

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:	Chapter 11
CONEXANT SYSTEMS, INC., <i>et al.</i> ,	Case No. 13-10367 (MFW)
Debtors.	Jointly Administered
	Hearing Date: April 10, 2013 at 11:30 a.m. Objection Deadline: April 3, 2013 at 4:00 p.m.
	Ref. No. 18

**OBJECTION OF ELPF SCRANTON ROAD LIMITED PARTNERSHIP
TO DEBTOR'S MOTION FOR ENTRY OF AN ORDER
AUTHORIZING THE REJECTION OF CERTAIN UNEXPIRED LEASES,
EFFECTIVE NUNC PRO TUNC TO THE PETITION DATE**

ELPF Scranton Road, Limited Partnership ("Scranton Road"), as its objection (the "Objection") to the Debtors' Motion for Entry of an Order Authorizing the Rejection of Certain Unexpired Leases, Effective *Nunc Pro Tunc* to the Petition Date [Docket No. 18] (the "Rejection Motion"), respectfully states as follows:

INTRODUCTION

Conexant Systems, Inc. ("Conexant") is both tenant and sublessor with respect to certain real property in San Diego, California. In the Rejection Motion, Conexant seeks authority to reject subleases with four subtenants and to reject its Master Lease with Scranton Road and asks the court to deem rejection retroactive to February 28, 2013. Nevertheless, over a month after this proposed retroactive date, those subtenants remain in possession of the Property and, even after rejection, they may elect to retain their possessory rights pursuant to section 365(h)(1)(A) of the United States Bankruptcy Code. Unless and until Conexant can deliver possession of the Property to Scranton Road, the Rejection Motion should be denied, and any order granting the Rejection Motion should only be effective upon entry by the Court.

BACKGROUND

1. On February 28, 2013 (the “Petition Date”), Conexant and four of its related entities (collectively, the “Debtors”) filed voluntary bankruptcy petitions under chapter 11 of the United States Bankruptcy Code (11 U.S.C. 101, *et seq.*, hereafter, the “Bankruptcy Code”) in the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”).

2. Conexant and Scranton Road are parties to a Master Lease Agreement, dated June 20, 2002 (the “Scranton Road Lease”), covering 199,458 square feet at real property located at 9808 and 9868 Scranton Road, San Diego, California (the “Property”). The Scranton Road Lease requires Conexant to pay Scranton Road base monthly rent of \$342,912.63, plus real estate taxes and insurance-related obligations that increase the current monthly obligation to \$403,495.12.

3. After entering into the Scranton Road Lease, Conexant entered into subleases (the “Subtenant Leases”) to sublease portions of the Property to three different entities: CareFusion 303, Inc. (“CareFusion,”); Applied Micro Circuits Corporation (“AMCC”); and Deli House (“Deli House” and, together with CareFusion and AMCC, the “Subtenants”). CareFusion’s Subtenant Lease covers 85,731 square feet of the Property. AMCC’s Subtenant Lease covers 19,873 square feet of the Property. Deli House’s Subtenant Lease covers 1,625 square feet of the Property. Each of the Subtenants continues to occupy and possess its subleased portion of the Property.

4. In addition, Conexant and NXP Semiconductors USA, Inc. (“NXP”) are parties to a License Agreement, licensing NXP’s use of 58,486 square feet of the Property (the “NXP License”). NXP continued to occupy its licensed portion of the Property on and after the Petition Date and remained in possession until March 31, 2013.

5. On February 28, 2013, the Debtors filed the Rejection Motion. In the Rejection Motion, the Debtors seek authority to reject the Scranton Road Lease, each of the Subtenant Leases, and the NXP License, retroactive to the Petition Date.

6. On information and belief, Subtenants CareFusion and Deli House will exercise their rights under section 365(h)(1)(A)(ii) of the Bankruptcy Code and seek to retain possession for the remaining term of their Subtenant Leases if their Subtenant Leases are rejected. Scranton Road has been informed by AMCC that it will voluntarily terminate its Subtenant Lease on August 1, 2013, but that it intends to occupy the Property until that date.

