UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF OHIO
AT CANTON

In re:	:	Chapter 11
	:	
SCHWAB INDUSTRIES, INC., *et al.*,[1]	:	Case No. 10-60702
	:	(Jointly Administered)
Debtors.	:	
	:	Judge Russ Kendig

REPLY OF THE DEBTORS TO OBJECTIONS OF (1) MANATEE COUNTY PORT AUTHORITY, (2) ALLEN CONCRETE & MASONRY, INC., (3) THE NATIONAL LIME & STONE COMPANY, (4) HOLCIM (US) INC., (5) ST. MARYS CEMENT COMPANY AND (6) THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO DEBTORS' MOTION FOR APPROVAL OF THE SALE OF SUBSTANTIALLY ALL OF ITS ASSETS, THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES AND RELATED RELIEF

Schwab Industries, Inc ("SII"), Medina Cartage Co. ("MCC"), Medina Supply Company ("MSC"), Quality Block & Supply, Inc. ("QBS"), O.I.S. Tire, Inc. ("OIS"), Twin Cities Concrete Company ("TCC"), Schwab Ready-Mix, Inc. ("SRM"), Schwab Materials, Inc. ("SMI") and Eastern Cement Corp. ("ECC"), and together with SII, MCC, MSC, QBS, OIS, TCC, SRM and SMI, the "Debtors"), the debtors and debtors in possession in the above-captioned Chapter 11 cases (the "Cases"), by and through their undersigned counsel, hereby reply (the "Reply") to the Objections[2] filed by (1) Manatee County Port Authority (the "Port Authority") [Docket No. 423],

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[1] The Debtors in these Chapter 11 Cases, along with the last four digits of each Debtor's tax identification number are: Schwab Industries, Inc. (2467); Medina Cartage Co. (9373); Medina Supply Company (3995); Quality Block & Supply, Inc. (2186); O.I.S. Tire, Inc. (7525), Twin Cities Concrete Company (9196); Schwab Ready-Mix, Inc. (8801); Schwab Materials, Inc. (8957); and Eastern Cement Corp. (7232).

[2] "Objections" means and refers to: (1) *Manatee County Port Authority's Limited Objection to Debtor's Proposed Sale and to Stated Cure Amount* (the "Port Authority Objection"); (2) *Objection of Allen Concrete & Masonry, Inc. to (A) Debtors' Motion for Order (1) Authorizing the Sale of Substantially All of the Debtors' Assets, Free and Clear of Liens, Claims, Interests and Encumbrances, Subject to Higher or Better Offers, Pursuant to Bankruptcy Code Sections 363 and 365; (2) Approving the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with Such Sale and Determining and Adjudicating Cure Amounts with Respect to Such Contracts and Leases; (3) Waiving the Fourteen-Day Stay Period Provided by Bankruptcy Rule 6004(H); and (4) Granting Related Relief [Docket No. 241], and (B) Debtors' Motion for Order (1) Authorizing the Auction Sales of Certain Non-Core Assets, Free and Clear of Liens, Claims, Interests and Encumbrances; (2) Waiving the*

(2) Allen Concrete & Masonry, Inc. ("Allen Concrete") [Docket No. 428], (3) The National Lime & Stone Company ("NLS") [Docket No. 431], (4) Holcim (US) Inc. ("Holcim") [Docket No. 433], (5) St. Marys Cement Company ("St. Marys") [Docket No. 367] and (6) the Official Committee of Unsecured Creditors (the "Committee") [Docket No. 434], and in support of their Sale Approval Motion (as defined herein), as forth more fully below. In support of this Reply, Debtors respectfully state as follows:

PRELIMINARY STATEMENT

1. None of the Objections bar this Section 363 sale.

2. The objections of the Port Authority, Allen Concrete, NLS, Holcim and St. Marys are essentially placeholders for claims they assert.

3. The Committee Objection, which questions the sale process, is entirely without merit and fails to establish that this Section 363 sale is not a proper exercise of Debtors' business judgment.

4. Debtors, with the support of their Secured Lenders, are seeking approval of the sale of substantially all their assets to the bidder(s) with the highest and best bid(s). Debtors'

Fourteen-Day Stay Period Provided by Bankruptcy Rule 6004(H); and (3) Granting Related Relief [Docket No. 242] (the "Allen Concrete Objection"); (3) *Limited Objection of the National Lime and Stone Company to Motion for Order (1) Authorizing the Sale of Substantially All of the Debtors' Assets, Free and Clear of Liens, Claims, Interests and Encumbrances, Subject to Higher or Better Offers, Pursuant to Bankruptcy Code Sections 363 and 365; (2) Approving the Assumption and Assignment of Certain Exectuory Contracts and Unexpired Leases in Connection with Such Sale and Determining and Adjudicating Cure Amounts with Respect to Such Contracts and Leases; (3) Waiving the Fourteen-Day Stay Period Provided by Bankruptcy Rule 6004(H); and (4) Granting Related Relief ("Sale Motion")* (the "NLS Objection"); (4) *Limited Objection of Holcim (US) Inc. to Debtor's Proposed Sale and to the Scheduled Pre-Petition Default Cure Amount* (the "Holcim Objection"); (5) *Objection of St. Marys Cement Co. to Debtors' Motion for a Revised Bidding Procedures Order Approving (1) Executed Stalking Horse Asset Purchase Agreement; (2) Proposed Break-Up Fee and Expense Reimbursement; (3) Revised Bidding Procedures; (4) the Form and Manner of Service of Notice of the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases* (the "St. Marys Objection"); and (6) *Objection of Official Committee of Unsecured Creditors to Debtors' Motion For Order (1) Authorizing the Sale of Substantially all of the Debtors' Assets, Free and Clear of Liens, Claims, Interests and Encumbrances, Subject to Higher or Better Offers, Pursuant to Bankruptcy Code Sections 363 and 365; (2) Approving the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with Such Sale and Determining and Adjudicating Cure Amounts with Respect to Such Contracts and Leases; (3) Waiving the Fourteen-Day Stay Period Provided by Bankruptcy Rule 6004(h); and (4) Granting Related Relief* (the "Committee Objection"). Capitalized terms used in this Reply that are not subsequently defined herein have the meanings ascribed to them in the Final Bid Procedures Order to which the Objections object.

authority to use cash collateral expires June 1, 2010. Time is of the essence, and approval of such sale(s) is necessary and appropriate.

5. The Sale Approval Motion is well founded and is a reasoned application of Debtors' business judgment. It should be granted.

A. BACKGROUND

1. The Bankruptcy Case

6. On February 28, 2010 (the "Petition Date"), Debtors commenced the Cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The Cases are being jointly administered pursuant to an Order of this Court.

7. Debtors are continuing in possession of their properties and assets and are operating and managing their businesses as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in the Cases.

8. On March 9, 2010, the United States Trustee appointed an official committee of unsecured creditors (the "Committee").

9. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§157 and 1334. Venue of this case in this district is proper pursuant to 28 U.S.C. §§1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2).

