

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

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|---------------------------|---|-------------------|
| In re: |) | |
| |) | |
| |) | Case No. 12-22602 |
| DICKINSON THEATRES, INC., |) | |
| a Kansas corporation, |) | Chapter 11 |
| |) | |
| Debtor. |) | |

DEBTOR'S MOTION FOR ORDER REJECTING, IN PART, THE AMENDED AND RESTATED MASTER LEASE AGREEMENT WITH SPIRIT MASTER FUNDING, LLC

Dickinson Theatres, Inc., debtor and debtor-in-possession in the above-captioned proceedings (the "Debtor"), through its undersigned counsel, hereby files this motion (the "Motion") requesting this Court enter its order authorizing the rejection, in part, of that certain amended and restated master lease agreement with Spirit Master Funding, LLC ("Spirit") pursuant to Sections 105(a) and 365(a) of title 11 of the United States Code (11 U.S.C. §§ 101 *et seq.*, as amended, the "Bankruptcy Code"), and Rule 6006 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). In support of this Motion, the Debtor states as follows:

I. JURISDICTION

1. The Court has jurisdiction over the Motion under 28 U.S.C. § 1334. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this Chapter 11 case in this District is proper under 28 U.S.C. §§ 1408 and 1409.

2. The statutory basis for the relief requested herein is Section 365 of the Bankruptcy Code and Rules 6003, 6006 and 9014 of the Bankruptcy Rules.

II. BACKGROUND

3. On September 21, 2012 (the "Petition Date"), the Debtor filed its voluntary petition in this Court for reorganization relief under Chapter 11 the Bankruptcy Code,

commencing the Debtor's Chapter 11 case (the "Chapter 11 Case"). The Debtor continues to operate its business and manage its properties as debtor-in-possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code. No request for the appointment of a trustee or examiner has been made in this Chapter 11 Case and, as of the date of the filing of this Motion, no official committees have been appointed or designated.

4. With its voluntary petition, the Debtor contemporaneously filed this Motion and an Emergency Motion for Expedited Hearings on Certain Motions and Applications (the "Hearing Motion"), wherein the Debtor requests an expedited hearing on, *inter alia*, this Motion.

5. The Debtor operates 18 movie theatres with 210 screens in seven states (the "Business"). All theatres are operated from leased facilities with the Debtor not operating any theatres from owned locations. The Business employs approximately 680 salaried and hourly employees (collectively, the "Employees"), the vast majority of whom work part-time. All of these Employees are on payroll of, and paid by, the Debtor.

6. Contemporaneously with the filing of its Chapter 11 petition, the Debtor filed a plan of reorganization (the "Plan") and disclosure statement ("Disclosure Statement") and requested the Court to schedule hearings on the adequacy of the Disclosure Statement and confirmation of the Plan. The proposed Plan provides for payment of all allowed claims in full with interest over five years.

7. Upon emergence and consummation of the Plan, Debtor will be significantly stronger and better able to compete and thrive in the highly competitive theatre/entertainment market.

III. FACTS PERTINENT TO THIS MOTION

8. The Debtor is a party to that certain amended and restated master lease agreement dated August 1, 2009, with Spirit (the "Amended Master Lease"). The Amended Master Lease Agreement amended and restated: (1) that certain master lease agreement dated July 28, 2004, between the Debtor and Spirit Finance Acquisitions, LLC, which was subsequently modified and amended on November 30, 2004, and February 23, 2006, respectively; and (2) that certain master lease agreement dated December 14, 2005, between the Debtor and Spirit Master Funding II, LLC (the "Prior Spirit Leases").

9. The Amended Master Lease provides that the terms of the Prior Spirit Leases were to remain in force and effect through and until August 1, 2009, at which point the terms of the Amended Master Lease would govern the rights between the Debtor and Spirit as to the subject matter contained therein.

10. Pursuant to the terms of the Amended Master Lease, the Debtor agreed to lease five separate properties from Spirit so that it could operate its movie theatre Business at each of the five locations. The movie theatres at the five properties are located at: (a) 4900 Northeast 80th Street, Kansas City, Missouri 64119, commonly known as the Northglen 14 Theatre (the "Northglen 14 Theatre"); (b) 1451 Northeast Douglas Street, Lee's Summit, Missouri 64086, commonly known as the Eastglen 16 Theatre (the "Eastglen 16 Theatre"); (c) 10301 South Memorial Drive, Bixby, Oklahoma 74133, commonly known as the Starworld 20 Theatre (the "Starworld 20 Theatre"); (d) 1325 North Litchfield Road, Goodyear, Arizona 85338, commonly known as the Palm Valley 14 Theatre (the "Palm Valley 14 Theatre")¹; and (e) 8601 West 135th

¹ Spirit Master Funding LLC allocates rental the Palm Valley 14 Theatre separately from the other premises for tax purposes.

