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UNITED STATES BANKRUPTCY COURT

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 **DEBTORS' REPLY TO 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**
This Filing Applies to: ■ All Debtors ❒ Specified Debtors	Hearing Date: September 2, 2009 Hearing Time: 9:00 a.m. Location: U.S. Bankruptcy Court 230 N. First Ave., Courtroom 703 Phoenix, AZ 85003

The above-captioned Debtors reply to the *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* [Docket No. 756] (the "**Objection**")[1] as follows:[2]

[1] Although titled a "Reply," the City's pleading was actually filed as a response to the Debtors' Motion.

[2] In support of this Reply, the Debtors incorporate the arguments set forth in *Debtors' Memorandum of Points and Authorities in Support of Motion to Sell Substantially All of Coyotes Hockey's Assets (Glendale Issues)*, dated June 5, 2009 [Docket No. 287].

The Issues Before The Court Regarding The Arena Lease

1. The Debtors' Motion, which is scheduled to be heard on September 2, asks the Court to decide three gating issues before the September 10 sale hearing:

   a. whether the Lease is a lease that can be rejected by the Debtors under Bankruptcy Code § 365(a) subject to the Court's approval;

   b. whether the City is entitled to injunctive relief in the form of specific performance for breach of the Lease; and

   c. whether all claims for damages resulting from rejection of the Lease are capped under Bankruptcy Code § 502(b)(6).

2. A fourth issue—which the Debtors are *not* asking the Court to determine *before* the September 10 hearing—is whether the Court should actually approve rejection of the Lease. On that issue, the Motion asks the Court to approve rejection of the Lease *if the Court approves a relocation sale*. **If the Court approves a relocation sale, then rejection of the Lease will be necessary (and clearly will satisfy the business judgment test), because no rational debtor would continue to incur liabilities under a lease for a building it will never use again.** The Motion, therefore, asks the Court to approve rejection of the Lease, effective as of the closing date of a relocation sale, but only if the Court does in fact approve a relocation sale. In other words, the Court need not approve or disapprove rejection of the Lease until the Court first determines which bid is the highest and best.

3. The three gating issues, however, should be decided before the September 10 sale hearing because the parties cannot fairly evaluate the relative merits of one bid versus another without a clear understanding and direction from the Court on those issues. For example, the City has stated—threatened—that the Debtors' rejection of the Lease "would give rise to a monstrously large claim" and that the claim would be "something in the magnitude of 500 [million dollars]." Transcript of May 19, 2009 Hearing, 81:12-13 and 82:5-6. The precise amount of the City's claim does not need to be decided by the Court at this time. The legal question, however, of whether the City's "monstrously large claim" would be subject to the

statutory cap of Bankruptcy Code § 502(b)(6) is directly relevant to the economic analysis of the competing bids. Similarly, the Court's decisions on the first and second gating issues are necessary so that the parties can evaluate the relative merits of a relocation bid versus a Glendale bid as they prepare for the September 10 sale hearing.

4. Accordingly, the City's two arguments regarding the ripeness of the issues before the Court, which the City appears to have tacked on to the end of its Objection as an afterthought, are misplaced.

The Debtors Did Not "Judicially Admit" Anything

5. The City states in footnote 2 of its Objection that the Debtors made "repeated judicial admissions" that "the City's resulting harm [from breach of the Lease] would exceed $700 million." To say that the City has lifted snippets of statements from the transcript and presented them out of context is an understatement. At the hearing on June 9, 2009, the Court and Debtors' counsel engaged in a lengthy discussion regarding the City's argument that the Lease cannot be rejected because rejection would cause enormous harm to the City. In order to make the legal point that the City's claim would be capped under § 502(b)(6), Debtors' counsel simply exaggerated the amount of the City's damages for rhetorical effect:

> **DEBTORS' COUNSEL:** The implication [of the City's argument], however, is that -- and therefore, because we're owed **$565 million or $700 million or $400 trillion**, it never makes sense as an economic matter in this case to reject this lease. It would never make sense to do it. But they forget that all of those damages, by virtue of McSheridan and all of the other cases all over the country that make it very clear that all of those resulting claims all go into the pot that then gets capped by 502(b)(6).