2. The Sale Approval Motion and Related Bid Procedures

10. On April 5, 2010, Debtors filed their *Motion for Order (1) Authorizing the Sale of Substantially all of the Debtors' Assets, Free and Clear of Liens, Claims, Interests and Encumbrances, Subject to Higher or Better Offers, Pursuant to Bankruptcy Code Sections 363 and 365; (2) Approving the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with Such Sale and Determining and Adjudicating Cure Amounts with Respect to Such Contracts and Leases; (3) Waiving the Fourteen-Day Stay Period*

Provided by Bankruptcy Rule 6004(H); and (4) Granting Related Relief (the "Sale Approval Motion") [Docket No. 241] and their *Motion for an Order (1) Approving Auction and Bidding Procedures and an Auction Date; (2) Scheduling Date and Time for Sale Hearing; (3) Approving the Form and Manner of Service of Notice of the Sale Hearing and Auction Pursuant to Bankruptcy Rules 2002, 6004 and 6006; (4) Approving the Form and Manner of Service of Notice of the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (5) Granting Related Relief* (the "Bid Procedures Motion") [Docket No. 245].

11. On April 16, 2010, the Court granted the Bid Procedures Motion pursuant to the *Order Granting Motion for an Order (1) Approving Auction and Bidding Procedures and an Auction Date; (2) Scheduling Date and Time for Sale Hearing; (3) Approving the Form and Manner of Service of Notice of the Sale Hearing and Auction Pursuant to Bankruptcy Rules 2002, 6004 and 6006; (4) Approving the Form and Manner of Service of Notice of the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (5) Granting Related Relief* [Docket No. 288].

12. On May 2, 2010, Debtors filed their *Motion for a Revised Bidding Procedures Order Approving (1) Executed Stalking Horse Asset Purchase Agreement; (2) Proposed Break-Up Fee and Expense Reimbursement; (3) Revised Bidding Procedures; (4) the Form and Manner of Service of Notice of the Sale Hearing and Auction; and (5) the Form and Manner of Service of Notice of the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases* [Docket No. 336 and as amended and redacted, Docket No. 344]. On May 14, 2010, the Court entered the *Agreed Order Granting Motion for a Revised Bidding Procedures Order Approving (1) Executed Stalking Horse Asset Purchase Agreement; (2) Proposed Break-Up Fee and Expense Reimbursement; (3) Revised Bidding Procedures; (4) the Form and Manner of Service of Notice of the Sale Hearing and Auction; and (5) the Form and Manner of*

Service of Notice of the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases [Docket No. 408] (the "Final Bid Procedures Order").

13. Pursuant to the Final Bid Procedures Order objections to the Sale Approval Motion were due no later than May 21, 2010. The Objections are the only objections filed in response to the Sale Approval Motion.

B. REPLY TO OBJECTIONS

14. None of the Objections pose an impediment to the approval of the proposed Section 363 Sale(s). Specific responses to each Objection follow.

1. Reply to Port Authority Objection

15. The Port Authority Objection essentially is a placeholder to insist on compliance with Section 365. Debtors intend to comply with Section 365. Debtors anticipate, based upon the bids received prior to the May 24, 2010 bid deadline, that any bidder that elects to include in its bid the assumption and assignment of the lease with the Port Authority has sufficient wherewithal to pay the Port Authority's stated cure amount ($493,117.31 as of May 19, 2010, with an additional $12,716.10 due on June 1, 2010, the projected closing date).

16. In its Objection, the Port Authority acknowledged the sufficiency of the adequate assurances of the Stalking Horse Bidder. Debtors believe that each bidder that elects to include it in its bid also has sufficient wherewithal to meet the adequate assurances requirement of Section 365(f)(2) as to the Port's lease.

2. Reply to Allen Concrete Objection

17. The Allen Concrete Objection is moot in that no bidder (other than Allen Concrete, which has bid on the partnership interest held by Debtor SRM in Allen Concrete Pumping) has expressed an interest in attempting to obtain the assumption and assignment of the partnership interest or partnership agreement.

18. To the extent any bids are advanced to include the acquisition of or the assumption and assignment of the partnership interest or partnership agreement, the Allen Concrete Objection essentially is a placeholder to insist on compliance with Section 365. To the extent necessary Debtors intend to comply with Section 365. Debtors anticipate, based upon the bids received prior to the May 24, 2010 bid deadline, that any bidder that elects to include the assumption and assignment of the Partnership Agreement has sufficient wherewithal to pay Allen Concrete's stated cure amount ($337,651.65 as of June 1, 2010, the projected closing date). Further, the Debtors believe that each bidder also has sufficient wherewithal to meet the adequate assurances requirement of Section 365(f)(2).

19. Debtors have shared Allen Concrete's stated concerns with the Stalking Horse Bidder, and will share the same information and concerns with any Qualified Bidder, inviting an open dialog between Allen Concrete and any Successful Bidder. Based on the information Allen Concrete has provided to Debtors, Debtors believe the discussion between Allen Concrete and such Successful Bidder can be had in less than 24 hours, especially considering the considerable "airplay" Allen Concrete has given these issues (including in filings commencing on May 5, 2010 [Docket No. 355] and in subsequent filings, including, to date, [Docket Nos. 385, 390, 427, 428 and 430]). Prior to the entry of the Final Bid Procedures Order, Debtors have consented to any Qualified Bidder having discussions with Allen Concrete regarding the Allen Concrete Objection in an effort to reach consensual conclusion to the Allen Concrete Objection.

3. Reply to NLS Objection

20. The NLS Objection is resolved by the approach taken by the United States Court of Appeals for the Seventh Circuit in its decision in *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003). In *Qualitech,* the Seventh Circuit held:

> Where estate property under lease is to be sold, section 363 permits the sale to occur free and clear of a lessee's possessory interest – provided that the lessee (upon request) is granted adequate protection for its interest. Where the property is not sold, and the debtor remains in possession thereof but chooses to reject the lease, section 365(h) comes into play and the lessee retains the right to possess the property.

Id. at 548. As Debtors can sell assets free and clear of any possessory interests under Section 363(f), NLS cannot preclude the sale. At most, NLS has a claim for adequate protection under Section 363(e).

21. Whether, and the extent to which, NLS is or may be entitled to adequate protection under section 363(e) turns in large measure upon the nature of the interest held by NLS under applicable nonbankruptcy law. The following timeline sets forth the facts relevant to the property located at 820 West Smith Road, Medina, OH (the "Property"), a portion of which is leased to NLS:

January 27, 2003	Open-end Mortgage, Assignment of Leases and Rents and Fixture Filing from MSC in favor of KeyBank National Association on the Property (as amended and modified, the "Mortgage")
November 29, 2007	Open-end Mortgage Modification Agreement from MSC in favor of KeyBank National Association on the Property
March 2, 2009	Memorandum of Lease between MSC as lessor and NLS as lessee on the Property (the "Lease")
February 28, 2010	MSC files its chapter 11 petition

22. Under Ohio law, when a lease of a property is recorded after a mortgage is recorded on the same property, the mortgagee can foreclose the lease and any interest under the lease by foreclosing upon the mortgage with notice to the lessee. *Cf. Michigan Mut. Life Ins. Co. v. Sheridon*, 11 Ohio App. 29, (Ohio Ct. App. 1918) (a lessee whose lease is foreclosed has a claim for compensation which is prior only to those liens recorded subsequent to the lease). The

interests of NLS in the Lease of the Property would be entirely extinguished in a foreclosure action in Ohio brought by the holder of the Mortgage.[3]

23. Under section 363(f)(1), therefore, the Property (in which NLS claims an interest by virtue of its Lease) may be sold free and clear of any interest NLS has or may claim through its Lease.