Street, Overland Park, Kansas 66223, commonly known as the Palazzo 16 Theatre (the "Palazzo 16 Theatre").

11. On February 29, 2012, the Debtor and Spirit entered into that first amendment to the Amended Master Lease (the "First Amendment") whereby it was agreed that the Palazzo 16 Theatre would be excluded from, and no longer be subject to, the terms of the Amended Master Lease. As a result of the First Amendment, the Amended Master Lease pertains only to the Northglen 14 Theatre, Eastglen 16 Theatre, Starworld 20 Theatre, and Palm Valley 14 Theatre (these properties are, collectively, the "Leased Theatres").

IV. RELIEF REQUESTED

12. By this Motion, the Debtor is asking the Court to enter its order granting the Debtor authority to reject the Amended Master Lease as to its obligations regarding the Palm Valley 14 Theatre (the "Rejected Theatre"),² effective as of thirty (30) days after an order is entered granting this Motion.

13. The Debtor has determined that its obligations under the Amended Master Lease, as they relate to the Rejected Theatre, are cumbersome and unprofitable.

14. The Debtor has also concluded that its obligations under the Amended Master Lease, as they pertain to the Rejected Theatre, have no value through assumption and assignment to a third-party purchaser and that the Rejected Theatre no longer provides any benefit to the Debtor. In an effort to minimize post-petition administrative costs, and in the exercise of the Debtor's sound business judgment, the Debtor has determined that it is in its best interests and in the best interests of the estate, creditors and interest holders to reject the Amended Master Lease as it pertains to the Rejected Theatre.

² The remainder of the Amended Master Lease will be addressed in the Plan.

15. In the event a potential assignee emerges for the Rejected Theatre, or if other good reason arises, Debtor reserves the right to withdraw the Amended Master Lease as it relates to the Rejected Theatre, prior to the hearing and/or entry of an order on this Motion, and *inter alia*, to seek to assume and assign the Amended Master Lease to any third-party assignees.

V. BASIS FOR RELIEF REQUESTED

A. **Rejection of Executory Contracts and Unexpired Leases**

16. Section 365(a) of the Bankruptcy Code provides that a debtor-in-possession "subject to the court's approval, may . . . reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a); *see also In re Kmart Corp.*, No. 02-02474, 2007 WL 4556991, at *7 (Bankr. N.D. Ill. Nov. 20, 2007); *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 973 F.2d 1065, 1075 (3rd Cir 1992). "This provision allows a [debtor in possession] to relieve the bankruptcy estate of burdensome agreements which have not been completely performed." *Stewart Title Guar. Co. v. Old Republic Nat'l Title Co.*, 83 F.3d 735, 741 (5th Cir. 1996) (*citing In re Muerexco Petroleum, Inc.*, 15 F.3d 60, 62 (5th Cir. 1994)).

17. Section 365(a) of the Bankruptcy Code, which has been interpreted as incorporating the "business judgment" standard, authorizes Debtor's rejection of the Leases. *See, Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R. Co.*, 318 U.S. 523, 550, 63 S.Ct. 727, 742 (1943) ("the question whether a lease should be rejected . . . is one of business judgment"); *Sharon Steel Corp. v. Nat'l Fuel Gas Distrib. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 524 (1984); *In re Federated Department Stores, Inc.*, 131 P.R. 808, 811 (S.D. Ohio 1991) ("courts traditionally have applied the business judgment standard in determining whether to authorize the rejection of executory contracts and unexpired leases").

18. The business judgment standard is satisfied when a debtor determines that rejection will benefit the estate. *In Re Chi-Feng Huang*, 23 B.R. 798, 800-801 (B.A.P. 9th Cir. 1982) (primary issue is whether rejection would benefit the general unsecured creditors); and *Commercial Financial Limited v. Hawaii Dimensions, Inc.*, 47 B.R. 425, 427 (D.Haw. 1985) ("under the business judgment test, a court should approve a debtor's proposed rejection if such rejection will benefit the estate").

