IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re:	:	**Chapter 11**
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FURNITURE BRANDS INTERNATIONAL, INC., *et al.*	:	**Case No. 13-12329(CSS)**
Debtors.	:	
	:	**Re: Docket Nos. 27, 191, 349 and 442**

MEMORANDUM ORDER DENYING DEBTORS' MOTION TO REJECT CERTAIN UNEXPIRED ANCILLARY AGREEMENT WITH COOL SPRINGS LOT 29 PARTNERS, *NUNC PRO TUNC* TO THE PETITION DATE

This matter having come before the Court on the Debtor's Motion for Entry of Order, Pursuant to Bankruptcy Code Sections 105(a), 365(a), and 554 and Bankruptcy Rule 6004, Authorizing Debtors to Reject Certain Unexpired Leases, Subleases, and Ancillary Agreements, *Nunc Pro Tunc* to Petition Date[1] (D.I. 27) (the "Motion") for entry of an order rejecting the ancillary agreement (defined *infra* as the "Guaranty") with Cool Springs Lot 29 Partners ("Lot 29");

THE COURT HEREBY FINDS AND HOLDS AS FOLLOWS:

A. Factual Background

1. Prior to the bankruptcy, Thomasville Retail, Inc. (f/k/a Classic Design Furnishings, Inc.) ("Tenant") and Lot 29 entered into a lease (the "Lease") of

[1] Previously, the Court entered orders on the relief requested in the Motion except as related to the Guaranty (defined *infra*). *See* D.I. 309, 371 and 382.

approximately 15,780 square feet of retail space located at 650 Frazier Drive, Franklin, TN (the "Premises").[2]

2. On or about the same time that the Lease was entered into, Furniture Brand International, Inc. ("FBN"), and Lot 29 entered into a Lease Guaranty (the "Guaranty"). The Guaranty states:

> WHEREAS, the Guarantor [FBN] desires to induce landlord [Lot 29] to enter into a lease with Classic Design Furnishings, Inc. . . . with respect to the [Premises]. . . "[3]

The Guaranty provides that FBN guarantee full payment and performance of all obligations owed to Lot 29, among other things. More specifically, FBN

> (a) unconditionally guarantees the prompt, punctual and full payment of the rent and all other sums due under the Lease . . . as if such guarantee had been made by Guarantor [FBN] on the face of the Lease; (b) unconditionally guarantees the prompt, punctual and full performance by Tenant of any and all of the agreements, covenants, terms and conditions agreed to be performed by Tenant under the Lease; and (c) covenants and agrees that in the event of default in payments or any default in performance of any of the terms, covenants or conditions thereof, the Guarantor [FBN], upon receipt of written notice, will promptly make or cause such payment to be made or will perform or cause to be performed all such terms, convenants and conditions . . . .[4]

Further, as it is relevant below, the Guaranty further states: "Guarantor [FBN] hereby waives any requirement or presentment, protest, notice of dishonor, notice of default,

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[2] The Tenant later subleased the Premises to a non-debtor third party (the "Sublease").

[3] Guaranty at p. 1.

[4] Guaranty at ¶ 1. The Guaranty is governed by Tennessee law. Guaranty at ¶ 9.

demand, and all other actions or notices that may be required on Landlord's [Lot 29] part in connection with the obligations guaranteed hereby."[5]

3. On September 9, 2013, the above-captioned debtors, including Tenant and FBN (collectively, the "Debtors"), filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

4. On the Petition Date, the Debtors filed the Motion seeking to reject, as of September 9, 2013, the Guaranty, the Lease, and the Sublease.[6]

5. Lot 29 objected to the rejection of the Guaranty on the basis that the Guaranty is not an executory contract. Thereafter, on October 2, 2013, the Court heard argument on the Motion and Lot 29's objection. After the hearing, both Lot 29 and the Debtors submitted letter briefs in support of their respective positions.[7] This memorandum order addresses the issue of whether the Guaranty is an executory contract.[8]

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[5] Guaranty at ¶ 14.

[6] The Court has previously granted the rejection of the Lease and Sublease. *See* D.I. 309.

[7] D.I. 349 and 422, respectively.