24. Accordingly, the full extent of adequate protection to which NLS is entitled consists of notice of the proposed Section 363 sale. NLS has been provided ample notice.[4] Whether or not the Court expressly follows *Qualitech*, this Section 363 sale provides NLS with adequate protection.

25. The Court should, nonetheless, follow *Qualitech*, without hesitation. Section 363 must control the treatment of "interests" in a section 363 sale. As the Seventh Circuit notes:

> [I]t is both reasonable and correct to interpret and reconcile sections 363(f) and 365(h) in this way. It is consistent with the express terms of each provision, and it avoids the unwelcome result of reading a limitation into section 363(f) that the legislature itself did not inscribe onto the statute.

Qualitech, 327 F.3d at 548. Other courts have found *Qualitech* persuasive in holding that section 365(h) does not apply in the context of a 363(f) sale and that a 363 sale extinguishes a lessees' possessory interest.[5] *See In re Hill*, 307 B.R. 821 (W.D. Pa. 2004) ("Although the courts of this

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[3] The cases cited by NLS concerning its state law rights under lease are inapposite, as neither involves a lease. In *Au v. Au Rustproof Ctr., Inc*. No. CA-2227, 1984 Ohio App. LEXIS 10561 (Ohio Ct. App. July 3, 1984), a sale confirmation order was reversed because it modified a lienholder's rights. In *Dir. Of Transp. v. Eastlake Land Dev. Co*., 894 N.E.2d 1255 (Ohio Ct. App. 2008), a sale confirmation order was reversed because of the lack of notice to a lienholder. Copies of these and all other unpublished opinions are attached collectively as Exhibit A and incorporated as if set forth in full herein.

[4] NLS is not merely scheduled as a creditor in these cases (which would be sufficient to apply Section 363(f) to NLS and its Lease). NLS serves on the Committee, upon information and belief is (or has been) Committee chair, has advanced a bid for certain of the Assets and is a Qualified Bidder.

[5] Courts have established a broad consensus that "any interest" under Section 363(f) encompasses a tenant's leasehold interest. *See In re Downtown Athletic Club of N.Y. City*, Case No. M-47, 2000 U.S. Dist. LEXIS 7917 at *11 (S.D. N.Y. June 9, 2000) ("[u]nder the expansive interpretation of 'any interest' under section 363(f)(4), Defendants' asserted possessory right as lessees fall within the scope of this section."); *In re Lady H. Coal Co., Inc*. 193 B.R. 233, 246 (Bankr. S.D. W.Va. 1996) ("the generally broad interpretation of 'any interest' as utilized under

circuit have not yet considered whether a sale under [Section 363(f)] terminates leaseholds, this Court finds persuasive the exhaustive treatment of this issue and conclusions of the U.S. Court of Appeals for the Seventh Circuit last year in [*Qualitech*]").

26. Each of the cases NLS cites as contrary to *Qualitech* is distinguishable from the case at bar.[6] A free and clear sale under section 363(f) extinguishes the tenant's leasehold interest.

27. NLS also attempts to distinguish *Qualitech* from the present case because the tenant in *Qualitech* "slept on its rights" and did not object until after the sale. However, this distinction is irrelevant. Nothing in *Qualitech* suggests a different result would apply had the tenant's objection had been made prior to the sale approval hearing. Any other result would undermine the public policy that promotes free and clear sales under section 363.

28. As the Seventh Circuit stated "because [a tenant's] right to possess the property as a lessee qualifies as an interest for purposes of section 363(f), the statute on its face authorized the sale of [the debtor's] property free and clear of that interest." *Qualitech*, 327 F.3d at 546.

4. Reply to Holcim Objection

29. The Holcim Objection asserts a claim arising under Section 503(b)(9). This claim, whatever the amount, does not preclude this Section 363 sale.

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§ 363(f)"); *In re Taylor*, 198 B.R. 142, 162 (Bankr. D.S.C. 1996) ("it appears that a leasehold is a type of 'interest' that fits within the plain text of the § 363(f)(4) statute"); *Qualitech*, 327 F.3d at 545 ("the term 'any interest' as used in section 363(f) is sufficiently broad to include Precision's possessory interest as a lessee.").

[6] *In re Haskell,* 321 B.R. 1(Bankr. D. Mass. 2005), is decided solely on the basis of section 363(f)(5), concluding that a leasehold interest is not reducible to a monetary claim. Under *Haskell* a sale pursuant to section 363(f)(5) does not necessarily permit a sale free and clear of a possessory interest. This sale is requested, and may be authorized, under section 363(f)(1). *In re Churchill Properties*, 197 B.R. 283 (Bankr. N.D. Ill. 1996), was decided before *Qualitech* and is no longer good law under *Qualitech's* holding that 363(f) trumps 365(h). *In re Samaritan Alliance, LLC*, Case. No. 07-50735, 2007 Bankr. LEXIS 3896 (Bankr. E.D. Ky. Nov. 21, 2007), is distinguishable as it is a dispute between the purchaser of the property free and clear and a sub-tenant that claims that it did not receive notice in which section 363 was not raised at all. *MMH Automotive Group, LLC,* 385 B.R. 347 (S.D. Fl. 2008) actually supports Debtors' contentions under Section 363(f).

30. Debtors' books and records relating to the period February 8 through 28, 2010 (*i.e.*, the 20 days before the Petition Date) establish that Debtors received actual shipments from Holcim of 1,447.82 tons of cement, at a price of $64.18 per ton, for a total of $92,921.09.

31. Holcim contends, based upon its records of total shipments into the silos at the Port, and the unsubstantiated contention that the silos are now "empty," that Debtors owe Holcim nearly $600,000. In fact, the silos are not "empty." The silos have not been cleaned in many years, and considerable quantities of cement cling to the walls of all four (4) silos, each having a capacity of over 11,000 tons. Holcim's method for determining the volume of cement allegedly received by Debtors between February 8 and February 28, depends upon clearly erroneous assumptions, and is seriously flawed.

32. The amounts of cement Debtors received from Holcim are the only volumes that benefited the Debtors during the 20-day window for Section 503(b)(9) Claims. The Holcim 503(b)(9) claim should be limited to $92,921.09 received during the 20-day window.[7]

33. Although the Stalking Horse APA proposes to have the Stalking Horse Bidder assume responsibility for the 503(b)(9) Claims, other bidders may not propose such generous treatment.

5. Reply to St. Marys Objection

34. Like the Holcim Objection, the St. Marys Objection is a placeholder for a Section 503(b)(9) claim. The same legal arguments apply.

35. As for the amount of the 503(b)(9) Claim of St. Marys, Debtors acknowledge owing St. Marys $60,732.01. This claim, in whatever amount, does not impede approval of the sale.

[7] Debtors reserve their rights as to the Holcim claims generally and its Section 503(b)(9) claim in particular.