ARGUMENT

I. The Debtors Should Not be Permitted to Reject the Scranton Road Lease.

7. In the Rejection Motion, the Debtors correctly cite *Nat'l Labor Relations Bd. v. Bildisco & Bildisco (In re Bildisco)*, 682 F.2d 72, 79 (3rd Cir. 1982), for the proposition that “[t]he usual test for rejection of an executory contract is simply whether rejection would benefit the estate, the ‘business judgment test.’” Rejection Motion, ¶ 9. However, the Rejection Motion does not present the usual case and therefore cannot be resolved by the “usual test.” Traditionally, when a trustee or a debtor in possession rejects a lease under which the debtor was a tenant, the landlord receives possession and may then assert a claim for damages arising from breach of the lease. In this case, however, the Debtors cannot surrender possession of the Property because they are both tenant and sublessor of the Property and the Subtenants have not vacated.

A. The Debtors Must Deliver Possession of the Property.

8. Recently, in *In re Amicus Wind Down Corporation (f/k/a Friendly Ice Cream Corporation)*, 2012 WL 604143 (Bankr. D. Del. 2012), Chief Judge Gross rejected a similar

motion to authorize rejection of a lease. In that case, the chapter 11 debtor served as both tenant and sublessor of a single property and sought to reject both its lease with the landlord and its sublease with the subtenant. As in the present case, the subtenant in *Amicus Wind Down* remained in possession of the property. Under those circumstances, the *Amicus Wind Down* Court acknowledged that “allowing a debtor-lessor to merely surrender the property to the over-landlord without delivering possession ignores the fact that there is no legal privity between the over-landlord and the subtenant, and the over-landlord will face significant legal obstacles if it wants to evict the subtenant. This is especially true if the over-landlord prefers to evict the current subtenant, rather than ‘enter into new agreements’ with the subtenant.” *Id.* at 2012 WL 604143, *2.

9. Ultimately, the *Amicus Wind Down* court refused to permit the debtor to reject its lease with its landlord, holding:

The Debtors enjoyed the right, and the benefit of the Sublease, and now they must also bear any burdens that result from the Sublease, including the present situation. The Debtors, not [the landlord] are in privity of contract with the Subtenant, and the Debtors are best legally suited to resolve this situation. . . The Debtors did not deliver possession of the property to [the landlord] because absent eviction proceedings in the New York courts, the Debtors can not unilaterally surrender the Subtenant’s possessory rights in the premises. . . . For the foregoing reasons, . . . the Rejection of the Over-Lease will not be effective until the Debtors relinquish control of the Premises by possession to [the landlord] by wresting possession from [the subtenant].

Amicus Wind Down Corp., 2012 WL 604143, at * 2-3.

10. The property rights between the debtor and a non-debtor party to an executory contract are determined pursuant to state law. *Butner v. United States*, 440 U.S. 48 (1979). The Scranton Road Lease specifically provides that “[t]his lease is entered into and to be performed entirely within the state of California and shall be governed by and construed in accordance with the laws of the state of California.” Scranton Road Lease, ¶ 20.6. Under California law, “A

subtenant generally has neither privity of estate nor privity of contract with the original lessor.”
Syufy Enterprises, LP v. City of Oakland, 104 Cal. App. 4th 869, 885 (2002).

