection Memorandum at ¶14-15; Agreement, § 14.7.2 and Exhibit A. Second, under the Management Component, the City would be entitled to

damages in an undetermined amount arising as a result of the loss of its manager for the Arena ("Management Damages"). See Agreement § 14.11. Finally, under the Lease Component, the City would suffer loss of rental payments aggregating approximately $21.5 million—a number that is almost trivial compared to the Use Damages. See Agreement, § 9.3; Lynch Decl., ¶ 13. ("Lease Damages").

E. As a Matter of State Law, Not All Parts of the Agreement Constitute a "Lease"

As acknowledged by the Debtors, bankruptcy courts look to state law to determine whether a contract constitutes a "lease." See Joy Enters. v. Reppel, 537 P.2d 591, 595 (Ariz. 1975) (a lease describes "the property to be leased, [gives] a definite agreed term, a definite and agreed price of rental and [includes] the time and manner of payment."). Under Arizona law (which governs the Agreement pursuant to § 19.7), the Agreement is not a lease.

Arizona law recognizes the difference between a license and a lease. "A license is an authority or permission to do a particular act or series of acts upon the land of another without possessing any interest or estate in such land. A license is merely a permit or privilege to do what otherwise would be unlawful, while a lease gives the right of possession of the property leased and exclusive use or occupation of it for all purposes not prohibited by its terms." Tanner Companies v. Arizona State Land Dept.,142 Ariz. 183, 193, 688 P.2d 1075, 1085 (Ariz. App. 1984).

Under Arizona law, the most important and most valuable part of the Agreement, the Mandatory Use Covenant, is a contractual promise coupled with a license, and not a lease. Wenner v. Dayton-Hudson Corp., 598 P.2d 1022, 1023-26 (Ariz. App. 1979) (finding the agreement between a department store and a retailer did not rise to the level of a lease, but was a license, because, among other things, (i) termination due to a breach created liability "only for accrued debts and contract damages, not for lost rent as it would be if the agreement was a lease", (ii) the licensee-retailer was granted non-exclusive access to the licensor's department store and could only conduct business at specified

times, and (iii) in exchange for furnishing certain services, the retailer paid the licensor department store a percentage of gross receipts with minimum monthly payment). The Agreement expressly provides that the Team must (and the right to) "use" the Arena (other than the Team Exclusive Spaces) to play all home games and all-star games and to conduct four hockey related events per year. Agreement, § 9.1. As in Wenner, the Team does not have exclusive use or occupation of the Arena "for all purposes" but only on a limited number of days, for a limited period of time on such days, and for a very limited purpose. Agreement, § 9.1. In fact, the Arena is used throughout the year for a number of different events, such as concerts and community events. During these times, the Team has no right to use or occupy the Arena (except for the limited purpose of accessing the Team Exclusive Spaces). Agreement, § 9.2. And, certainly, the Team's promise to not play elsewhere is not a lease, by any definition.

Under Arizona law, the second most important and valuable part of the Agreement, the Management Component, is a contract for services, not a lease. Under the Agreement, the Arena Manager is charged, and compensated for, its services as manager and operator of the Arena. While the Arena Manager is authorized to conduct its business in the Arena, it is not given any "lease" rights to any portion of the Arena. The reward for performance of the Management Component is a sharing in the profits and losses generated from the services provided thereunder. See In re SCCC Associates II Ltd. Partnership, 158 B.R. 1004, 1011 (Bankr. N.D. Cal. 1993) (looking to the economic substance of an agreement to discern whether it was lease, and citing the sharing in profit and loss as evidence against the agreement being a lease). Further, under certain circumstances, the Arena Manager may be replaced and relieved of its rights and obligations under the Agreement. Agreement, § 14.11.

It is incumbent upon this Court to interpret the meaning of the words of the Agreement "in light of the intention of the parties as shown by the whole writing, and not to isolate the words and give them a meaning foreign to such intention." Chu v. Ronstadt, 498 P.2d 560, 563-64 (Ariz. App. 1972) (viewing the negotiated documentation as a

whole, and not focusing only on the isolated words cited by the proponent, the court concluded that a lease contract did not result from such documentation). The Agreement was heavily negotiated by sophisticated parties that were represented by capable counsel. Had the parties intended that the Team be granted lease rights in the Arena as a whole they would have expressly indicated so in the Agreement. When the parties intended to provide for a lease (as they did only for the Team Exclusive Spaces) they used the word "lease" and detailed the rights and obligations that actually comprise a lease under state law. Agreement, §§ 9.2 and 9.3. When the parties intended to provide for a license, some other promise or a contract for management services, they used the appropriate language as described above.