6. Reply to Committee Objection

36. The Committee Objection makes several arguments, each of which are without merit.

a. Debtors Have Not Suppressed Any Bids

37. Contrary to the Committee's outrageous fabrications, Debtors have not rejected any bids or refused to qualify any bids. In its "Statement" [Docket No. 441] the Committee reports that Debtors tried to bar a bidder group (Straub and Zinc). The Committee fails to state that Debtors accommodated this group, and that the group submitted multiple "basket bids." Further, Debtors qualified the bids of this group, and of every other party that complied with the Final Bid Procedures Order .

b. Debtors Have Properly Exercised Their Business Judgment

38. The fact that Debtors' management is having discussions with bidders about matters that pertain to their interests is a red herring. The Debtors have and will continue to evaluate bids based upon their merits and their benefits to the Debtors' estates.

c. Neither the Cement Resources nor any Other Bid Constitutes a Sub Rosa Plan

39. No transaction contemplated by Debtors pursuant to the Section 363 sale approaches a *sub rosa* plan or otherwise circumvents the plan process. As noted in *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009):

> A 363 sale may also may be objectionable as a *sub rosa* plan if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors [footnote omitted]
>
> But none of those factors is present here. The MPA does not dictate the terms of a plan of reorganization, as it does not attempt to dictate or restructure the rights of the creditors of this estate. It merely brings in value. Creditors will thereafter share in that value pursuant to a chapter 11 plan subject to confirmation by the Court. A transaction contemplating that does not amount to a *sub rosa* plan. [footnote omitted]

Id., at 495-96. The bids are all or predominantly cash deals. No creditors' rights are restructured. No future plan terms are dictated. No releases are requested or offered. The *sub rosa* plan argument is pure make weight.

RESERVATION OF RIGHTS

40. Debtors are filing this Response as the Auction is commencing, and is continuing to negotiate with all parties in interest. Debtors reserve the right (a) to amend, supplement, or otherwise modify this Reply as they deem necessary or proper; and (b) to submit such other and further responses to support the relief requested in the Motion at or before any hearing(s) thereon.

WHEREFORE, Debtors respectfully request that the Court (a) grant the Motion and overrule the Objections; and (b) grant Debtors such other and further relief to which they are justly entitled.

Dated: May 27, 2010

Respectfully submitted,

/s/ Daniel A. DeMarco

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EXHIBIT A

LEXSEE 1984 OHIO APP. LEXIS 10561

RICHARD D. AU, Plaintiff, vs AU RUSTPROOFING CENTER, INC., Defendant, AU RUSTRPOOFING CENTER, INC., Plaintiff-Appellee, vs GULF OIL CORPORATION, et al., Defendants-Appellants

CASE NO. CA-2227

COURT OF APPEALS FOR RICHLAND COUNTY, OHIO, FIFTH APPELLATE DISTRICT

1984 Ohio App. LEXIS 10561

July 3, 1984

COUNSEL: [*1] JAMES DeWEESE, INSCORE, RINEHARDT AND WHITNEY, 3 North Main Street, Suite 304, Mansfield, Ohio 44902, COUNSEL FOR PLAINTIFF-APPELLEE.

RALPH E. DILL, GURVIS, KAUFFMAN, KURGIS & DILL, 50 West Broad Street - 40th Floor, Columbus, Ohio 43215, COUNSEL FOR DEFENDANTS-APPELLANTS.

JUDGES: Hoffman, P.J. and Wise, J. concur.

OPINION BY: TURPIN, J.

OPINION

JUDGMENT ENTRY

For the reasons stated in the Memorandum-Opinion on file, the judgment of the Court of Common Pleas of Richland County, Ohio, is reversed and this cause is remanded to that court for further proceedings according to law.

OPINION

This case is a result of a receivership proceeding begun by Richard D. Au against Au Rustproofing Center, Inc. Richard D. Au was appointed the receiver in these proceedings. Appellant, Gulf Oil Corporation, is a secured creditor of Au Rustproofing Center, Inc. On June 22, 1983, the receiver filed a motion asking leave to sell certain real property free and clear of liens. Liens on the real property were then attached to the fund created by the sale. Gulf was one of the lien holders which would have been affected. Accordingly, Gulf filed its objections to that motion. Subsequently, the receiver [*2] withdrew his motion and on October 20, 1983, filed a complaint asking the same relief sought in his motion. Gulf answered on November 22, 1983, setting up its objections to the sale.

After an evidentiary hearing on January 23, 1984, the court issued an order permitting the sale of the real property upon the terms proposed by the receiver.

Gulf has taken this appeal from the final order of January 25, 1984, and makes the sole assignment of error as follows:

ASSIGNMENT OF ERROR NO. I

THE TRIAL COURT ERRED IN ISSUING AN ORDER APROVING THE PROPOSED SALE OF REAL PROPERTY BY THE RECEIVER ON TERMS WHICH DIVESTED THE LIEN OF GULF UPON THAT REAL PROPERTY, AND WHICH ALLOWED PAYMENT BY THE PURCHASER OVER FIVE YEARS.

The error complained of is sustained, and we reverse. We believe the courts do not have the power in receiver proceedings to take away lien rights in property which were vested by contract or by operation of law without the consent of lien holders.

In this particular case, the five-year payoff provision, in and of itself, impairs appellant's security. It converts the immediate right to payment to appellant into a five-year obligation. Appellant is forced to accept [*3] a

promise of payment later in exchange for a much more immediate payment.

For the reasons stated, the decision of the trial court approving the sale of the real property is reversed and this matter is remanded to the Court of Common Pleas of Richland County, Ohio, for further proceedings according to law.

LEXSEE 2000 U.S. DIST. LEXIS 7917

In re: DOWNTOWN ATHLETIC CLUB OF NEW YORK CITY, INC., Debtor. CHESLOCK-BAKKER & ASSOCIATES, INC. and 19 WEST HOTEL LLC, Plaintiffs/Appellants, -v.- ROBERT KREMER, THOMAS B. TYRREL, and VLADIMIR V. FISENKO, Defendants/Appellees. DOWNTOWN ATHLETIC CLUB OF NEW YORK CITY, INC., Plaintiffs/Appellants, -v.- ROBERT KREMER, THOMAS B. TYRREL, and VLADIMIR V. FISENKO, Defendants/Appellees.

M-47 (JSM)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2000 U.S. Dist. LEXIS 7917; 44 Collier Bankr. Cas. 2d (MB) 342

June 9, 2000, Decided
June 9, 2000, Filed

DISPOSITION: **[*1]** Bankruptcy Court's decision reversed and case remanded.

COUNSEL: For ROBERT KREMER, THOMAS B. TYRREL, appellants: Robert J. Gumenick, Michael F. Schwartz, Penn & Proefriedt, New York, NY.

For DOWNTOWN ATHLETIC CLUB OF NEW YORK, appellee: Richard Isgard, Pisano, Mills & Isgard, L.L.P., New York, NY.

For DOWNTOWN ATHLETIC CLUB OF NEW YORK, debtor: Richard Isgard, Pisano, Mills & Isgard, L.L.P., New York, NY.

JUDGES: JOHN S. MARTIN, JR., U.S.D.J.

OPINION BY: JOHN S. MARTIN, JR.

OPINION

MEMORANDUM OPINION AND ORDER

JOHN S. MARTIN, Jr., District Judge:

Plaintiffs Cheslock-Bakker & Associates, Inc. and 19 West Hotel LLC (collectively, "CBA") and the debtor, the Downtown Athletic Club of New York City, Inc. (the "DAC"), appeal from a memorandum decision and an order of the United States Bankruptcy Court denying them summary judgment and granting summary judgment to Robert Kremer and Thomas B. Tyrrel (collectively, "Defendants"), thereby dismissing Counts One and Four of the DAC's complaint (the "Complaint"). For the following reasons, the Bankruptcy Court's memorandum decision and its order are reversed and the case is remanded for further proceedings.