B. The Debtors’ Subtenants Continue to Occupy the Property and Assert a Right to Remain.

11. Here, Scranton Road’s ability to obtain possession of the Property is complicated by section 365(h) of the Bankruptcy Code, which provides specific protections to a tenant under a nonresidential lease rejected by a debtor/landlord. Specifically, section 365(h)(1)(A) states, in pertinent part:

If the trustee [or debtor in possession] rejects an unexpired lease of real property under which the debtor is the lessor and -

* * * *

(ii) if the term of such lease has commenced, 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 and any right of use, possession, quiet enjoyment, subletting, assignment or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

11 U.S.C. § 365(h)(1)(A).

12. As set forth above, the Subtenants remain in possession of the Property. In addition, AMCC has notified Scranton Road that AMCC will occupy the Property until August 1, 2013, and CareFusion, intends to retain its rights under its Subtenant Lease and remain in possession of its subleased portion of the Property through at least June 20, 2015, if its Subtenant Lease is rejected.¹ Thus, the Debtors have not surrendered and are currently unable to surrender possession of the Property and cannot effectively reject the Scranton Road Lease at this time.

¹ The Term of the Subtenant Lease runs through June 20, 2015. The Subtenant Lease also grants CareFusion the option for a three-year extension.

13. The Debtors will no doubt argue that Scranton Road is not adversely impacted by the Subtenants' continued possession because it has entered into Attornment and Lease Recognition Agreements (the "Attornment Agreements") with two of the Subtenants, AMCC and CareFusion. These Attornment Agreements provide, *inter alia*, for the formation of Direct Leases with these subtenants in the event that the Scranton Road Lease is terminated. However, Scranton Road has no such agreement with Deli House, who continues to occupy the Property or with NXP, who occupied its licensed portion of the Property for 31 days after the filing of the Rejection Motion.

14. Furthermore, the Attornment Agreements impose direct leases upon Scranton Road only in the event of a *termination* of the Scranton Road Lease. Even assuming, *arguendo*, that the Bankruptcy Court were to permit the Debtors to reject the Scranton Road Lease, such rejection would constitute only a breach of the Scranton Road Lease, not a termination. *See* 11 U.S.C. § 365(g).

15. The distinction between rejection and termination is significant. The Seventh Circuit Court of Appeals recently confirmed the importance of this distinction, finding that rejection of a license agreement freed the trustee from performance, but did not terminate the contractual rights granted by the debtor. *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372, 377 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 790, 184 L. Ed. 2d 596 (U.S. 2012) ("What § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place . . . But nothing about this process implies that any rights of the other contracting party have been vaporized."); *see also In re CB Holding Corp.*, 448 B.R. 684, 687 (Bankr. D. Del. 2011) (MFW) (following rejection of a lease, the court refused to enforce a purchase option triggered by termination or expiration, finding, "[t]he Court

here is constrained to apply the literal language of the Lease, which provides that the Debtors are obligated to offer the license for sale to the Landlord only at the expiration or termination of the Lease. Neither has occurred yet.”); *see also Amicus Wind Down Corp.*, 2012 WL 604143, at *2 (citations omitted) (“Rejection of the lease ‘frees the bankruptcy estate from its obligation to perform’ but ‘it does not make the contract disappear.’”).

16. Scranton Road is entitled to specific types of damages upon termination that are intended to make Scranton Road whole. The Subtenants’ rights under the Attornment Agreements to impose new direct leases upon Scranton Road are premised upon Scranton Road receiving payment in full of those damages from the Debtors. In bankruptcy, upon rejection of the Lease, Scranton Road’s right to its contractual damages would be converted to a prepetition claim which is expected to be paid pennies on the dollar.² *See* 11 U.S.C. § 365(g). Under these circumstances, Scranton Road would not “terminate” the Scranton Road Lease and would not be bound to leases with CareFusion and AMCC by the Attornment Agreements.

C. Scranton Road is Harmed by the Subtenants’ Continued Possession of the Property

17. The inequity of rejection of the Scranton Road Lease is also made evident by the provisions of 11 U.S.C. § 502(b)(6) that would govern Scranton Road’s rejection damages claim. Following rejection, a landlord typically is able to recover damages from the debtor’s estate, limited by section 502(b)(6) of the Bankruptcy Code, to compensate it for loss of revenue during the time necessary to replace the debtor as tenant. As explained by the court in *In re Allegheny Int’l, Inc.*, 136 B.R. 396 (Bankr. W.D. Pa. 1991) *aff’d and remanded*, 145 B.R. 823 (W.D. Pa. 1992):

² According to the Debtors’ recently-filed Plan and Disclosure Statement, Scranton Road can expect a distribution of between 1% and 4% on account of an unsecured rejection damages claim.