[8] Herein, the Court examines whether the Guaranty between one of the Debtors and Lot 29 is an executory contract which the Debtors can reject. Although raised briefly at the hearing on the Motion and discussed in the Debtors' letter brief, the issues of the priority and/or amount of any claim filed by Lot 29 relating to the Guaranty is not presently before the Court; the Court hereby limits its ruling to the present issue of whether the Guaranty is an executory contract which the Debtors may reject.

B. Summary of the Dispute

6. Lot 29 asserts that the Guaranty is not an executory contract because, as of the Petition Date, FBN had unperformed, material duties and promises owed to Lot 29 under the Guaranty, including payment and performance of all obligations owed by Tenant under the Lease. Lot 29 asserts that the Guaranty is an absolute, unconditional guaranty and is wholly separate from the Lease. On the other hand, Lot 29 argues that it did not owe any material duties or promises to FBN that would render the Guaranty executory. Lot 29 asserts that FBN executed the Guaranty to induce Lot 29 to enter into the Lease and that once Lot 29 executed the Lease; essentially all material obligations owed to FBN were satisfied.

7. The Debtors agree that FBN has material obligations under the Guaranty to Lot 29. However, the Debtors assert that Lot 29 has many continuing material obligations to FBN, including providing quiet enjoyment to the Premises, the continuation of repairs and maintenance, and access to the Premises by Tenant or subtenant, among others. The Debtors note that all commercial leases in Tennessee contain an implied covenant of good faith and fair dealing. The Debtors continue that, through that covenant, parties to an agreement cannot do anything that will injure the right of the other to receive benefits under the agreement. Lastly, the Debtors argue that the obligations under Guaranty are triggered by receipt of written notice from Lot 29, which is a material obligation. The Debtors conclude that as both the Debtors and

Lot 29 have continuing material obligations to one another, the Guaranty is an executory contract that can be rejected.

C. Executory Contracts and Guaranties

8. The Bankruptcy Code does not define "executory contract" for the purpose of section 365. The Third Circuit has held: "'[An executory contract is] a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.'"[9]

> Thus, unless both parties have unperformed obligations that would constitute a material breach if not performed, the contract is not executory under § 365. When it is the nonbankrupt party who has substantially performed so that its failure to complete performance would not constitute a material breach excusing performance of the debtor, the nonbankrupt party is "relegated to the position of a general creditor of the bankrupt estate." The time for testing whether there are material unperformed obligations on both sides is when the bankruptcy petition is filed.[10]

For example, the Third Circuit refused to find that a contract fell within the definition of an executory contract where, after interpreting the contract, the Court found that the party had substantially performed and, therefore, did not owe any "material continuing obligation[s]."[11] As such, the relevant inquiry "is to determine whether the relevant instrument contained at least one obligation for both the promisee and promisor that

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[9] *Enterprise Energy Corp. v. U.S. (In re Columbia Gas Sys. Inc.)*, 50 F.3d 233, 239 (3d Cir. 1995) (*quoting Sharon Steel Corp. v. Nat'l Fuel Gas Distribution Corp.*, 872 F.2d 36, 39 (3d Cir. 1989)).

[10] *Columbia Gas Sys. Inc.*, 50 F.3d at 239-40 (citations and footnote omitted).

[11] *In re Exide Technologies*, 607 F.3d 957, 964 (3d Cir. 2010); *see also In re Foothills Texas, Inc.*, 476 B.R. 143, 152 (Bankr. D. Del. 2012).

would constitute a material breach under applicable state law if not performed. If not, then the Instrument is not an executory contract."[12] Furthermmore, "[t]he general rule is that a contract is not executory where the only obligation of a party to a contract is the payment of money."[13]

9. It appears that both the Debtors and Lot 29 agree that FBN has material continuing obligations under the Guaranty. As such, the Court must analyze whether Lot 29 has a material continuing obligation under the Guaranty.

10. Although the Guaranty is to be interpreted under Tennessee law, there is a series of decisions in the Second Circuit that "hold that the trustee of one who has guaranteed the obligation of or become a surety for a lessee of real estate cannot reject his debtor's obligation after the lessee's default."[14] For example, in *In re Grayson-Robinson Stores, Inc.*, the Second Circuit, in determining whether a guaranty was executory held:

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[12] *In re Foothills Texas, Inc.*, 476 B.R. at 152 (citations and internal quotation marks omitted).