FACTS

The DAC filed a voluntary **[*2]** petition for relief under Chapter 11 of the Bankruptcy Code (or the "Code") on February 27, 1998 and remained in possession and control of its business and assets pursuant to Sections 1107 and 1108 of the Code until the Bankruptcy Court confirmed its Reorganization Plan. Among the DAC's assets was a thirty-five story building (the "DAC Building"), where this non-profit corporation has been continuously located for over seventy-one years. The top fifteen floors of the DAC Building (the "Hotel Floors") consist of rooms for accommodation, and the rest of the building houses the DAC's health club, restaurant, retail, and social facilities (the "Club Facilities").

Defendants have been DAC members for a number of years, although Defendant Kremer permitted his membership to expire. Both defendants currently occupy suites on the Hotel Floors, which they refuse to vacate. Neither defendant has a written lease for his suite, and

Defendant Kremer and Defendant Tyrrel did not request leases until July 22, 1999 and September 21, 1999, respectively--after confirmation of the Reorganization Plan.

By an order dated March 24, 1998 (the "Bar Date Order"), the Bankruptcy Court set April 27, 1998 (the **[*3]** "Bar Date") as the last date for filing claims against the DAC. Pursuant to the court's order, the DAC served a copy of the Bar Date Order on all of its members by March 26, 1998. Neither Defendant Kremer nor Defendant Tyrrel filed a claim before the Bar Date passed. After noticing and holding confirmation hearings, the Bankruptcy Court issued an order confirming the Reorganization Plan on June 16, 1999 (the "Confirmation Order"). [1]

> 1 Despite receiving timely notice of the confirmation hearings, neither defendant appeared at the hearings or objected to the Reorganization Plan.

Under this plan, the DAC sold the DAC Building to CBA free and clear of all liens, claims, encumbrances, and other interests of any kind. Based upon a separate agreement, which was incorporated into the Reorganization Plan, CBA agreed to lease the Club Facilities back to the DAC with a right to repurchase that lower portion from CBA. Pursuant to this transaction, CBA retained ownership of the Hotel Floors, i.e., the upper portion of the **[*4]** building, and paid the DAC $ 16 million in consideration.

On January 22, 1999, after the DAC filed its petition and the Bar Date passed but before the Reorganization Plan was confirmed, Defendant Kremer filed a complaint with the New York State Division of Housing and Community Renewal (the "DHCR") alleging that the DAC Building was subject to the Rent Stabilization Law of the City of New York (the "RSL") and that the DAC had violated the RSL by overcharging him rent for his rooms in the building. On May 14, 1999, Defendant Tyrrel filed a similar complaint with the DHCR. Both defendants sought compensatory damages for the alleged rent overcharges.

The DHCR served the DAC with Defendant Kremer's and Defendant Tyrrel's complaints on or about March 15, 1999 and July 21, 1999, respectively. The DAC has responded to the complaints, denying liability to Defendants and denying that the RSL applies to the DAC Building.

On or about October 18, 1999, the DAC initiated this adversary proceeding before the Bankruptcy Court against Defendants and Vladimir V. Fisenko. The Complaint contains the four counts, two of which are relevant to this appeal. Count One seeks an order permanently enjoining **[*5]** Defendants from commencing or continuing any action or proceeding seeking to obtain possessory, leasehold, or other interest in the DAC Building. Count Four seeks an order declaring that Defendants have no possessory, leasehold, or other interest in the building and enjoining them from using their rooms in the building. Defendants answered the Complaint timely, denying that the DAC is entitled to any relief thereunder and asserting various affirmative defenses and counterclaims. [2]

> 2 Fisenko did not answer the Complaint or otherwise appear in this proceeding.

On October 20, 1999, at the DAC's request, the Bankruptcy Court directed Defendants and Fisenko to show cause on October 27, 1999, why the court should not preliminarily enjoin them from, *inter alia*, seeking to obtain possessory, leasehold, or other interest in the DAC Building pursuant to Count One. In response, Defendants filed motions on or about October 21, 1999 seeking leave to file late proofs of claims against the DAC (the "Bar Date Motions"). **[*6]** On the consent of the parties, the Bankruptcy Court adjourned the preliminary injunction hearing pending resolution of Defendants' Bar Date Motions. The court denied these motions by an order dated November 19, 1999. [3]

> 3 The Bankruptcy Court's denial of the Bar Date Motions, affirmed by this Court on April 27, 2000, rendered moot Counts Two and Three of the Complaint.

Judge Garrity, then, set an expedited briefing and hearing schedule on cross-motions for summary judgment filed by Defendants, the DAC, and CBA (collectively, the "Summary Judgment Motions") with respect to Counts One and Four. The court heard oral argument on the Summary Judgment Motions on December 9, 1999, and on December 15, 1999, issued a memorandum decision denying the motions for summary judgment filed by the DAC and CBA and granting the motion for summary judgment filed by Defendants. In granting Defendants' summary judgment motion, Judge Garrity dismissed Counts One and Four of the Complaint. An order incorporating and implementing the **[*7]** memorandum decision was entered December 29, 1999.

In deciding the Summary Judgment Motions, the Bankruptcy Court considered "only the narrow issue of whether the DAC's obligations under the RSL, if any, were discharged pursuant to the Confirmation Order." The court found that the DAC's obligations under state law could not be discharged, and it authorized Defendants to continue to use their rooms in the DAC Building pending a determination of their rights by the DHCR.

CBA and the DAC filed a timely Notice of Appeal of the Bankruptcy Court's memorandum decision and its order.

DISCUSSION

The Court reviews the Bankruptcy Court's conclusions of law de novo and its findings of fact for clear error. See *In re Bayshore Wire Products Corp., 209 F.3d 100, 103 (2d Cir. 2000)*. The issues raised in this appeal are subject to de novo review.

The Bankruptcy Court correctly concluded that Defendants' claims against the DAC were discharged pursuant to *11 U.S.C. § 1141(d)(1)(A)*, but incorrectly concluded that CBA did not acquire the DAC Building "free and clear" of Defendants' alleged leasehold interests in it.

Under the Bankruptcy Code, confirmation **[*8]** of a bankruptcy reorganization plan discharges a debtor from any pre-confirmation "debt." See *11 U.S.C. § 1141(d)(1)(A)*. An order confirming such a plan is binding upon the debtor's creditors, regardless of whether they voted to accept the plan. See *Maxwell Communication Corp. v. Societe Generale (In re Maxwell Communication Corp.), 93 F.3d 1036, 1044 (2d Cir. 1996)*. Thus, the Confirmation Order is binding upon Defendants and it discharged any "debt" that the DAC owed to Defendants, including liability on any claims for alleged rent overcharges. See Bankr. Dec. at 20.

Had the DAC Building not been sold and had the DAC simply continued its operations as owner of the building, the Bankruptcy Court would have been correct that the discharge pursuant to *Section 1141* of the Code would not affect the DAC's obligations under the RSL, if any, because these obligations are not a "debt," as defined by the Code. See id. at 20-22. [4]

4 Since the Code defines a "debt" as a "liability on a claim," *11 U.S.C. § 101(12)*, the DAC's obligations are a "debt" that can be discharged in bankruptcy proceedings only if these obligations provide Defendants with a "claim." However, the Code defines a "claim" as a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." Id. *§ 101(5)(B)*.