A landlord, unlike other creditors, regains its original assets upon bankruptcy and can relet them to another tenant. *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 455, 57 S.Ct. 298, 303, 81 L.Ed. 340 (1937). From an economic viewpoint, the statutory cap was an attempt by Congress to reflect this fact. By allowing the landlord a period of time in which to relet the premises, the landlord has the opportunity to restore itself to the same position as if the lease had not been terminated.

Allegheny Int'l, Inc., 136 B.R. at 403.

18. With the Debtors' Subtenants claiming a continued right of possession in the event of a rejection, Scranton Road would face substantial challenges reletting the unoccupied portions of the Property. *See* Rejection Motion, ¶ 7 (recognizing "structural and use limitations" that have limited monthly sublease income), and would be entirely unable to recapture the differential between the Debtors' rental rate and the lower rental charged in the Subtenant Leases.³ Scranton Road would be unduly harmed by rejection and the damages available upon rejection, to the extent limited by section 502(b)(6) of the Bankruptcy Code, would fall short of providing the compensation intended by the Bankruptcy Code. This harm also warrants denial of the Rejection Motion.

II. Rejection, if Allowed, Should Not be Effective until the Debtors Deliver Possession.

19. Despite setting the Rejection Motion for hearing 41 days after their bankruptcy filings and failing to surrender possession of the Property to Scranton Road during that time, the Debtors ask that their rejection of the Scranton Road Lease be deemed to be effective as of February 28, 2013. For support, the Debtors cite *In re Chi-Chi's, Inc.*, 305 B.R. 396 (Bankr. D. Del. 2004) for the proposition that "Courts may approve retroactive rejection of nonresidential leases 'after balancing the equities' and concluding they weigh in favor of the debtor." *See* Rejection Motion, ¶ 12. Here, the equities strongly favor denial of retroactive relief.

³ For example, CareFusion pays roughly \$0.56 less per square foot per month on its Subtenant Lease, creating a monthly differential of approximately \$48,000.

20. An order granting relief *nunc pro tunc* is not a remedy that should be given as a matter of course, but only after a balancing of the equities in a particular case. It is the burden of the moving party to show that relief, of this character, is appropriate. *In re TW, Inc.*, 2004 WL 115521 (D. Del. Jan. 14, 2004). In *TW, Inc.*, the District Court affirmed, on appeal, this Court's refusal to grant retroactive rejection in a case in which the debtor had closed its operations on the premises prior to the petition date, and had provided notice of its intent to reject, but had not turned over the keys. Although the result of this Court's ruling was that the debtor became obligated to pay an additional month's rent for space it was not using, this Court nevertheless determined that the equities did not warrant retroactive rejection and the District Court refused to find error in that determination. *Id.* at *1-2.

21. Finally, although this Court has approved retroactive rejection of a lease in the absence of any objection from the affected landlord, Scranton Road has been unable to identify any case in which this Court has granted such retroactive relief over the objection of a landlord based on the failure to surrender actual possession of the premises. *See, e.g., In re THQ, Inc.*, Case No. 12-13398 (MFW) (Bankr. D. Del. Feb. 19, 2013) [Docket No. 385] (following objection of landlord based on continued possession by subtenants, debtor agreed and court entered an order making rejection effective as of the date the subtenant surrendered possession of the premises); *In re Buffets Rests. Holdings, Inc.*, Case. No. 12-10237 (MFW) (Bankr. D. Del. Feb. 14, 2012) [Docket No. 226] (following landlord's objection, the Court entered an order, based on an agreement reached by the parties, providing for retroactive rejection, but only to the date the debtors surrendered possession.).