Transcript of June 9, 2009 Hearing, 192:8-16 (emphasis added).

6. Debtors' counsel never conceded that the City would suffer damages in the amount of "565 million or $700 million or $400 trillion." *Id.* A complete and honest reading of the transcript makes clear that Debtors' counsel was simply engaged in the common practice of "assuming *arguendo*" — *i.e.,* even assuming for the sake of argument that the City has a claim of "565 million or $700 million or $400 trillion," the City's claim is subject to the statutory cap.

Moreover, the City's counsel knows very well that the amount of the City's rejection damages will be addressed at a later time through claim objection procedures, if the Court approves rejection of the Lease. At the hearing, Debtors' counsel was making an independent legal argument that the cap would apply, regardless of the actual amount of the City's rejection damages and exaggerating for rhetorical effect. *See* Transcript of May 2009 Hearing, 206:5-6 ("**DEBTORS' COUNSEL:** "They [the City] very well might be right. Maybe they've even underestimated [the amount of rejection damages]. I don't know.").[3]

7. Far from constituting judicial admissions, the statements of counsel regarding the City's damages were nothing more than exaggerated, fleeting concessions made for the sake of argument; they were not offers of proof, judicial admissions, or a waiver of any disputed fact. *See* 9 J. Wigmore, Wigmore on Evidence § 2594 (Chadbourn rev. 1981) ("It is of the nature of an admission, plainly, that it be by intention an act of waiver relating to the opponent's proof of the fact and not merely a statement of assertion or concession made for some independent purpose"); *see also In re Applin*, 108 B.R. 253, 258 (Bankr. E.D. Cal. 1989) ("Judicial admissions are not made upon ambiguous, 'assuming arguendo' comments by counsel and are not made upon inconsistent pleas").

The City Wants To Avoid A Relocation Sale At All Costs
Even If Relocation And Rejection Of The Lease Is In The Best Interests Of Creditors

8. Much of the City' Objection is devoted to casting aspersions against the Debtors, Mr. Moyes, and Mr. Balsillie in the form of spurious allegations of bad faith, self-dealing collusion, and bid-chilling. *See* Objection Introduction § 2; Objection Argument §§ 2, 5, and 7. Invoking pejoratives such as "scheme" and "conspired" cannot magically convert normal negotiations into bad faith. Nor does the City's repeated fiduciary duty and self-dealing allegations convert an effort to obtain the best price for all creditors into wrongful conduct. The City has an interest that is contrary to most other creditors. The City desperately wants the team

[3] Debtors' counsel also made clear that the Debtors question "whether there really is a huge loss to the cultural integrity of Glendale if the Coyotes were to leave." *See* Transcript of June 9, 2009 Hearing, 203:18-19.

to stay in Glendale, regardless of its financial condition, regardless of its repeated losses, regardless of the increasing debt, and regardless of who picks up the tab (so long as it is not Glendale). Accordingly, when the City states that "rejection of the Agreement and relocation of the Team would cause tremendous harm to many of the estates' creditors," Glendale is really only referring to itself.

9. Moreover, the false allegations are directed toward defeating a relocation sale; they do not pertain to any of the gating issues set forth in the Motion. Try as it might through diversionary tactics and mud-slinging, the City simply cannot ignore the fundamental and compelling business justification for rejecting the Lease: if the Court approves a relocation sale, then the Lease must be rejected, because no rational debtor would continue to incur liabilities under a lease after its business has moved to a different location.

10. The City's argument that the Debtors filed the Motion in bad faith for the sole purpose of benefitting Mr. Moyes is also unavailing. Rejection of the Lease is governed by the business judgment rule. *See, e.g., In re Pomona Valley Medical Group, Inc.*, 476 F.3d 665, 670 (9th Cir. 2007). Under the business judgment rule, "the bankruptcy court should presume that the debtor-in-possession acted prudently, on an informed basis, in good faith, and in the honest belief that the action was in the best interests of the bankruptcy estate." *Id.* at 670.

