

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

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

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

Spirit Master Funding, LLC (“Spirit”) objects to the debtor’s motion for an order authorizing the rejection, in part, of the Amended Master Lease¹ between the Debtor and Spirit.

I. PRELIMINARY STATEMENT

1. “It is the intent of the parties . . . that they have executed and delivered this Lease with the understanding that . . . this Lease constitutes an unseverable and single lease of all, but not less than all, of the Properties.” Amended Master Lease, § 31B(i).

2. The issue presented by the Debtor’s Motion is straightforward: What was the Debtor and Spirit’s intent with respect to the severability of the Amended Master Lease at the time the parties entered into the lease? Although not presented as such in the Motion, the Amended Master Lease is crystal clear on this issue.

3. The provisions on which the Debtor would have this Court rely, while artfully cited out of context, are so standard in commercial real estate leases that if the Court determines that this lease meets the standard for severability, the Court might just as well find that any commercial real estate lease involving more than one property is severable as a matter of law.

¹ Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to such terms in the *Debtor’s Motion for Order Rejecting, in Part, the Amended and Restated Master Lease Agreement with Spirit Master Funding, LLC* [Docket No. 15].

4. The unambiguous language of the Amended Master Lease, which expressly states that the parties intended that the lease be an unseverable and single lease of all the properties, should end the analysis of whether the Amended Master Lease is severable and result in a denial of the Motion.

II. ARGUMENT AND AUTHORITIES

A. The Amended Master Lease Is Not Severable Under Applicable Law

5. Section 365 of the Bankruptcy Code permits a debtor-in-possession, subject to court approval, to assume or reject an executory contract or unexpired lease to which the debtor is a party. 11 U.S.C. § 365. It is well established, however, that “bankruptcy law generally does not permit a debtor or an estate to assume the benefits of a contract and reject the unfavorable aspects of the same contract.” DB Structured Prods., Inc. v. Am. Home Mortgage Holdings, Inc. (In re Am. Home Mortgage Holdings, Inc.), 402 B.R. 87, 94 (Bankr. D. Del. 2009) (quoting Folger Adam Sec., Inc. v. DeMatteis/MacGregor, JV, 209 F.3d 252, 264 (3d Cir. 2000)).

6. Nevertheless, in limited circumstances, which include the requirement that the contract be severable under the state law governing the contract, courts can make an exception to the general rule and allow the contract to be severed. See, e.g., In re Buffets Holdings, 387 B.R. 115, 120 (Bankr. D. Del. 2008) (“The determination of whether a specific contract or lease is an indivisible agreement or several agreements in one is a question of state law.”); In re Aneco Elec. Constr., Inc., 326 B.R. 197, 201 (Bankr. M.D. Fla. 2005). The issue of whether the Debtor should be permitted to reject in part the Amended Master Lease therefore turns on the application of state law to determine whether the Amended Master Lease is severable.

7. The Debtor contends that either Kansas or Delaware law should apply to the Amended Master Lease.² For purposes of the Motion, Spirit is willing to accept that the tests for severability under 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.” Motion, ¶ 24 (emphasis added).

8. As discussed in the Motion, 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, 608 P.2d 908, 913 (Kan. 1980)). Under Delaware law, the determination of 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) (stating that “[i]f there be a single assent to a whole transaction, involving several things or several kinds of property, a contract is always entire”) (quoting Orenstein v. Kahn, 119 A. 444, 446 (1922)).

9. The Debtor correctly frames the test of severability as turning on whether the parties intended for the contract to be severable. Even a cursory analysis of the Amended Master Lease leaves no question that the Debtor and Spirit intended that the Amended Master Lease “constitute[] an unseverable and single lease” with respect to all of the properties covered by the lease. Amended Master Lease, § 31B(i).

² Generally, the law of the state in which the property is located governs a real property lease. However, solely for purposes of the Motion, Spirit is willing to assume that either Kansas or Delaware law applies to the Amended Master Lease.

I. Section 31B of the Amended Master Lease Expressly States the Intent of the Parties

10. Two provisions of the Amended Master Lease squarely address the intent of the Debtor and Spirit in entering into the Amended Master Lease. Section 31B provides:

The following expressions of intent, representations, warranties, covenants, agreements, stipulations and waivers are a material inducement to Lessor entering into this Lease:

(i) It is the intent of the parties hereto, and the parties acknowledge and agree that they have executed and delivered this Lease with the understanding that (1) this Lease constitutes an unseverable and single lease of all, but not less than all, of the Properties, and, if at any time this Lease covers other real property in addition to the Properties, neither this Lease, nor Lessee's obligations or rights hereunder may be allocated or otherwise divided among such properties by Lessee

...