F. Case Law Recognizes That Rejection of an Agreement Comprised of Lease Provisions and Other Provisions, While Perhaps Executory, Gives Rise to Some Rejection Damages That are Potentially Capped, *and Some That Are Not*

With this more fulsome and accurate reading of the Agreement, it is clear that the parties intended certain sections of the Agreement would give rise to specific remedies for breaches of specific parts of the Agreement. Furthermore, and most importantly, although a rejection under section 365 of the Bankruptcy Code would constitute a breach of each section of the Agreement, only the Lease Damages (as described above) would be arguably subject to the statutory cap of section 502(b)(6).

There is, admittedly, limited case law addressing facts such as these. However, what case law there is squarely supports the City here. For example, in In re Leslie Fay Companies, Inc., 166 B.R. 802 (Bankr. S.D.N.Y. 1994), the late Judge Tina Brozman dealt thoughtfully and extensively with the damages arising from a debtor's rejection of a single agreement containing both a real estate lease and an option to purchase the subject real estate. Judge Brozman held that the portion of the rejection damages corresponding to the loss of future unpaid rent were subject to the section 502(b)(6) cap. However, Judge Brozman also found that the termination of the purchase option gave rise to an independent rejection claim separate and distinct from the capped lease damages. Id. at

810. Pressed by the debtor there to include the damages arising from rejection of the purchase option within the capped amount, the Judge explained that such a result would be inconsistent with the statutory language and Congress's purpose for adopting a cap on "lease" damages. Judge Brozman explained:

> This provision, which is grounded in principles of ratable distribution, balances the interests of landlords against those of other creditors by preventing landlords from receiving a windfall as a result of the filing of the bankruptcy petition. . . . Assuming without deciding that Leslie Fay is able to reject the land sales contract, it follows that damages arising from a breach of the exercised purchase option would not be capped by section 502(b)(6) of the Bankruptcy Code. . . . The conclusion is inescapable that 502(b)(6) does not cap damages from the termination of a sale of real property notwithstanding the contract arose from the exercise of an option contained in a lease.

Id. at 809-810 (citations omitted).

Judge Brozman's careful reasoning here is important and based on solid footing. She found that imposing a cap on damages comprised of future rental payments avoids a windfall in favor of the landlord, as Congress has decided in its wisdom that landlords should be able to mitigate such damages by re-letting the subject property. Other damages, even though resulting from rejection of other aspects of a single contract containing a lease, and – most critically here - even though such damages would arise from a "termination" of the "lease" (as those terms are used in section 502(b)(6)), the damages to a "landlord" resulting from the **non-lease** provisions of the contract in question would **not** be subject to the type of mitigation that Congress assumed, and so do not fall within the statutory cap. Id.

Thus, the damages for breach of the Mandatory Use Covenant and the Management Provisions cannot be subject to the limiting formula of section 502(b)(6) because these damages do not arise by virtue of, nor are they related to, the termination of a "lease." Those damages arise from the breach of the other components of the Agreement, and there is no cap on such damages under any section of the Bankruptcy Code.

5. HERE, USE OF THE BANKRUPTCY CODE'S EXTRAORDINARY "REJECTION" AND "CLAIMS CAP" POWERS TO BENEFIT SHAREHOLDERS AT THE EXPENSE OF LEGITIMATE CREDITORS WOULD BE ABUSIVE, IN BAD FAITH AND NOT CONDONED BY THE BANKRUPTCY CODE

In recent years, there have been a number of decided cases dealing with the difficult issues arising in cases where debtors seek to use the extraordinary powers granted by the Bankruptcy Code to avoid contractual obligations or limit damage claims, and whether courts should permit the exercise of such powers at the expense of creditors for the sole or primary benefit of shareholders. Many well reasoned decisions prohibit the use of such powers in such circumstances. See, e.g., Dunes Hotel Assocs. vs. Hyatt Corp., 245 B.R. 492, 507-8 (D.S.C. 2000) (and the many cases cited therein). Some other decisions refuse to limit the exercise of such avoidance and other extraordinary powers, even where exercised to benefit shareholders. See, e.g., In re Sylmar Plaza, L.P., 314 F.3d 1070 (9th Cir. 2002).

At first reading, it is in some respects difficult to reconcile those cases. At a closer read, however, all of the decisions gravitate to a single theme. Reduced to their essence, these decisions fall into three very discernable groupings:

- Several decisions, including at the circuit level, deny a debtor's use of rejection, claims cap or other extraordinary powers when the effect of doing so would primarily benefit shareholders;
- A second group of decisions permits a debtor's use of these extraordinary powers, even for the benefit of shareholders, if and only if necessary to prevent a windfall to the objecting creditors; and
- The final group prohibits the use of such extraordinary powers to benefit shareholders regardless of whether the result might be a creditor windfall.