A. The Debtors Have Not Delivered Possession of the Property.

22. As set forth above, the Debtors elected to sublease portions of the Property to the Subtenants and have obtained financial benefits therefrom for a number of years. To date, each of the Subtenants continues to possess their portion of the Property. Furthermore, at least one of the Subtenants has announced its intention to continue to do so through at least June 20, 2015.⁴

23. In *Chi-Chi's*, the court found the fact that “the premises are subject to subleases/sub-subleases, and the current tenants remain on the premises” to be a sufficient basis to refuse to make rejection retroactive to the Petition Date. *Chi-Chi's*, 305 B.R. at 399. Instead, the *Chi-Chi's* court made rejection effective on “the day the Debtors surrendered the premises to the Landlords, and the Landlords were able to enter into agreements with the current tenants,” a date that was at the earliest, 23 days later than the date requested by the debtor.

24. In *Chi-Chi's*, the debtors entered into leases for restaurant space and then subleased those entire spaces to single subtenants seeking to operate restaurants on the same premises. *Id.* at 398-399. As a result, following rejection, the *Chi-Chi's* landlords were able to enter into new leases for the entire space previously leased to Chi-Chi's, effectively mitigating their rejection damages. Here, that option is not available to Scranton Road. Each Subtenant subleased only a portion of the Property. Over 30,000 square feet of office space leased to the Debtors is not subject to a sublease or license. Accordingly, unlike the subtenants in *Chi-Chi's*, the Subtenants cannot, individually or collectively, replace the Debtors as Scranton Road's tenant.

⁴ The Subtenant Lease between the Debtors and CareFusion provides CareFusion with the ability to exercise its option to extend the term of the Subtenant Lease by three additional years.

B. Scranton Road is Currently Unable to Mitigate its Damages.

25. The Debtors ask the Court to make rejection effective on February 28, 2013 because the Debtors “have, or are in the process of, returning keys to the counterparties to the Office Leases . . . with an unequivocal statement of the Debtors’ intent to relinquish their interests under the Office Leases.” Rejection Motion, ¶ 13. Although the Debtors state that “the Debtors will not withdraw this motion with respect to any of the Office Leases, absent the Landlord’s consent” (Rejection Motion, ¶ 14), the fact that the Debtors’ Subtenants continue to occupy the Property and that the Rejection Motion has not been granted prevent Scranton Road from reletting any portion of the Premises.

26. On March 28, 2013, the Debtors filed the Debtors’ Motion for Entry of an Order Authorizing the Rejection of their Corporate Headquarters [Docket No. 109] (the “Headquarters Rejection Motion”). In the Headquarters Rejection Motion, the Debtors did not seek retroactive relief. Instead, the Debtors acknowledged that their obligation to surrender possession upon rejection required more than just an unequivocal statement of the Debtors’ intent to relinquish their interest. Therefore, the Debtors sought rejection to be effective when the space had actually been vacated. Specifically, the Debtors state:

The Debtors are hopeful that they will turn over the property under the Corporate Headquarters Lease on or before April 30, 2013, thereby avoiding any additional rent for the Corporate Headquarters Lease beyond April. If the Debtors determine, however, that they are unable to provide the existing Landlord with access to the premises by April 30, 2013, the Debtors intend to notify the Landlord on or before April 15, 2013, that they will occupy the premises through May 30, 2013.

Headquarters Rejection Motion, ¶ 13.

27. Although the Debtors might seek to draw a distinction between the Debtors’ employees and the Debtors’ licensee or Subtenant, there is no distinction with respect to a landlord’s ability to relet the premises. In each case, the premises have been, and continue to be

occupied and the landlord does not have the present ability to remove the occupiers from the premises.