(iii) Lessee waives any claim or defense based upon the characterization of this Lease as anything other than a true lease and as a master lease of all of the Properties. Lessee stipulates and agrees (1) not to challenge the validity, enforceability or characterization of the lease of the Properties as a true lease and/or as a single, unseverable instrument pertaining to the lease of all, but not less than all, of the Properties, and (2) not to assert or take or omit to take any action inconsistent with the agreements and understandings set forth in this Section 31B.

Amended Master Lease, § 31B(i) & (iii). Perhaps understandably, but at some cost to its credibility, the Debtor does not refer the Court to either of these provisions in the Motion, despite acknowledging that the severability of the lease turns on the intent of the parties. See Motion, ¶ 24.

11. The Debtor and Spirit are sophisticated parties who, at the time of entering into the Amended Master Lease, contemplated and clearly and directly addressed their agreement on the severability issue. Delaware and Kansas law both recognize that in such a situation, the contract is not severable. See ARY Jewelers, L.L.C. v. Krigel, 85 P.3d 1151, 1159 (Kan. 2004) (stating that, under Kansas law, "whether a contract is entire or divisible is a question of

construction to be determined by the court according to the intention of the contracting parties as ascertained from the contract itself, upon a consideration of all the circumstances surrounding the making of it and the subject matter of the agreement” (emphasis added)); Palumbo v. Ewing, 540 F. Supp. 388, 391 (D. Del. 1982) (stating that, under Delaware law, “whether a contract is to be construed as divisible or entire depends on the intention of the parties, as ascertained by reference to the text and subject matter of the contract and from any other facts and circumstances shown by the evidence” (emphasis added)).

II. The Amended Master Lease Provisions Cited by the Debtor Are Unpersuasive and Fail to Demonstrate the Intent of the Parties

12. The first provision cited by the Debtor in support of its position is Section 18C(v) of the lease, which governs what happens if any of the properties covered by the lease is condemned or destroyed. Such a provision is included in most commercial real estate leases, even those for a single property, because it is necessary to address what will happen if a portion of the property is condemned or destroyed. Such a provision does not reflect any intent that the lease be severable, nor would it even in the absence of Section 31B. Certainly it cannot be read as overriding the expression of the parties’ intent, indeed their agreement, that the lease could not be severed.

13. The Debtor then cites Section 20B(ix) for the proposition that, if Spirit were to, at its election, terminate the Amended Master Lease as to any one property upon the occurrence of an event of default, such section provides for a method of rent allocation. Motion, ¶ 27. However, even assuming arguendo that it is possible to allocate rent by property, the applicable test under both Kansas and Delaware law is not whether it is possible to sever a contract but whether the parties intended that the contract be severable. Indeed, not one of the Kansas or Delaware cases cited by the Debtor even considers whether it is possible to sever the contract.

See Blakesly, 608 P.2d at 913; Greenway Elec., Inc., 795 P.2d 951; Orenstein, 119 A. at 446; Lowe, 1994 Del. Super. LEXIS 628 at *6-7. The Debtor's reliance on this provision is misplaced.

14. The Debtor next directs the Court to Section 20A, which provides that certain defaults relative to one property are defaults under the lease. Motion, ¶ 27. Simply put, the Debtor has multiple obligations under the Amended Master Lease, some of which relate to the properties individually and some of which relate to all of the properties. Of course a failure to meet such obligations with respect to any of the properties is a default under the lease. It would be nonsensical for Spirit to permit the Debtor, for example, to fail to pay taxes related to one property so long as the Debtor did not do so with respect to all of the properties. How Section 20A supports the Debtor's position is unclear. The fact that the Debtor's actions with respect to any of the properties could trigger an event of default under the Amended Master Lease (thereby permitting, among other things, Spirit to terminate the Lease as to all properties under Section 20B(i)), actually supports Spirit's position that the parties intended the Lease to be a single unseverable agreement.