[13] *In re Leibinger-Roberts, Inc.*, 105 B.R. 208, 212 (Bankr. E.D.N.Y. 1989) (citations omitted). The bankruptcy court in this jurisdiction has stated "section 365's prohibition against termination of contracts based on insolvency or bankruptcy does not apply to contracts, such as guarantees, to extend 'financial accommodations, to or for the benefit of the debtor.'" *In re Stone & Webster, Inc.*, 279 B.R. 748, 786 n. 19 (Bankr. D. Del. 2002) (*quoting* 11 U.S.C. § 365(e)).

[14] *Matter of Van Dyk Research Corp.*, 13 B.R. 487, 505 (Bankr. D.N.J. 1981) (collecting cases). *See also In re Unishops, Inc.*, 422 F.Supp. 75 (S.D.N.Y.1975), aff'd, 543 F.2d 1017 (2d Cir.1976) (agreement to guarantee debts of another is not executory); *In re Chateaugay Corp.*, 130 B.R. 162, 165-66 (S.D.N.Y. 1991) (holding a "debtor's obligation to pay money, standing alone, is insufficient to render a contract executory."); *In re Chateaugay Corp.*, 102 B.R. 335, 347 (Bankr. S.D.N.Y. 1989) ("Even if this Court held that the parties' off-setting monetary obligations did in fact constitute a material remaining performance obligation, it is clear that such obligations merely represent obligations for the payment of money only and are therefore insufficient to make these TBT Agreements executory."); *In re Leibinger-Roberts, Inc.*, 105 B.R. 208, 213 (Bankr. E.D.N.Y. 1989) ("A guaranty agreement is not executory because it holds no future benefit for the guarantor."); *In re Elegant Concepts, Ltd.*, 61 B.R. 723, 728 (Bankr. E.D.N.Y. 1986) (holding that "it is clear that its obligation to pay money, which is all that remains for the debtor to perform, cannot be deemed any longer to be 'executory'.").

> A guarantor of a lease has no interest in the lessor's future performance. Such an agreement of guaranty is not in itself any part of a bargain for future performance. Rather than having any interest in the lessor's performance, the guarantor's interest would be better served by non-performance, since in that event the guarantor would be released from the obligation which he has undertaken. The agreement of guaranty is therefore not an executory contract within the meaning of Section 313(1) [of the Bankruptcy Act]. The guarantor, by the lessor's execution of the lease, has received all of the consideration for which he bargained with the lessor. The contract between them is executed except for the guarantor's obligation to pay upon default of the lessee. By his 'rejection' the guarantor would be relinquishing no benefits; he would merely be repudiating his obligations. A guarantor is therefore no more entitled to reject his agreement of guaranty than would any bankrupt be entitled to 'reject' his accrued debts.[15]

Similarly, in *In Matter of Unishops, Inc.*,[16] the court, relying on *Grayson-Robinson Stores, Inc.*, held that the guaranty therein was not executory.[17]

11. Interestingly, Debtors cite to *SCA Tax Exempt Fund Ltd Partnership v. Kahn*[18] for the proposition that a guaranty is executory. In *Kahn*, the court, in considering whether a guaranty was an executory contract, was faced with a plaintiff

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[15] *In re Grayson-Robinson Stores, Inc.*, 321 F.2d 500, 502 (2d Cir. 1963). Although not directly on point, in *In re Leibinger-Roberts*, 105 B.R. 208 (E.D. N.Y. 1989), the issue before the court was whether a shareholders' agreement was executory after minority shareholders moved to compel the corporate debtor to assume or reject the shareholder agreement. The debtor in that case analogized the shareholder agreement to guaranty agreements, which are not be executory. However, although the court noted the series of decisions holding that guaranties were not executory, the court concluded that the "instruments of the type represented by the subject shareholders' agreement are extremely individualized and must be looked at in the context of their own facts and circumstances." *Id.* at 213 n. 19.

[16] 422 F. Supp. 75 (S.D. N.Y. 1975), *aff'd,* 543 F.2d 1017 (2d Cir. 1976).

[17] *Matter of Unishops, Inc.*, 422 F. Supp. 75, 81 (S.D.N.Y. 1975) *aff'd*, 543 F.2d 1017 (2d Cir. 1976) (Although *Unishops* followed *Grayson-Robinson Stores, Inc.*, the court did express that "[p]erhaps, a fuller record [in *Grayson-Robinson Stores, Inc.*] might have constrained the court to depart from the general rule that agreements of guarantee are non-executory . . . " (*Unishops,* 422 F. Supp. at 81)).