28. The *Amicus Wind Down* Court acknowledged that the burden of removing a debtor's subtenants should fall to the debtor, and not its lessor. However, even if Scranton Road were willing to voluntarily bear the expense of attempting to evict the Debtors' Subtenants, it would have no legal basis to do so unless and until the Bankruptcy Court enters an order authorizing the Debtors' proposed rejections. The Debtors' statement of its intention to reject the Subtenant Leases and the NXP License is simply no substitute for an order of this Court. See *Thinking Machs. Corp. v. Mellon Fin. Servs. Corp. (In re Thinking Machs. Corp.)*, 67 F.3d 1021, 1025 (1st Cir.1995) (“[W]e believe that section 365(a) is most faithfully read as making court approval a condition precedent to the effectiveness of a trustee's rejection of a nonresidential lease.”). Furthermore, the Debtors' promise not to withdraw the Rejection Motion ignores the possibility that one or more of the Subtenants or some third party might object to the Rejection Motion and the Rejection Motion might be denied.

29. Although Scranton Road opposes the Rejection Motion in its entirety, if its objection to rejection is overruled, the earliest that the Bankruptcy Court would enter an order approving the rejection of the Scranton Road Lease, the Subtenant Leases and the NXP License would be on April 10, 2013. Furthermore, even if Scranton Road were to initiate eviction proceedings against the Subtenants on April 10, 2013, Scranton Road anticipates that it would take months, if not longer, to successfully complete those proceedings, especially because Scranton Road would be forced to litigate the issue of the Subtenants' entitlements under section 365(h) of the Bankruptcy Code.

C. The Debtors Could Have, but Failed to Seek Expedited Determination of the Rejection Motion.

30. Had the Debtors wished to do so, they could have sought an expedited determination of their right to reject the Scranton Road Lease and the Subtenant Leases. In fact, on March 28, 2013, the Debtors filed the Debtors' Motion to Shorten Notice with Respect to Debtors' Motion for Entry of an Order Authorizing the Rejection of their Corporate Headquarters [Docket No. 110] (the "Expediting Motion"), seeking a hearing on the Headquarters Rejection Motion 13 days after its filing. Notably, the Debtors state that "[a]n expeditious hearing on the Lease Rejection Motion is crucial to avoid the mounting monthly administrative expenses for underutilized space associated with the Debtors' Corporate Headquarters Lease and allow the Debtors to relocate to a new location that better fits their operational needs." Expediting Motion, ¶ 4. In contrast, the Debtors did not seek expedited hearing on the Rejection Motion, instead setting it for hearing 41 days after its filing. Throughout this period, Scranton Road's ability to pursue a replacement tenant has been restricted by the continued occupation of the Debtors' Subtenants and, even with respect to areas vacated by the Debtors, the lack of a final determination of the Rejection Motion.

31. The Debtors' decision to wait 41 days for hearing renders retroactivity highly inequitable.

CONCLUSION

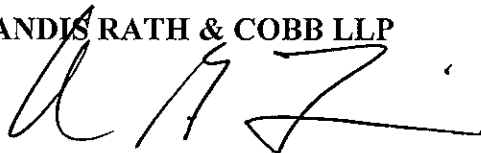
32. Throughout the time the Rejection Motion has remained pending, Scranton Road has been unable to effectively market the Property and has continued to suffer all of the burdens of the Debtors' continued tenancy. If the Subtenant Leases are rejected and Subtenants elect to retain possession, this situation will persist. Under these circumstances, the equities weigh strongly against an allowance of rejection. These same factors weigh against retroactivity when

and if the Rejection Motion is ultimately granted. For the reasons set forth above, the Debtors' rejection of the Scranton Road Lease should be denied.

WHEREFORE, ELPF Scranton Road LP respectfully requests that the Court (i) deny the Rejection Motion with respect to the Scranton Road Lease, and (ii) grant such other and further relief as is just.

Dated: April 3, 2013
Wilmington, Delaware

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