11. In determining whether the Lease should be rejected, "The primary issue is whether rejection would benefit the general unsecured creditors." *In re Huang*, 23 B.R. 798, 801 (B.A.P. 9th Cir. 1982). Mr. Moyes is a general unsecured creditor, and the fact that he is an insider does not make his claim less relevant than other general unsecured claims for purposes of the business judgment rule. The City argues that the Court should disapprove rejection of the Lease simply because Mr. Moyes is an insider who, like other general unsecured creditors, might benefit if the Lease is rejected. That is not the law. In determining whether rejection would benefit general unsecured creditors, the Court cannot simply ignore claims of insiders. *See In re Huang*, 23 B.R. 798, 802 (B.A.P. 9th Cir. 1982) (holding that bankruptcy courts cannot disregard insiders' claims for purposes of the business judgment rule).

12. In all events, the Debtors have soundly refuted the City's allegations in other pleadings filed with the Court, and the Debtors will not reiterate those refutations in this Reply. The City, of course, has threatened to introduce new evidence "at trial" based on document requests which "continue to reveal additional materially wrongful conduct." What that evidence might be is a mystery to the Debtors.

The Lease Is A Non-Severable Lease

13. The City has now backed away from its previous position that the Lease is not a lease under Arizona law, and now argues that the Lease constitutes three separate and distinct contracts: a lease, a license, and a contract for services. The City's strategy in changing its position is transparent. The City knows the Lease is a lease, and in a desperate attempt to maximize its claim for rejection damages, it is attempting to carve out portions of the Lease that would not be subject to the mandatory cap of § 502(b)(6). This attempt fails, however, because the Debtors have already demonstrated that the Lease is a lease under Arizona law, and that the Lease is non-severable.

14. Furthermore, it is clear that no portion of the Lease constitutes a license. The only use of the term "license" in the Lease is to refer to license agreements in which ***third-parties*** are the licensees. *See* Lease, § 5.6. The City is never referred to as a licensor in the Lease, and none of the Debtors are referred to as licensees in the Lease. Furthermore, the Lease contains a definition of "License" that *expressly states that the Lease is not a license*:

> **"License"** means any agreement or contract (other than Tickets) entered into by the Arena Manager pursuant to the terms of this Agreement for the use of the Arena (or any portion thereof) with any party (other than the Team with respect to Hockey Events and the City with respect to City Sponsored Events and Community Events), including any agreement or contract with a promoter or sponsor for Events or other activities at the Arena (other than Hockey Events, City Sponsored Events, and Community Events), but **excluding the following: (i) this Agreement**; (ii) Concessions Agreements; (iii) Suite Licensing Agreements; (iv) Premium Seat Agreements; (v) Advertising Agreements; and (vi) Naming Rights Agreements.

Lease, § 1.1 (emphasis added).

15. That definition also expressly precludes the team from being a party to a "License" with respect to "Hockey Events." The Lease defines "Hockey Event" as follows:

> **"Hockey Event"** means any of the following when played and/or conducted at the Arena Facility: (i) any Home Game (including any related Warm-up Sessions); (ii) any All-Star Game any related Warm-up Sessions); or (iii) any Hockey-Related Event.

Lease, § 1.1.

16. Accordingly, the City's argument that the Mandatory Use Covenant (which requires the team to play all its home games at the Arena) is a license directly contradicts the express language of the Lease.

17. Similarly, the City's argument that a portion of the Lease is severable into a separate and distinct "contract for services" has no legal or factual support. The City simply picks out various sections of the Lease and declares them by fiat to constitute a stand-alone contract. Moreover, the only case the City cited to support the existence of this so-called "contract for services" actually held that the agreement in question ***was a lease*** under state law that the debtor was required to either assume or reject, **in its entirety**, under Bankruptcy Code § 365. *See In re SCCC Associates II Limited Partnership*, 158 B.R. 1004, 1004 (Bankr. N.D. Cal. 1993) ("The court finds that the agreement is a lease subject to § 365").