[18] 974 F.2d 1339 (6th Cir. 1992).

who purchased a bond the proceeds of which were loaned to a developer. In connection with the financing requirements in the loan, the defendants executed a limited operating guaranty, which did not guarantee repayment of the loan, but guaranteed to loan money to the developer for operating expenses up to a stated amount (which would include the principal and interest payments of the bond held by the plaintiffs). The court found that the developer (turned debtor) was the third party beneficiary of the guaranty as the guaranty was a promise to loan money to the developer. As such, the court, in determining whether the guaranty was executory, looked to the performance of the defendants and the *developer* (rather than the plaintiffs). The court held that the developer had not yet performed under the guaranty because the developer did not incur operating losses prior to the petition date (per the terms of the guaranty) nor had the developer accepted the operating loan. The court then held that the defendants also had not performed as the guaranty called for the defendants to loan money to the developer, which had not been done. Ultimately, the court found that the guaranty was executory. However, the court gave a "final observation" which, although arguably *dicta*, warrants note:

> As a final observation, we note that if SCA [the plaintiff] wanted the defendants to personally guarantee the repayment of the bond, it could have required the defendants to execute a conventional guaranty, requiring that if the Developer defaulted on the bond payments, SCA would gain the right to collect directly from the defendants. Nevertheless, SCA did not demand this type of guaranty. Instead, SCA required the defendants to execute the contract at issue, under which the defendants' liability to the Developer does not survive the Developer's bankruptcy

> filing. While this may not have been the result hoped for SCA, it is the result compelled by the language of the guaranty.[19]

It appears, that the Sixth Circuit's "final observation" regarding a "conventional guaranty" is more akin to the matter *sub judice* then the third-party beneficiary guaranty to lend operating expenses presented in *Kahn*. As such, the Court believes that the Debtors' reliance on *Kahn* is unpersuasive.

12. Furthermore, under Tennessee law, "[c]ontracts of guaranty are to be construed according to the ordinary meaning of the wordage used and with the view to carry out the intent as therein expressed. Guarantors are not favored under the law of Tennessee."[20] As such, even the Guaranty states Lot 29's material obligation is to enter the Lease with Tenant, which it did.[21] The Guaranty does not provide for any other material obligations by Lot 29.

13. At first blush the Debtors' argument concerning Lot 29's continuing obligations under the Lease (such as quiet enjoyment, covenant of good faith and fair dealing) seems plausible. However, those (among others) are Lot 29's obligations under the Lease and not the Guaranty. This Court agrees with *Grayson-Robinson Stores, Inc.* which held that a guarantor of a lease has "no interest in the lessor's future

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[19] *SCA Tax Exempt Fund Ltd. P'ship v. Kahn*, 974 F.2d 1339 (6th Cir. 1992).

[20] *First Nat. Bank, Hope, Ark. v. Foster*, 451 S.W.2d 434, 436 (Ct. App. 1969) (citations omitted). *See also Wilson v. Kellwood Co.*, 817 S.W.2d 313, 318 (Tenn. Ct. App. 1991) ("A guarantor in a commercial transaction is to be held to the full extent of his engagements, and the rule in construing such an instrument is that the words of the guaranty are to be taken as strongly against the guarantor as the sense will admit." (citation omitted)).

[21] Guaranty at p. 1.

performance" under the Lease.[22] Furthermore, and as stated above, the plain language of the Guaranty does not contain ongoing material obligations by Lot 29.

14. Lastly, the Debtors also argue that Lot 29 has the continuing duty to give notice under the Guaranty; however, as noted above, in the Guaranty, FBN expressly waives notices.[23] As such, the notice requirement is not a material continuing obligation.

D. Conclusion

15. The Court finds that the Guaranty is not an executory contract and hence the Motion is denied as to the Guaranty.

16. This Court retains jurisdiction in connection with this Order and all matters related thereto.

Christopher S. Sontchi
United States Bankruptcy Judge

Dated: November 7, 2013

[22] *Grayson-Robinson Stores, Inc.*, 321 F.2d at 502.

[23] Guaranty at ¶ 14.