Under this definition, the DAC's obligations under the RSL do not constitute a "claim." First, these obligations do not entitle Defendants to a "right of payment." Second, the DAC's obligations do not provide Defendants with a "right to an equitable remedy for breach of performance [that] gives rise to a right of payment." As Judge Garrity noted, Defendants' asserted right to an equitable remedy (i.e., the DHCR's enforcement power under the RSL) is a "claim" only if payment can be accepted in lieu of enforcing the equitable remedy. See, e.g., *In re Ben Franklin Hotel Assocs., 186 F.3d 301, 305 (3d Cir. 1999)* ("An equitable remedy will 'give rise to a right to payment,' and therefore be deemed a 'claim,' when the payment of the monetary damages is an alternative to the equitable remedy."); *United States v. LTV Corp. (In re Chateaugay Corp.), 944 F.2d 997, 1008 (2d Cir. 1991)* (finding that order giving rise to injunctive relief is not a "claim" if creditor has no option to accept payment in lieu of enforcement of order). Because neither Defendants nor the DHCR can accept payment as an alternative to the DHCR's enforcement of the DAC's obligations under the RSL, these obligations are not a "claim." Thus, as these obligations do not provide Defendants with a "claim," they could not be discharged as a pre-confirmation "debt" under *Section 1141(d)(1)(A)*. See Bankr. Dec. 20-22.

[*9] However, the Bankruptcy Court was in error in concluding that CBA did not obtain title to the DAC Building "free and clear" of Defendants' asserted "interests" in the building. See id. at 22-24. As a result, the court failed to recognize that the sale to CBA extinguished any ongoing interest of the defendants in the building that could be enforced against either CBA or the DAC.

In response to arguments by the DAC and CBA that pursuant to the Confirmation Order, CBA purchased the DAC Building free and clear of all interests (including Defendants' alleged rights under the RSL to obtain leases), the Bankruptcy Court found that the DAC could not "evade its obligations under the [RSL]" because the RSL validly "imposes duties upon the DAC" pursuant to New York's police and regulatory power.

The error in the Bankruptcy Court's analysis is understandable given the fact that the DAC will continue to operate part of the facility in which Defendants have maintained rooms for several years. Since the Bankruptcy Court was correct in noting that DAC could not "evade its obligations under the [RSL]," see Bankr. Dec. at 22 (citing *Friarton Estates Corp. v. City of New York (In re Friarton Estates Corp.), 65 B.R. 586, 590 (Bankr. S.D.N.Y. 1986))*, **[*10]** it would appear to follow that Defendants may continue to attempt to enforce their alleged rights against the DAC.

The problem with that analysis is that Defendants now have no interest in their former apartments to enforce against anyone because the building was sold to CBA "free and clear" of "any interest" pursuant to *Section 363(f)*. Whether claims are discharged in bankruptcy

proceedings is different from whether property may be sold free and clear of any third-party interests. See *In re Lady H Coal Co., Inc., 193 B.R. 233, 246 (Bankr. S.D.W. Va. 1996)*.

Under the Code, a debtor "may sell property . . . free and clear of any interest in such property of an entity other than the estate" if, *inter alia*, "such interest is in bona fide dispute." See *11 U.S.C. § 363(f)* (emphasis added). Here, there is a bona fide dispute about whether Defendants have an interest in the property. See *In re Collins, 180 B.R. 447, 452 (Bankr. E.D. Va. 1995)* (noting that there must be "an objective basis for either a factual or legal dispute as to the validity of the debt"). Defendants maintain that they have a right under the RSL to **[*11]** obtain leases to their rooms in the DAC Building, and CBA and the DAC contend that no such right exists. Consequently, pursuant to *Section 363(f)(4)*, if Defendants' asserted rights under the RSL to obtain leases are "interests" in the DAC Building, then the DAC sold, and CBA purchased, the building free and clear of "any interest" that Defendants had in the building.

Under the expansive interpretation of "any interest" under *Section 363(f)(4)*, Defendants' asserted possessory rights as lessees fall within the scope of this section. The parties dispute whether the term "any interest" includes Defendants' asserted right to obtain leases. While CBA concedes that the Code does not define the term "interest," CBA correctly maintains that according to the term's plain meaning, it includes Defendants' asserted leasehold interests. See *In re Lady H Coal Co., Inc., 193 B.R. at 246* (noting "the generally broad interpretation of 'any interest' as utilized under *§ 363(f)*"); see also *WBQ Partnership v. Commonwealth of Va. Dep't of Med. Assistance Services (In re WBQ Partnership), 189 B.R. 97, 105 (Bankr. E.D. Va. 1995)* (noting that the term "interest" extends **[*12]** beyond liens); *In re Taylor, 198 B.R. 142, 162 (Bankr. D.S.C. 1996)* (finding that "it appears that a leasehold is a type of 'interest' that fits within the plain text of the *§ 363(f)(4)* statute"). Thus, as Defendants' asserted rights are "interests" and there is a bona fide dispute regarding these interests, CBA purchased the DAC Building from the DAC "free and clear" of Defendants' asserted interests. Once title passed to CBA free and clear, any interest that Defendants had in their leaseholds was extinguished and they had no right to continue to occupy these premises.

Defendants contend that the DAC Building cannot be sold free and clear of their asserted leasehold interests pursuant to *Section 363* because *11 U.S.C. § 365(h)* governs. *Section 365(h)* allows a tenant-lessee to remain in possession after a debtor-lessor rejects the tenant-lessee's unexpired lease. However, *Section 365(h)* applies when a debtor-lessor remains in possession of its property and rejects a lease, not when the debtor-lessor sells property subject to an interest (such as a lease) free and clear of that interest pursuant to *Section 363*. Thus, when the debtor-lessor sells **[*13]** property subject to a lease free and clear of that lease pursuant to *Section 363(f)*, the Court will not apply *Section 365(h)*.

Defendants cite *In re Stable Mews Associates, 35 B.R. 603 (Bankr. S.D.N.Y. 1983)*, and *In re Yasin, 179 B.R. 43 (Bankr. S.D.N.Y. 1995)*, for the proposition that *Section 363* does not allow the sale of property free and clear of a tenant's asserted possessory rights. Both cases, however, are distinguishable. [5] First, Yasin is inapplicable because this decision concerns neither a free and clear sale of property under *Section 363* nor rejection of an unexpired lease by a debtor-lessor under *Section 365(h)*. Second, the Bankruptcy Court's dicta in Stable Mews does not control because the court was addressing whether property could be sold free and clear after the rejection of unexpired leases by a trustee or debtor-in-possession in the context of *Section 365(h)*, not whether property can be sold free and clear of leases under *Section 363*. See *35 B.R. at 607*.

5 The Court also declines to follow *In re Taylor, 198 B.R. 142, 164-67 (Bankr. D.S.C. 1996)* (finding that *Section 365(h)* is debtor's sole remedy for relief from an unexpired lease), for the reasons explained above.

[*14] CONCLUSION

Because CBA acquired the building free and clear, the Bankruptcy Court should have granted summary judgment to the DAC on Count One and issued a permanent injunction against Defendants from commencing or continuing any action to obtain a possessory, leasehold, or other interest in the DAC Building. The court should have also granted summary judgment on Count Four and issued both a declaratory judgment that Defendants have no possessory, leasehold, or other interest in the DAC Building and an injunction against them from using the rooms in the building. Thus, the Bankruptcy Court's decision is reversed and the case is remanded.