18. Because the City cannot successfully argue that the Lease is severable into three distinct contracts, it likewise cannot successfully argue that only a portion of its rejection damages are subject to the cap. *See* Objection, 26:23-28. Furthermore, *In re Leslie Fay Companies, Inc.*, 166 B.R. 802 (Bankr. S.D.N.Y. 1994) does not support the City's argument that the cap applies to only a severed portion of the Lease. *Leslie Fay* involved two separate contracts (a lease and a sale contract). Not surprisingly, the Court held that the statutory cap of § 502(b)(6) did not apply to damages that resulted from rejection of the sale contract, because the sale contract was not a lease. *See id.* at 810 ("If Congress had intended to limit the amount of a claim for breach of a contract for the sale of real property, it would have provided so expressly,

most probably by including another subsection in 502(b)"). Thus, the City is incorrect when it suggests that *Leslie Fay* dealt with "a single contract containing a lease."

19. The Lease is a non-severable lease, and rejection of the Lease under § 365 would result in a breach of the entire Lease, including all covenants contained in the Lease such as the Team Use Covenant:

> Reading these provisions [of § 365] as a whole, therefore, rejection of the lease results in the breach of each and every provision of the lease, including covenants, and § 502(b)(6) is intended to limit the lessor's damages resulting from that rejection. The damages are those resulting from nonperformance of the debtor's obligations under the lease. [In re Mr. Gatti's, Inc., 162 B.R. 1004, 1011 (Bankr. W.D. Tex. 1994)]. The distinction between past obligations under the lease and damages "caused" by the termination is incorrect because all damages due to nonperformance are encompassed by the statute.

In re McSheridan, 184 B.R. 91, 101-02 (B.A.P. 9th Cir. 1995).

20. Moreover, all of the City's damages that result from rejection of the Lease would be capped under § 502(b)(6). *Id.; In re El Toro Materials Co.*, 504 F.3d 978, 980 (9th Cir. 2007) ("The cap applies to damages 'resulting from' the rejection of the lease").

21. Arizona law governs any dispute over whether portions of a single agreement are severable *See In re Or. Arena Corp.*, 2006 U.S. Dist. LEXIS 10042, at **5 (D. Or. Feb. 28, 2006) (applying state law to find agreements indivisible under § 365; "Whether multiple obligations in an agreement are severable is a question of state law") (citation omitted); *see also In re Qintex Entertainment, Inc.*, 950 F.2d 1492, 1496 (9th Cir. 1991) (applying state law to find that contract is not severable). Under Arizona law, courts consider several factors when determining if contract provisions are severable, including (a) whether the parties intended the contract to be read as a whole, (b) whether the consideration is separate, and (c) whether the clauses are dependent or independent. *See Kahl v. Winfrey*, 81 Ariz. 199, 203-04 (1956); *Clark v. Levy*, 25 Ariz. 541, 543-545 (1923). "Any ambiguity in a lease is generally construed most

strongly against the lessor," or the City in this case. *Wilson v. Pate*, 17 Ariz. App. 461, 461, (Ariz. App. 1972).

22. **The parties intended the Team Use Covenant to be indivisible from the remainder of the Lease**. The City argues that the Team Use Covenant found in Section 9.5 of the Lease is somehow severable from the other provisions of the Lease. The Lease itself precludes such an argument, as does Arizona law.

23. The first factor the courts consider when determining whether a contract's provisions are severable is "[t]he intention of the parties, as determined from the contractual language and the subject matter…" *Kahl*, 81 Ariz. at 203-04; *see also Leeker v. Marcotte*, 41 Ariz. 118, 123, (Ariz. 1932); *O'Malley Inv. & Realty Co. v. Trimble*, 5 Ariz. App. 10, 17 (Ariz. App. 1967) (examining both the subject matter of and the language employed by the contract).