For example, in In re Chameleon Systems, Inc., the Court permitted a solvent debtor to use chapter 11 to reject its only lease, and to cap the lease rejection damages, if by refusing to do so the landlord would "receive a windfall" if it were able to re-let the subject property within the next thirty months. "As a result of these unusual facts," and appreciating that it was faced with a "Hobson's choice," with dismissal of the case requiring the debtor to remain in existence simply to pay rent, the Court permitted

rejection to preclude the likelihood of landlord windfall. 306 B.R. 666, 670 (Bankr. N.D. Cal. 2004).

Likewise, in Sylmar Plaza, supra, the Ninth Circuit refused to adopt a per se rule prohibiting the imposition of a rejection claims cap where the primary beneficiary of such cap would be the debtor's owners. Instead, dictating that the analysis must be on a case-by-case basis taking into account the facts and particular features of each case, the Court distinguished prior decisions by emphasizing that the only complaining creditor in the case before it was unimpaired. Accordingly, as the use of the rejection and claims cap powers by the Sylmar Plaza debtor would merely prevent the award of a windfall to an unimpaired creditor, and have no affect on any other creditor, the Court affirmed the holding below permitting rejection. 314 F.3d 1070, 1075.

However, in those many cases where rejection and the imposition of a claims cap would not prevent a windfall to an undeserving creditor, but impair the rights of creditors for the benefit of owners, all or the great majority of the decided cases come down squarely against a debtor's ability to use its extraordinary rejection and claims cap powers. For example, in In re Integrated Telecom Express, Inc., the United States Court of Appeals for the Third Circuit gave exhaustive study to the previously decided cases, and held that dismissal of the cases was a more just result than permitting rejection of a lease and the capping of rejection damages to benefit owners. 384 F.3d 108 (3d Cir. 2004). The Court's opinion rings true here, given the facts that will be proven at trial:

> To be filed in good faith, a petition must do more than merely invoke some distributional mechanism in the Bankruptcy Code. . . . See [citations omitted] for the proposition that 'an almost axiomatic principle of business law is that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse – up to the full amount of their investment.'
>
> * * *
>
> Taken to its logical conclusion the [debtor's] argument is that any entity willing to undergo Chapter 11 proceedings may cap the claims of its landlord. Nothing in the Bankruptcy Code or its legislative history suggests that § 502(b)(6) was meant to allow tenants to avoid their leases whenever the landlord's state law remedy exceeds the cap under § 502(b)(6) by an amount greater than the cost of proceeding through a Chapter 11

> reorganization or liquidation. Such a rule would not only obviate the need for a good faith requirement, but would be antithetical to the structure and purposes of the Bankruptcy Code.

Id. at 129.

Similarly, the United States Bankruptcy Court for the Northern District of California found that the debtor's attempt to use its rejection and claims cap powers was in bad faith, and dismissed the case, in In re Liberate Techs., 314 B.R. 206 (Bankr. N.D. Cal. 2004). Again, the critical analysis was whether these extraordinary powers would be properly deployed to prevent a creditor windfall, or merely to line the pockets of its owners at the expense of creditors suffering legitimate losses:

> The legislative history states that the purpose of the section is to protect creditors where landlords' claims for future rent would reduce payment to other unsecured creditors. . . . States differently, limiting claims for future rent is not an independent objective of the Bankruptcy Code.

Id. at 215. Consistently with the other reported decisions, the Court stressed the inequity of the debtor's stated goal: "Debtor seeks to impose real hardships on its creditors. Most notably, it seeks to reduce the amount owed [the landlord] from the $45 million due under state law to the $8 million due under 502(b)(6) of the Bankruptcy Code." Id.; accord Dunes Hotel, 245 B.R. at 507-508 (and cases cited and discussed therein).

On the facts here, the application of these many decisions could not be more clear. The Debtors filed these cases to attempt to shift sale proceeds from holders of legitimate claims, and counterparties would suffer great and irreparable harm if the Debtors' scheme were condoned. The use of these extraordinary powers for the benefit of Mr. Moyes and those who conspired with him to concoct the present scheme would be at the great expense and cause harm to those same creditors that Mr. Moyes would not compensate before reaping additional tens of millions of dollars in sales proceeds himself. None of the decided cases would permit this result, and this type of inequitable scheme should not be first approved here.