19. Upon finding that the Debtor has exercised its sound business judgment in determining that rejection of the Rejected Contracts is in the best interests of the Debtor, its creditors and other parties in interest in the Chapter 11 Case, the Court should approve rejection of the Rejected Contracts pursuant to Section 365(a) of the Bankruptcy Code. *See, e.g., In re Bradlees Stores, Inc.*, 194 B.R. 555, 558 n.1 (Bankr. S.D.N.Y. 1996); *Summit Land Co. v. Allen (In re Summit Land Co.)*, 13 B.R. 310, 315 (Bankr. D. Utah 1981) (holding that, absent extraordinary circumstances, court approval of a debtor's decision to assume or reject an executory contract "should be granted as a matter of course"). If a debtor's business judgment has been reasonably exercised, a court should approve the assumption or rejection of an executory contract or unexpired lease. *See, e.g., NLRB v. Bildisco & Bildisco*, 465 U.S. at 523; *In re Sharon Steel Corp.*, 872 F.2d at 39-40.

20. Rejection of an unexpired contract is appropriate where such rejection would benefit the estate. *See Sharon Steel Corp.*, 872 F.2d at 39 (citing *Wheeling-Pittsburgh Steel Corp. v. West Penn Power Co. (In re Wheeling-Pittsburgh Steel Corp.)*, 72 B.R. 845, 846 (Bankr. W.D. Pa. 1987)). The business judgment standard requires that the Court approve the debtor's business decision unless it is the product of bad faith, whim or caprice. *See In re Trans World Airlines, Inc.*, 261 B.R. 103, 121 (Bankr. D. Del. 2001); *see also Lubrizol Enter., Inc. v.*

Richmond Metal Finishers, 756 F.2d 1043, 1047 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1986).

B. Rejection of Master Lease Agreements

21. Bankruptcy courts have found that a debtor has the ability, under Section 365 of the Bankruptcy Code, to reject cumbersome portions of a master lease agreement. *See, e.g., In re Cafeteria Operators, L.P.*, 299 B.R. 384 (Bankr. N.D. Tex. 2003); *In re Convenience USA, Inc.*, 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb 12, 2002). In *In re Cafeteria Operators, L.P.*, the debtor, Fur's Cafeteria, was a party to a master sublease agreement in which it agreed to sublease 43 separate restaurant facilities from K Mart Corporation, pursuant to the terms of the master sublease agreement, which K Mart Corporation leased from other parties. *See* 299 B.R. at 387-388. The debtor sought to reject the master sublease agreement as to some, but not all, of the restaurants it operated under the master sublease agreement. *Id.* The bankruptcy court found that in the Fifth Circuit, as a matter of law, a master lease agreement is severable, in part, only if the state law which governs the terms of the contract permits the severability of contracts.³ *Id.* at 389. In determining whether the master sublease agreement at issue was severable, the bankruptcy court found that Michigan law applied, pursuant to the terms of the master sublease agreement, and permitted contracts to be severable and divisible. *Id.* Applying Michigan law, the bankruptcy court found that whether the master sublease agreement was divisible depended upon the intent of the parties, subject matter of the master sublease agreement, and conduct of the parties. *Id.*

22. After examining the language of the master sublease agreement, the bankruptcy court in *In re Cafeteria Operators, L.P.*, found that the debtor and its lessor intended for the

³ Counsel for the Debtor was unable to find any Tenth Circuit legal authority which either allows, or denies, a debtor to sever a master lease agreement for purposes of assumption or rejection under Section 365 of the Bankruptcy Code.

master sublease agreement to be divisible for the following reasons: (a) the master sublease agreement provided for rent reduction amounts in the event the debtor lost a restaurant to condemnation or catastrophe; (b) the primary term for some of the restaurants were not uniform; (c) the lessor's remedies upon default were enforceable against the individual defaulting restaurant properties only, coupled with an integration clause that found that enforcement against one restaurant did not disturb either parties' obligations of performance as to the other restaurants; and (d) the debtor was permitted to re-let any of the restaurants without affecting the enforceability of the master sublease agreement as to the remaining restaurants. *Id.* at 390-391. Accordingly, the bankruptcy court found that the debtor and its lessor intended for the master sublease agreement to be severable. *Id.* Next, the bankruptcy determined whether the subject matter of the master sublease agreement made it severable from each other. *Id.* at 392. Citing the rationale espoused in *In re Convenience USA, Inc.*, 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb. 12, 2002), the bankruptcy court found the fact that each restaurant subject to the master sublease agreement could be operated separately and independently of each other was evidence that the master sublease agreement "inherently lends itself to being divisible." *Id.* Finally, the bankruptcy court found that the lessor's conduct, from prior judicial admissions in pleadings filed in a related bankruptcy case, evidenced that the master sublease agreement was divisible. *Id.* Accordingly, the court found that the master sublease agreement was divisible and that the debtor was able to assume in part, and reject in part under Section 365 of the Bankruptcy Code.