24. Here, the Lease makes plain that the parties intended the Lease and the Team Use Covenant to be read as a whole, not as separate agreements. As an initial matter, the parties agreed to a clause limiting invalidity, to preserve the entirety and integrity of the Lease as a whole:

> If any article, section, subsection, term or provision of this Agreement … shall, to any extent, be invalid or unenforceable, the remainder of the article, section, subsection, term or provision of this Agreement … other than those to which it is held invalid or unenforceable, shall not be affected thereby, and each remaining article, section, subsection, term or provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

Lease, § 19.3.

25. That the Team Use Covenant is not severable from the remainder of the Lease is also apparent from the fact that the parties expressly made other clauses in the Lease severable. *See, e.g.*, *id.* § 13.3.6 (the City's covenant not to participate in any events that may compete with Coyotes Hockey "shall be construed as an agreement independent of any other provision in this Agreement"). The parties expressly agreed in Section 13.3.6 of the Lease the City's covenant

not to participate in events that would compete with Coyotes Hockey "shall be construed as an agreement ***independent*** of any other provision in this Agreement" (emphasis added). No such language appears in the Team Use Covenant or in any provision permitting the City to enforce the Team Use Covenant.

26. **The consideration in the Lease is for all promises and cannot be apportioned.** Another factor Arizona courts consider to determine whether a contract's provisions are severable is "whether the consideration for two or more promises is entire or if it is capable of apportionment among the several promises." *See Kahl*, 81 Ariz. at 203-204 (separate consideration is an indicia of severability). When "the consideration for a contract can be apportioned, each item of the contract will be treated as a separate unit rather than a part of the whole." *Goodman v. Newzona Inv. Co.*, 101 Ariz. 470, 473 (1966).

27. Here, the consideration of the parties under the Lease is contained in one promise; the parties did not apportion the consideration and it is not capable of being apportioned. *See* Lease, Recitals, ¶ L (Coyotes Hockey agrees to play its home games at the Arena, and pay rent and other sums "In reliance upon and in consideration of the City's obligations under this Agreement and the Related Agreements"). The Lease repeatedly states that the consideration provided by Coyotes Hockey is "consideration for the rights granted to the team under this Agreement." *Id.* §§ 9.3.1(b), 9.3.1(a) ("As part of the consideration for the rights granted to the Team under this Agreement, the Team shall pay to the City the following amounts"). The parties unequivocally intended that the consideration be indivisible. There is no separate consideration for the Team Use Covenant or any other individual covenant or obligation under the Lease.

28. The Lease ties the consideration paid by Coyotes Hockey to *all* the rights granted by the City to Coyotes Hockey. It is impossible to separate the consideration for any one obligation in the Lease from any other obligation in the Lease. It is impossible to separate consideration paid for occupancy and consideration paid for the Team Use Covenant. In fact, it is apparent from the form of the liquidated damages clause, which decreases in direct proportion to payments made by Coyotes Hockey, that the consideration for the Lease (*i.e.* the payments made

by Coyotes Hockey) is indistinguishable and not severable from the consideration for the Team Use Covenant.

29. **The Lease's clauses are not independent of one another.** Finally, courts applying Arizona law to determine whether contract provisions are severable examine whether the clauses depend on one another. *See Clark v. Levy*, 25 Ariz. 541 (1923) (construing two leases and a memorandum as an indivisible agreement where all of the documents related to the same real property and could not be read independently); *Waddell v. White*, 51 Ariz. 526, 540 (1938) ("a severable contract is one [in] which… matters and things contemplated and embraced by the contract … are not necessarily dependent upon each other").

30. Several key operative provisions of the Lease tangibly depend on one another. Under Section 14.7.2, the liquidated damages remedy for a violation of the Team Use Covenant is directly tied to amounts already paid under the Lease for rent, maintenance, and many other obligations; the alleged liquidated damages are calculated by subtracting the total amounts paid by Coyotes Hockey to the City from a predetermined amount. When the damages for breach of one clause (*e.g.,* the Team Use Covenant) can only be calculated by referring to another clause (*i.e.,* ongoing payment obligations), those clauses undeniably depend on each other.