15. The Debtor then states in the Motion that Spirit "allocates rental the Palm Valley 14 Theatre separately from the other premises for tax purposes." Motion, ¶¶ 10 n.1, 27. Spirit is merely attempting to comply with its obligations under state and local law, and any such allocation made in order to do so does not reflect the parties' intent with respect to severability of the lease. Indeed, as discussed below, the fact that it is possible to allocate rent among the properties is irrelevant to the determination of the parties' intent. See infra ¶ 13; supra ¶ 19.

16. Finally, in a last, almost incidental, gasp, the Debtor points to Section 40E, which is a standard boilerplate "severability" provision that is included in most contracts to prevent an

entire contract from being deemed invalid if, for example, a damages provision is deemed unenforceable. Section 40E relates to the severability of provisions of the Amended Master Lease, rather than the severability of subject matter. See Amended Master Lease, § 40E (“The provisions of this Lease shall be deemed severable.” (emphasis added)). Furthermore, the entire purpose of Section 40E is “to give maximum legal effect to the intention of the parties as expressed in the [Amended Master Lease].” Id. The Debtor cannot seriously contend that this boilerplate provision, tucked back in the “miscellaneous” section between a provision addressing captions and one addressing further assurances, was intended to override the parties’ express agreement on the severability issue in Section 31B of the lease.

17. In short, the provisions cited by the Debtor do not assist the Court in determining the intent of the parties. The Court simply needs to go no further than the unambiguous provisions of Section 31B to determine that the Debtor and Spirit intended that the Amended Master Lease not be severable.

III. The Subsequent Conduct of the Parties Further Demonstrates the Parties’ Understanding That the Amended Master Lease Is Not Severable

18. The Debtor points to the First Amendment to the Master Lease as evidence that “any of the Leased Theatres are capable of being operated independently and separately from each other.” Motion, ¶ 29. Certainly Spirit will not dispute that a movie theater in Arizona can be independently operated from others in Missouri, Oklahoma and Kansas. The Debtor cites In re Convenience USA, Inc. for the proposition that the ability of a debtor to operate any of the properties subject to a master lease independently supports the conclusion that the lease is severable. See Motion, ¶ 29 (citing In re Convenience USA, Inc., 2002 Bankr. LEXIS 348, *18 (Bankr. M.D.N.C. Feb. 12, 2002)). However, the Debtor’s reliance on In re Convenience is

misplaced, as the lease at issue in In re Convenience is easily distinguished from the Amended Master Lease. See discussion supra ¶¶ 21-25.

19. In a 2008 decision, the Bankruptcy Court for the District of Delaware, applying Illinois law³ to two master leases of real property on which restaurants were operated by the debtors, explicitly rejected the debtors' argument that "the fact that the rent is apportionable is a critical factor mandating a finding that the Master Leases are severable." See In re Buffets Holdings, Inc., 387 B.R. 115, 121-22 (Bankr. D. Del. 2008). The court went on to state that, "[t]he ability to apportion the consideration to different parts of the contract is one factor to be considered in determining the intent of the parties but it is not conclusive." Id. Indeed, the court emphasized that the intention of the parties is critical, and even if a contract is capable of being severed, "that contract cannot be severed after the fact if the parties entered it 'as a single whole, so that there would have been no bargain whatever, if any promise or set of promises were struck out.'" Id. (quoting In re United Air Lines, Inc., 453 F.2d 463, 468-70 (7th Cir. 2006) (applying Colorado law)). The In re Buffets Holdings court went on to state that "the fact that the Master Lease could in certain circumstances be severed by their terms does not mean that the parties intended them to be separate agreements for all purposes. In fact, it demonstrates the opposite: that the parties intended each Master Lease to be an integrated agreement except for certain specifically identified circumstances." Id. at 123.

20. Prior to filing for bankruptcy, the In re Buffets Holdings debtors had been negotiating to substitute a real property lease the debtors had in one location for a lease they had in another location, which was not performing well. Id. The lessor had agreed to the

³ The test for whether a contract is severable under Illinois law is almost identical to that under Kansas and Delaware law. Illinois law requires a determination of "the intention of the parties as established by a reasonable interpretation of the terms and provisions of the contractual document itself, by the circumstances of the transaction at issue, and by the subject matter to which the contract has reference." See, e.g., Super Stop Petrol., Inc. v. Clark Retail Enters. (In re Clark Retail Enters.), 308 B.R. 869, 888 (Bankr. N.D. Ill. 2004).

substitution, but it was not completed prior to the debtors' bankruptcy filing. Id. The court agreed with the lessor that, far from showing the master lease in question was severable, such conduct "demonstrate[d] that they did not have the power to sever the Master Lease under Illinois law." Id. (stating that "the Debtors apparently recognized that the leases were not severable under Illinois law"). Just as in the In re Buffets Holdings case, the First Amendment to the Amended Master Lease establishes that the Debtor did not have the ability to sever the Amended Master Lease under applicable law.