C. Severability of the Amended Master Lease

I. The Amended Master Lease is Severable Under Both Kansas and Delaware Law

23. As discussed above, whether a contract is severable, for purposes of assumption or rejection under Section 365 of the Bankruptcy Code, depends upon whether the state law governing the contract's interpretation permits the contract to be severed. *See, e.g., In re Cafeteria Operators, L.P.*, 299 B.R. 384 (Bankr. N.D. Tex. 2003); *In re Convenience USA, Inc.*, 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb 12, 2002); *In re Holly's Inc.*, 140 B.R. 643, 681 (Bankr. W.D. Mich. 1992); *In re Cutters, Inc.*, 104 B.R. 886, 889 (Bankr. M.D. Tenn. 1989); *Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 739 (5th Cir. 1996); *In re Plum Serv. Corp.*, 159 B.R. 496, 498-99 (S.D. Ohio 1993).

24. Although the Amended Master Lease has a subsection titled choice of law, that particular subsection, nor any other section, does not actually provide for a negotiated choice of law provision. Thus, Debtor submits that either Kansas law, the Debtor's state of incorporation, or Delaware law, Spirit's state of incorporation, applies to determine whether the Amended Master Lease is severable. Under Kansas law, the severability of a contract is "to be determined by the court according to the intention of the contracting parties as ascertained from the contract itself and upon a consideration of all the circumstances surrounding the making of it." *Greenway Elec., Inc. v. Vaughn*, 795 P.2d 951 (Kan. Ct. App. 1990) (citing *Blakesly v. Johnson*, 227 Kan. 495, 500-01 (Kan. 1980)). Under Delaware law, to determine whether a contract is severable "depends upon the intention of the parties and this must be gathered from their acts under all the facts and circumstances of the transaction in question." *Lowe v. Bennett*, 1994 Del. Super. LEXIS 628, 6-7 (Del. Super. Ct. Dec. 29, 1994) (citing *Orenstein v. Kahn*, Del. Supr., 13 Del. Ch. 376, 119 A. 444, 446 (1922)). Accordingly, the Debtor submits that both Kansas and

Delaware law are nearly identical and that each allows contracts to be severable, provided that the parties' intended the contract to be severable.

II. Both the Debtor and Spirit Intended for the Amended Master Lease to be Severable

25. The Debtor submits that, although the Leased Theatres were subject to the Amended Master Lease, it was the intention of the parties as evidenced by the written terms of the Amended Master Lease to make it severable.

26. Specifically, the Debtor cites the following clauses of the Amended Master Lease regarding the events of default.

27. First, Section 18C(v) of the Amended Master Lease specifically allows for an apportionment of rent in the event of certain casualty or condemnation events. Second, Section 20B(ix) of the Amended Master Lease *specifies a rent allocation* if there is a default and the lessor elects to terminate the Amended Master Lease as to any specific location:

Upon the occurrence of an Event of Default, with or without notice or demand, except as otherwise expressly provided herein or such other notice as may be required by statute and cannot be waived by Lessee [Debtor], Lessor [Spirit] shall be entitled to exercise, at its option, concurrently or successively, or in any combination, all remedies available at law or in equity, including without limitation, any one or more of the following:

(ix) To terminate this Lease *as to any or all of the Properties...recover as damages...an amount equal to the then present value of all rent...to become due and owing under this Lease with respect to the Properties so terminated...*

(emphasis added)

Additionally, the Amended Master Lease provides in Section 20A(iii) and (v) the following regarding events of default:

Each of the following shall be an event of default by Lessee [Debtor] under this Lease (each, an "Event of Default"):

(iii) if Lessee [Debtor] fails to pay, prior to delinquency, any taxes, assessments or other charges the failure of which to pay will result in the imposition of a lien against any of the Properties;

(v) if Lessee [Debtor] vacates or abandons a Property;

(emphasis added)

Specifically, an event of default under the Amended Master Lease may occur with respect to the Debtor's actions against any of the Leased Theatres. Additionally, Spirit's ability to enforce its remedies upon an event of default evidences the parties intention that the Amended Master Lease be severable:

Upon the occurrence of an Event of Default, with or without notice or demand, except as otherwise expressly provided herein or such other notice as may be required by statute and cannot be waived by Lessee [Debtor], Lessor [Spirit] shall be entitled to exercise, at its option, concurrently or successively, or in any combination, all remedies available at law or in equity, including without limitation, any one or more of the following:

(ix) To terminate this Lease as to any or all of the Properties...recover as damages...an amount equal to the then present value of all rent...to become due and owing under this Lease with respect to the Properties so terminated...The rental allocable to each such Property as to which the Lease is terminated shall be equal to the percentage of the total purchase price attributed to such Property by lessor under the applicable Purchase and Sale Agreement...