31. What is more, the effective term of the Lease depends on the Team Use Covenant. *See* Lease § 9.6 (establishing circumstances when Team Use Covenant may be suspended). When the Team Use Covenant is suspended, the Lease is effectively frozen in time, and the term of the Lease is also halted until the Team Use Covenant becomes effective again. That the Lease's term is dictated by whether the Team Use Covenant is suspended compels one to conclude that the covenants in the Lease as a whole, including the Team Use Covenant, are dependent on each other.

32. The Lease's own terms and the clear dictates of applicable Arizona law establish that the Lease is a nonresidential real property lease and that its provisions are not severable from one another. As such, the Lease is subject to assumption or rejection under Bankruptcy Code § 365. If the proposed sale of Coyotes Hockey's assets is approved and the hockey team

relocated, the Debtors will reject the Lease. That rejection easily satisfies the business judgment standard for rejecting executory contracts and unexpired leases under Bankruptcy Code § 365.

The City's "Disproportionate Harm" Argument Ignores The Cap

33. The Ninth Circuit has stated that "There may be cases where the disproportionate damage to the party whose contract is to be rejected demonstrates that the debtor-in-possession's decision [to reject the contract] could not be based on sound business judgment." *In re Pomona Valley Medical Group, Inc.*, 476 F.3d 665, 671 (9th Cir. 2007) (finding no such disproportionate harm, and affirming bankruptcy court's approval of rejection of medical provider contract). Latching on to this and other similar statements, the City argues that the Debtors' decision to reject the Lease can never pass the business judgment test because the damages the City would incur as a result of rejection outweigh the benefits that would accrue to other unsecured creditors. The obvious problem with the City's argument is that the City's rejection damages claim is subject to the cap of § 502(b)(6). Rejecting the Lease and capping the City's claim necessarily results in a larger recovery for the other general unsecured creditors; and, therefore, a greater benefit to those creditors. That is the entire policy underlying the statutory cap in § 502(b)(6): "It is designed to compensate the landlord for his loss while not permitting a claim so large (based on a long-term lease) as to prevent other general unsecured creditors from recovering a dividend from the estate." House Report No. 95-595, 95th Cong., 1st Sess. 352-354 (1977).

34. The City argues that the cap should not be applied to the City's claim in connection with the business judgment test, but that plainly is not the law. *See In re Federated Department Stores, Inc.,* 131 B.R. 808 (S.D. Ohio 1991) (affirming bankruptcy court's approval of lease rejection because rejection in conjunction with the § 502(b)(6) cap on the lessor's claim was in the best interests of general creditors as a whole); *see also In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197, 203-04 (3rd Cir. 2003) (holding that lessor's capped claim was unimpaired for purposes of voting on plan because application of § 502(b)(6) cap is mandatory, not discretionary).

35. Furthermore, the City cites three cases in which bankruptcy courts refused to approve rejection of an executory contract because rejection would result in disproportionate harm to the non-debtor party to the contract. **None of those cases involved rejection of a lease;** application of the mandatory cap of § 502(b)(6) in connection with the business judgment rule was not an issue. *See In re Petur U.S.A. Instrument Co.,* 35 B.R. 561 (Bankr. W.D. Wash. 1983) (intellectual property license agreement); *In re Monarch Tool & Mfg. Co.*, 114 B.R. 134 (Bankr. S.D. Ohio 1990) (distributorship agreement); *Infosystems Tech., Inc. v. Logical Software, Inc.*, 1987 U.S. Dist. LEXIS 6285 (D. Mass. 1987) (distributorship agreement).

Conclusion

For the reasons stated above, the Debtors respectfully request that the Court overrule the Objection in its entirety.

Dated: August 31, 2009.

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