B. The Cases on Which the Debtor Relies Do Not Control the Instant Case

21. The Debtor primarily relies on two cases to support its position. See In re Cafeteria Operators, L.P., 299 B.R. 384 (Bankr. N.D. Tex. 2003) (applying Texas law); In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb 12, 2002) (applying Michigan law). However, the leases in both of these cases are easily distinguished from the terms of the Amended Master Lease and therefore are not instructive. Instead, Spirit would direct this Court to In re Buffets Holdings for precedent of a court's analysis of a similar lease.

22. First and most importantly, in neither In re Cafeteria Operators nor In re Convenience did either court make mention of any specific provision expressly stating the parties' intent with respect to severability. See In re Cafeteria Operators, L.P., 299 B.R. 384; In re Convenience USA, Inc., 2002 Bankr. LEXIS 348. Accordingly, in these cases the courts had to look elsewhere to determine the parties' intent. In this case, however, the Court need not attempt to decipher the parties' intent by examining provisions governing what happens if a property is condemned or if there is a default. The parties' intent is expressly stated in the Amended Master Lease.

23. Second, in both cases, there was more than one lessor, which resulted in the inclusion of certain other lease provisions that informed the courts' analysis. In In re

Convenience, a provision in the master lease stated that “each of the six separate landlords named in the lease is leasing its respective premises, as identified on Exhibit A, to tenant on a several, and not joint and several basis,” which the court found instructive as to the parties’ intent. See In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 at *16 (quoting the master lease) (internal quotations omitted). In In re Cafeteria Operators, L.P., there were two lessors and the term of the master lease was different for the individual groups of properties. See In re Cafeteria Operators, L.P., 299 B.R. at 387, 390. In the present case, there is only one lessor and one lessee and, thus, there is no several liability issue. See Amended Master Lease, preamble. Further, the lease term is the same with respect to all of the properties, and the Debtor has the option to extend the lease term “for all and not less than all” of the properties. Id. § 3.

24. Third, in In re Convenience, the court relied heavily on the fact that an exhibit to the lease assigned specific amounts of rent to each of the 27 lease properties. See In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 at *13-14. Following execution of the lease, the parties agreed upon a schedule that “specifically and on a property-by-property basis detailed the amount of the annual and monthly rent allocated to each property.” Id. Here, there is no such schedule and rent has not been apportioned on a property-by-property basis. Amended Master Lease, § 4. Instead, the Debtor is required to pay rent in a lump sum for all of the properties. Id.

25. To permit the Debtor to reject the Palm Valley 14 Theatre without continuing to pay the total rent “would be to destroy the essence of [Spirit’s] bargain.” In re Buffets Holdings, 387 B.R. at 124. As the In re Buffets Holdings court noted, “there is ‘no federal policy which requires severance of a lease condition solely because it makes a debtor’s reorganization more

feasible.” Id. (quoting Bistrain v. E. Hampton Sand & Gravel Co., 25 B.R. 193, 199 (Bankr. E.D.N.Y. 1982)).

III. CONCLUSION

26. The issue before this Court is simple: the Court must determine whether the Debtor and Spirit intended, at the time they entered into the Amended Master Lease, that the lease be severable. The clear and unambiguous language of Section 30B of the lease addresses that very issue. Accordingly, under applicable law, the Amended Master Lease is not severable and may not be rejected in part by the Debtor. Rather, the Debtor must either assume or reject the lease in its entirety.

Dated: October 3, 2012

Respectfully submitted,

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ATTORNEYS FOR SPIRIT MASTER
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CERTIFICATE OF SERVICE

I certify that on this 3rd day of October, 2012, a true and correct copy of *Spirit Master Funding, LLC's Objection to the Debtor's Motion for Order Rejecting, in Part, the Amended and Restated Master Lease Agreement with Spirit Master Funding, LLC* was electronically filed and served on all interested parties requesting electronic notification.

/s/ Scott M. Brinkman