SO ORDERED.

Dated: New York, New York

June 9, 2000

JOHN S. MARTIN, JR., U.S.D.J.

LEXSEE 2007 BANKR. LEXIS 3896

IN RE: SAMARITAN ALLIANCE, LLC d/b/a Samaritan Hospital, et al., DEBTORS

CASE NO. 07-50735, Chapter 11, Jointly Administered

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF KENTUCKY, LEXINGTON DIVISION

2007 Bankr. LEXIS 3896; 58 Collier Bankr. Cas. 2d (MB) 1635

November 21, 2007, Decided

COUNSEL: **[*1]** For Samaritan Alliance, LLC, dba Samaritan Hospital, fdba James Noble Rural Health Care Clinic, Lexington, KY, Debtor: Bunch & Brock, Joseph H. Miller, Samuel G. Carneal, Steve Price, W Thomas Bunch, II, W. Thomas Bunch, Sr, Lexington, KY.

For U.S. Trustee, Lexington, KY, U.S. Trustee: Rachelle C. Williams, Lexington, KY.

For Official Committee of Unsecured Creditors, Cincinnati, OH, Creditor Committee: Frost Brown Todd LLC, Adam R Kegley, Lexington, KY; Ronald E. Gold, Frost Brown Todd LLC, Cincinnati, OH.

JUDGES: William S. Howard, Bankruptcy Judge.

OPINION BY: William S. Howard

OPINION

MEMORANDUM OPINION

This matter is before the court to resolve a dispute between Cardinal Hill Rehabilitation Unit at Samaritan Hospital ("Cardinal Hill" or "CHRU")) and the University of Kentucky ("UK") concerning whether Cardinal Hill will continue to operate a 34-bed sub-acute Skilled Nursing Facility ("SNF") on the seventh floor of Samaritan Hospital ("the Hospital"), the facility formerly operated by the Debtor Samaritan Alliance, LLC. UK purchased the Hospital in a *Bankruptcy Code section 363* sale. The purchase is memorialized in the Sale Order and Agreed Order of Settlement by and among the Debtor, University of Kentucky, KMSF, **[*2]** Ventas Realty, Limited Partnership and the Official Committee of Unsecured Creditors ("the Sale Order," Doc. # 234) entered herein on June 6, 2007.

1. Factual and procedural history

On February 1, 2005, Samaritan and Ventas Realty LP ("Ventas") entered into an Acquisition Agreement and a Master Lease Agreement ("the 2005 Master Lease"). Under the terms of the Acquisition Agreement the Hospital and certain personal property were transferred to Ventas. Ventas then leased the purchased property to Samaritan under the terms of the Master Lease. On September 20, 2005, Samaritan entered into several integrated agreements with Cardinal Hill regarding Cardinal Hill's opening a sub-acute SNF at the Hospital. These agreements were a Skilled Nursing Facility Lease Agreement ("the SNF Lease"), a Purchased Services Agreement, and a Patient Transfer Agreement (collectively "the CHRU Agreements"). On April 12, 2006, the parties entered into a Letter of Agreement to add storage space and rent to the SNF Lease. The term of the SNF Lease was through the year 2015.

On April 12, 2007, clearly in contemplation of the bankruptcy to be filed, the Debtors, UK, and Ventas, the owner of the real property, entered **[*3]** into a Master Agreement. Simultaneously, Ventas and UK entered into a new master lease of the Hospital, and Ventas terminated the 2005 Master Lease. Under the terms of the Master Agreement, Samaritan was required to give written notice to its sub-tenants that their subleases had terminated by operation of law effective on April 12, 2007. Cardinal Hill states that it never received such written notice. The Debtors filed their Chapter 11 petitions on

April 16, 2007 and operated the hospital and related facilities as debtors in possession until the sale.

On April 30, 2007 Samaritan Alliance, LLC and the related Debtors filed their Motion for Order...Authorizing the Rejection of Certain Executory Contracts and Leases (Doc. # 86, "the Rejection Motion"). On May 3, 2007 they filed their Motion to Authorize the Emergency Sale of Substantially All of the Debtors' Assets to the University of Kentucky (Doc. # 93, "the Sale Motion"). Cardinal Hill filed its Objection to Debtor's Motion to Reject Lease and Agreements and Request for Continuance (Doc. # 141, "the Objection") on May 17, 2007. On June 4, 2007, the Debtors, UK, and Cardinal Hill entered into an Agreed Order (Doc. # 209) regarding Cardinal **[*4]** Hill's Objection.

The Agreed Order set out that Cardinal Hill and UK had attempted to resolve the matters between them regarding the CHRU, but had been unable to do so. They agreed that Cardinal Hill would withdraw its Objection to the Rejection Motion, and further agreed that they would continue negotiations until June 30, 2007 "regarding the financial details of Cardinal Hill's continuing day-to-day operations." They preserved all rights and issues under Code *sections 363(f)* and *365(h)*. After the Sale Order was entered, the court entered an Order Regarding Objections of...Cardinal Hill (Doc. # 235)on June 6, 2007. This order clarified that nothing in the Sale Order altered the terms of the Agreed Order.

On June 28, 2007, UK filed a Motion to Approve Methodology for Establishing Value (Doc. # 314). UK and Cardinal Hill entered into an Agreed Scheduling Order (Doc. # 369) on August 6, 2007, and on August 22, 2007, Cardinal Hill filed its Motion for Order Determining Rights under *11 U.S.C. section 365* (Doc. # 413, "the *Section 365* Motion"). UK filed its Response to Cardinal Hill Motion for Order Determining Rights under *11 U.S.C. section 365* (Doc. # 438, "the UK Response") on August 31, **[*5]** 2007. The Debtors filed a Motion to Compel Payment of Rents (Doc. # 430) on August 29, 2007. Cardinal Hill filed its Response to Debtors' Motion to Compel Payment of Rents and Reply to UK Response (Doc. # 441) on September 5, 2007. UK filed its Reply to Cardinal Hill's Reply (# 447) on September 7, 2007. All of these matters were heard on September 6, 2007, and taken under consideration for decision.

2. Discussion

The central issue to be determined, and the one which will dictate the resolution of the various matters before the court, is whether Cardinal Hill retains rights under Code *section 365(h)* in regard to the 2005 Master Lease. *Section 365(h)* provides in pertinent part:

> (h)(1)(A) If the trustee 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 such 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 **[*6]** lease and for any renewal or extension of such rights to the extent such rights are enforceable under applicable non-bankruptcy law.

11 U.S.C. § 365(h)(1)(A)(ii). UK maintains that *section 365(h)* is inapplicable because any rights that Cardinal Hill had were cut off prior to the filing of the bankruptcy case. Cardinal Hill contends that it retains its rights under the SNF Lease and that UK may not prevail on that argument.

Cardinal Hill characterizes the pre-filing arrangements between and among the Debtor, UK, and Ventas as "machinations." Whether or not they sink to the level of "machinations," the court must consider whether they deprived Cardinal Hill of rights in a manner which would not have been allowed in a non-bankruptcy context. Cardinal Hill states that "it would appear by the undisputed facts that a consensual surrender occurred on April 12, 2007," i.e., UK, Ventas, and the Debtors were in extensive negotiations for several months prior to bankruptcy, and the lease termination occurred two (business) days before the bankruptcy filing. Cardinal Hill also provides a copy of public filings in March 2007 with the Kentucky Cabinet for Health and Family Services wherein UK provided **[*7]** notice of its intent to terminate the Cardinal Hill SNF Lease and transfer the beds there back to UK as part of the overall transaction.