(emphasis added)

Thus, the enforcement of default provision in the Amended Master Lease evidences that the amount of Debtor's liability to Spirit can be based upon action with respect to any of the Leased Theatres. Third, Spirit itself has allocated the Palm Valley 14 Theatre rent under the Amended Master Lease for purpose of its Arizona income taxes. Last, in the miscellaneous provisions of the Amended Master Lease, both the Debtor and Spirit acknowledge that "[t]he provisions of this Lease shall be deemed severable. If any part of this Lease shall be held unenforceable by any court of competent jurisdiction, the remainder shall remain in full force and effect, and such

unenforceable provision shall be reformed by such court so as to give maximum legal effect to the intention of the parties expressed therein." (emphasis added)

28. Accordingly, each of the above cited provisions of the Amended Master Lease evidence that the Debtor and Spirit intended for severability in the same manner as the bankruptcy court found in *In re Cafeteria Operators, L.P.*, 299 B.R. 384 (Bankr. N.D. Tex. 2003). Each of the above cited provisions evidence the parties intention that any of the Leased Theatres are capable of being considered individual theatres.

III. The Subject Matter of the Amended Master Lease, Coupled With The Debtor and Spirit's Subsequent Conduct Evidences Severability

29. Notwithstanding the plain language of the Amended Master Lease, the Debtor's and Spirit's conduct subsequent to entering into the Amended Master Lease evidence that the parties considered the Amended Master Lease severable. Specifically, when the Debtor and Spirit entered into the First Amendment to the Amended Master Lease, and expressly removed the Palazzo 16 Theatre from the subject matter of the Amended Master Lease, it evidenced that any of the Leased Theatres are capable of being operated independently and separately from each other. The ability of a debtor to operate any of the properties subject to a master lease agreement independently and separately from each other was the rationale that the bankruptcy court in *In re Convenience USA, Inc.*, 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb. 12, 2002), found persuasive that a master lease agreement was severable, and capable of being assumed and rejected in parts, by a debtor. In this case, the Palazzo 16 Theatre was severed from the Amended Master Lease and has been operating independently and separately from any of the Retained Theatres. Accordingly, the subject matter of the Amended Master Lease evidences that any of the Leased Theatres are capable of operating independently and separately from each other. Moreover, the Amended Master Lease is the typical type of master agreement that is

capable of being assumed and rejected in part. *See In re Cafeteria Operators, L.P.*, 299 B.R. 384 (Bankr. N.D. Tex. 2003) ("This type of agreement, which addresses numerous independently operated restaurant facilities scattered across multiple states, inherently lends itself to being divisible.").

VI. CONCLUSION

30. The Debtor submits that it has satisfied the business judgment standard for rejecting the Amended Master Lease, in part, with respect to its obligations regarding the Rejected Theatre. As explained in detail above, performance under the Amended Master Lease as it relates to the Rejected Theatre is costly and unnecessary to the Debtor's on-going operation and Business. Moreover, the Amended Master Lease, as it pertains to the Rejected Theatre, is not a source of potential value for the Debtor's estate, creditors and interestholders through assumption and assignment to possible third parties. Accordingly, the Debtor has determined that the Amended Master Lease, and the obligations regarding the Rejected Theatre, constitute an unnecessary drain on its cash flow, and, therefore, rejection of the Amended Master Lease, in part, reflects the Debtor's exercise of sound business judgment.

31. The Debtor further requests that the Court require that Spirit must submit any claim from the rejection of the Amended Master Lease, as it pertains to the Rejected Theatre, within thirty (30) days after the date of the effective date of the Plan.

32. The Debtor may have claims against Spirit arising under, or independent of, the Amended Master Lease as it pertains to the Rejected Theatre. The Debtor does not waive such claims by the filing of this Motion or by the partial rejection of the Amended Master Lease. The Debtor reserves all of its rights with respect to the Amended Master Lease, including, but not limited to, the right to contest any claims that arise out of its rejection. Nothing contained herein is intended or shall be construed as: (a) an admission as to the validity of any claim against the

Debtor, (b) a waiver of the Debtor's rights to dispute any claim or (c) an approval or assumption of any agreement, contract, program, policy or lease under Section 365 of the Bankruptcy Code.

WHEREFORE, the Debtor requests the Court enter an order (i) granting this Motion, and (ii) granting such other and further relief as may be just and equitable under the circumstances.

Dated: September 21, 2012.

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