In the hundreds or even thousands of pages filed in these cases, no one has even dared suggest that there is any danger that the City may reap a "windfall." Just the

opposite is true: Mr. Moyes acknowledges the great harm to the City that would be caused by his actions. Here, then, we have the ANTI-WINDFALL case if there ever were one, and no law condones what these owners would have this Court bless.

6. THE AMOUNT OF ALLOWABLE CLAIMS IS NOT DETERMINATIVE OF THE HARM TO CREDITORS CAUSED BY REJECTION

Despite the Debtors' lengthy attempt to force the entirety of a multi-faceted agreement (with a minor lease component) into the confines of section 502(b)(6), whether or not the City's rejection claim is capped or not capped is irrelevant to the Court's analysis of the harm to creditors that would be caused by rejection of the Agreement and relocation of the Team. As described more fully above, when considering whether rejection of a contract is in the best interests of creditors, courts do not undertake some sort of "allowed claim" analysis, but instead consider whether the resulting harm to the non-debtor contract counterparty is disproportionate to any benefit derived by creditors. See In re Monarch Tool & Mfg. Co., 114 B.R. 134, 137-38 (Bankr. S.D. Ohio 1990) (denying rejection of an exclusive distributorship agreement because rejection would "ruin" the counterparty distributor); Petur, 35 B.R. at 563 (denying rejection of license agreement in light of the resulting damages to creditor notwithstanding the "conjectural" nature of the damages estimate); Infosystems Tech., Inc. v. Logical Software, Inc., C.A. No. 87-0042, 1987 U.S. Dist. LEXIS 6285, at *2-4 (D. Mass. Jun. 25, 1987) (reversing bankruptcy court's authorization of rejection of distributorship agreement, and ordering court to consider whether rejection will benefit general unsecured creditors, which would require a balancing of interests and a determination as to whether disproportionate harm would result to the non-debtor).

Consistent with the policy reasons for section 502(b)(6), the City acknowledges that it might be able to find a replacement tenant for the Team Exclusive Spaces within three years in an effort to mitigate its modest lease damages. The City's true harm, which the Debtors completely ignore, is that it will almost certainly never be able to find a replacement NHL hockey team for its state of the art hockey facility. Mitigation of the

great bulk of the City's claims here then, is not a realistic possibility. Rejection, under those circumstances, is not warranted by applicable law.

7. REJECTION OF THE AGREEMENT SHOULD BE DENIED BECAUSE IT IS BOUND TO A SECTION 363 SALE THAT SHOULD NOT BE APPROVED

The City's objections to the Debtors' so-called "relocation" sale to PSE will be filed at the appropriate time, once all bids are in. The City does note at this time, however, that the Debtors seem to seek rejection of the Agreement only if the Court approves at some later point a sale to PSE. The City believes that there are many strong legal and factual reasons for the Court's denial of that sale, including that any such sale would be in bad faith and not in the best interests of creditors, and that the Debtors cannot compel a sale free and clear of the City's interests in the Debtors' assets. Accordingly, as the sale to which the rejection is pinned is unlikely to occur, rejection likewise should be denied.

8. CONSIDERATION OF THE DEBTORS' REJECTION MOTION, AND THE CITY'S REJECTION DAMAGES, ARE CONSTITUTIONALLY PREMATURE

The City respectfully asserts that the Court's consideration of the Debtors' authority to reject the Agreement is premature. As the Rejection Motion seeks authority to reject the Agreement only in the event this Court approves a bid that requires relocation of the Team, the rejection issue is not yet ripe. See In re Papercraft Corp., 129 B.R. 56, 57 (Bankr. W.D. Pa. 1991) (court was not in a position to determine allowed amount of rejection claim until a pending motion to reject had been adjudicated); In re Liescheidt, 404 B.R. 499, 505 (Bankr. C.D. Ill. 2009) (holding that a claim is not ripe for adjudication if it rests upon contingent future events that may not occur as anticipated, or may not occur at all).

Further, as rejection has not yet occurred, the City has not yet asserted its rejection claims. Determination of what claims the City may file, once any rejection were unconditionally sought and approved, would at this time be at best an advisory opinion and likewise premature.

CONCLUSION

As set forth more fully in the Reply, rejection of the Agreement would cause great and irreparable harm to the City and other creditors. The Debtors have proven no benefit to creditors afforded by relocation of the Team and resulting rejection of the Agreement. As a result, rejection of the Agreement for the benefit of owners would not be in the best interests of creditors and the Court should deny the Rejection Motion.

WHEREFORE, for the reasons discussed herein, the City respectfully requests that this Court enter an order denying the Rejection Motion and granting to the City such other relief as is just and appropriate.

Dated: August 24, 2009 FENNEMORE CRAIG, P.C.

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