On this basis, Cardinal Hill contends that the lease termination at issue was voluntary, and that its voluntary nature provides an exception to the general rule that when a lease expires according to its terms or is terminated through enforcement of termination rights following default, any sub-tenancy is terminated as well. In support of its position regarding the effect of voluntary termination, Cardinal Hill cites *McKenzie v. Lexington, 34 Ky. 129, 1836 WL 2022, *2 (1836)* ("The surrender of his lease, by a tenant, will not divest his subtenants of

their rights; and he will be justly liable for their subsequent use and occupation.").

Pursuant to its terms, Ventas had the right to terminate the 2005 Master Lease upon any default. UK maintains that there were several events of default on Samaritan's part (which do not appear to have been specified by the parties), and that Ventas could have terminated the 2005 Master Lease well before the actual termination. UK therefore takes the position that the 2005 Master Lease terminated by operation of **[*8]** law, Samaritan having failed to satisfy certain obligations under it, and that upon its termination, any rights Cardinal Hill had as a subtenant under the SNF Lease were extinguished. However, the Master Agreement among the parties dated April 12, 2007 does not seem to read that way.

The question of whether the termination of the 2005 Master Lease was voluntary or by operation of law does not yield a simple answer. This is especially true in light of the dearth of facts before the court surrounding the pre-bankruptcy transactions. The record does reflect, however, that negotiations between and among the Debtors, UK, and Ventas were in progress more than two months before the filing of the Chapter 11 case and that the plan included Samaritan's filing of a bankruptcy petition as part of the plan to transfer operation of the hospital to UK. This is further buttressed by the payment of a retainer to bankruptcy counsel on April 6, 2007 as reflected in Doc. 3 in the affidavit of the proposed attorneys. The April 12, 2007 Master Agreement provides in pertinent part:

> B. On February 13, 2007, the Parties entered into a letter of intent ("LOI") pursuant to which the Ventas Leases were to terminate; **[*9]** UK and Ventas were to enter into a new one-year lease renewable for 12 years . . . for the properties covered by the Ventas Leases; . . . UK, subject to due diligence, was to enter into an asset purchase agreement with Associated and Samaritan to purchase all assets of Associated and Samaritan necessary by UK to the operation of the hospital and the medical office building; . . .

Master Agreement, April 12, 2007, pp. 1-2. This language suggests to the court that Ventas did not simply impose a termination of the 2005 Master Lease upon Samaritan because it was in default, but that the termination was part of a more comprehensive plan, including the Debtors' bankruptcy filing, that was formulated and agreed to by Ventas, the Debtors and UK. The parties appear to have taken great pains to assure that other potential purchasers of the Hospital would be at a significant disadvantage by having the lease assigned to UK prior to the filing, in addition to having UK's affiliate (KMSF) hold the position of major secured creditor.

The court is therefore of the opinion that *Bankruptcy Code section 365(h)* is applicable here. UK argues, however, that even if Cardinal Hill is determined to have rights **[*10]** under *section 365(h)*,such determination does not impair UK's position under the terms of Code *section 363(f)*, i.e., that it purchased the Hospital free and clear of liens and encumbrances. UK cites in support of this position *Precision Indus., Inc. v. Qualitech Steel SBQ, 327 F.3d 537 (7th Cir. 2003)*, wherein the court held that the terms of *section 365(h)* do not supercede the terms of *section 363(f)*, but that

> . . . the two statutory provisions can be construed in a way that does not disable *section 363(f)* vis a vis leasehold interests. Where estate property under lease is to be sold, *section 363* permits the sale to occur free and clear of a lessee's possessory interest-provided that the lessee (upon request) is granted adequate protection for its interest. Where the property is not sold, and the debtor remains in possession thereof but chooses to reject the lease, *section 365(h)* comes into play and the lessee retains the right to possess the property.

Id. at 548. The *Precision Industries* court seems to find *section 365(h)* only "comes into play" when property is not sold.

Cardinal Hill cites in response *In re Haskell L.P., 321 B.R. 1 (Bankr. D. Mass. 2005)*. There the court denied the **[*11]** Chapter 11 debtor's motion to sell real property free and clear of liens and encumbrances because it could not demonstrate that its affected tenant could be compelled to accept a monetary satisfaction of its interest in the debtor-landlord's property pursuant to *section 363(f)(5)*. The court, after pointing out that the focus of *section 363(f)(5)* is whether the lessee's interest can be reduced to a monetary claim, stated:

> [W]here the Debtor is rejecting the lease with [the tenant], under its Liquidating Plan, [the tenant] has, at its option, the right to remain on the premises in accordance with *§ 365(h)*. . . . If the Court were to grant the Debtor's Sale Motion, the provisions of *§ 365(h)* would be eviscerated. In other words, the Debtor would be

> doing indirectly what it could not do directly, namely, dispossessing [the tenant].

Id. at 9.

The issue of whether UK purchased the Hospital "free and clear" of Cardinal Hill's interest has been retained for consideration per the terms of the Agreed Order. Cardinal Hill reiterates its argument that UK did not buy the Hospital free and clear of its rights, and that the court should follow *Haskell* and so rule. The court finds the reasoning in *Haskell* **[*12]** instructive, and agrees with its conclusion that *section 365(h)* is applicable in the context of a *section 363(f)* sale. Cardinal Hill's possessory interest in the Hospital property and the rights appurtenant thereto, as embodied in the SNF Lease, are preserved by *section 365(h)*. The court will therefore grant Cardinal Hill's request that it enter an order finding that Cardinal Hill has full *section 365(h)* rights to continue in possession of the leased premises and to operate the SNF Unit through the full term of the SNF Lease.

Cardinal Hill further contends that it should be entitled to offset the full present value of the rental accruing under the remaining term of the SNF Lease ($ 186,695.00 per annum through September 2015, including amounts held in escrow since these cases were filed). Cardinal Hill seeks to have the court determine the dollar amount it may offset against obtaining replacement services which Samaritan is no longer obligated to provide under "the integrated contract," i.e., the CHRU Agreements.

UK's response to this argument is that *section 365(h)* only applies to services "under the lease" and may not be expanded to include executory contracts such as the Purchased **[*13]** Services Agreement:

> If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.

11 U.S.C. § 365(h)(1)(B). UK contends that the Purchased Services Agreement is not a lease and that the protections afforded by *section 365(h)* do not apply to it. The court, however, agrees with Cardinal Hill that the CHRU Agreements form an integrated whole, and that *section 365(h)* applies not only to the SNF Lease but to the agreements appurtenant to it and to the rights contained therein. Cardinal Hill acknowledges that its remedies are limited to offsetting rent against its damages and that *section 365(h)(1)(B)* **[*14]** provides that it does not have additional rights to assert a rejection damages claim against the estate.

Finally, the court having determined that Cardinal Hill has rights under *Bankruptcy Code section 365(h)*, the Debtors' Motion to Compel Payment of Rents and UK's Motion to Approve Methodology for Establishing Value will be overruled. The court reserves for determination and decision the issue of the amount Cardinal Hill may offset against its damages. An order in conformity with this opinion will be entered separately.