

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

IN RE:

FFP OPERATING PARTNERS, LP

Debtor.

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CASE NO. 03-90171-BJH-11

MEMORANDUM OPINION AND ORDER

Before the Court is the Amended Motion to Reject Leases with Neutze Properties, Ltd. Pursuant to § 365(a) (“the Motion”) filed by FFP Operating Partners, LP (“FFP” or the “Debtor”). In the Motion, the Debtor seeks authority to reject what it contends is a severable lease agreement with respect to certain pieces of real property covered by that lease agreement.¹ Neutze Properties,

¹The Court previously extended the time period within which the Debtor must make decisions to assume or reject its non-residential real property leases. So, if the Court concludes that the lease at issue here is severable, as the Debtor contends, the Debtor has additional time to make its decisions with respect to the remaining properties

LTD (“Neutze” or the “Lessor”) opposes a piecemeal rejection of what it contends is a single lease of multiple pieces of real property – *i.e.*, it contends that the Debtor must either assume the lease in its entirety, or reject it, but that the Debtor cannot pick and choose what properties it wishes to reject and what properties it wishes to keep as a part of its reorganization.

The hearing on the Motion commenced on June 30, 2004 and concluded on July 28, 2004. The Court has core jurisdiction over the Motion in accordance with 28 U.S.C. §§ 1334 and 157(b). This Memorandum Opinion and Order contains the Court’s findings of fact and conclusions of law.

Background Facts

On or about December 30, 1986, Allen’s Convenience Stores, Inc. purchased all of the stock of Minit Mart, Inc. (“Minit Mart”), and on the same date Minit Mart entered into a sublease agreement with Neutze, Inc. (the predecessor to Neutze) for all 22 of the convenience store locations operated by Minit Mart (the “Lease”). *See* Neutze Exhibit 1. The parties agree that FFP became the lessee under the Lease on December 17, 1997, and that the Lease has been extended from its original 10 year term and remains in effect as between Neutze and FFP. *See* Neutze Exhibits 2, 3, 4, & 5. Exhibit A to the Lease contains the legal description of each of the 22 pieces of real property covered by the Lease. Exhibit B to the Lease prorates the base rent among the 22 properties.² By agreement of the relevant parties, two of the properties have been severed out of the Lease. *See, e.g.*, Neutze Exhibit 8. Thus, as amended, the Lease currently covers 20 pieces of real property. FFP’s convenience store operations on several of those properties are unprofitable and FFP seeks in the Motion to reject the Lease as it relates to 10 of those properties.

covered by the lease.

²While the base rent is defined as “not less than \$45,000.00 per month,” *see* Neutze Exhibit 1, ¶ 3, the total rent as shown on Exhibit B is slightly less – \$44,769.00.

Legal Analysis

Section 365 of the Bankruptcy Code gives a debtor the right to assume or reject unexpired leases and executory contracts. The general rule, however, is that such leases or contracts must be assumed or rejected in their entirety. A debtor is not entitled to assume those portions of a lease or contract it likes, while rejecting those portions it no longer cares for. *See Stewart Title Guar. Co. v. Old Republic Nat'l Title*, 83 F.3d 735, 741 (5th Cir. 1996). But, if a lease or contract contains several different agreements, and the lease or contract can be severed under applicable non-bankruptcy law, section 365 allows assumption or rejection of the severable portions of the lease or contract. *See id.* at 739; *In re Cafeteria Operators, L.P.*, 299 B.R. 384, 389 (Bankr. N.D. Tex. 2003); *In re Convenience USA, Inc.*, No. 01-81478, 2002 WL 230772, at *2 (Bankr. M.D.N.C. Feb. 12, 2002). Texas law governs the Lease.

A severable contract is one “that includes two or more promises each of which can be enforced separately, so that failure to perform one of the promises does not necessarily put the promisor in breach of the entire contract.” Black’s Law Dictionary (8th ed. 2004), *available at* <http://www.westlaw.com>, Blacks. There is no one test or rule of law that determines whether a contract is severable. *In re Ferguson*, 183 B.R. 122, 125 (Bankr. N.D. Tex. 1995) (citing *Hamilton v. Tex. Oil & Gas Corp.*, 648 S.W.2d 316, 320 (Tex. App.—El Paso 1982, writ ref’d n.r.e.)). Under Texas law, a contract’s severability depends on several factors: (1) the intent of the parties; (2) the subject matter of the agreement; and (3) the conduct of the parties. *E.g.*, *Johnson v. Walker*, 824 S.W.2d 184, 187 (Tex. App.—Fort Worth 1991, no writ) (citing *Chapman v. Tyler Bank & Trust Co.*, 396 S.W.2d 143, 146-47 (Tex. Civ. App. — Tyler 1965, writ ref’d n.r.e.)); *see also Hamilton*, 648 S.W.2d at 320.

For the reasons explained more fully below, the Court concludes that the Lease is severable and that the Debtor is entitled to reject the Lease as it relates to the 10 properties at issue in the Motion.

The Intent of the Parties

To determine whether the Lease is severable, the Court must first consider the intent of the parties, which is the factor given the greatest weight. *Stewart Title Guar. Co.*, 83 F.3d at 739. The parties' intent is normally determined from the language of the contract itself. *Id.*; *In re Payless Cashways, Inc.*, 230 B.R. 120, 135 (8th Cir. BAP 1999), *aff'd* 203 F.3d 1081 (8th Cir. 2000) (citing *Blackstock v. Gribble*, 312 S.W.2d 289, 292-93 (Tex. Civ. App. – Eastland 1958, no writ). Absent ambiguity, parol evidence is not admissible. *See Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653, 658 (5th Cir. 1999); *Nat'l Union Fire Ins. Co. v. CBI Indus.*, 907 S.W.2d 517, 520 (Tex. 1995).

Here, however, Neutze's principal, Pete Neutze, testified as to his intent when entering into the Lease without objection from FFP. Mr. Neutze's testimony is clear – he did not intend that the Lease be severable. According to Mr. Neutze, each time he borrowed money to purchase another property on which he (or another family member) would operate a convenience store, he was required to pledge the other properties as additional collateral for the loan. In this fashion, the debts and the properties became cross-collateralized. Moreover, Mr. Neutze testified that he was required to personally guarantee the various loans. Because of his personal exposure and the fact that a default on one note could result in the loss of more than one of the properties, Mr. Neutze testified that when he executed the Lease on behalf of the Lessor, he intended that the properties be considered an integrated package. Mr. Neutze further testified that he did not intend to apportion

the rent by property because he did not want to have to separately collect rent from each of the 22 store locations. *See* Neutze Exhibit 1, ¶3. Rather, Mr. Neutze testified that he wanted a lump sum payment of rent for all of the properties and that he wanted a default under the Lease as to one of the 22 properties to be a default on the package of properties. According to Mr. Neutze, the base rent under the Lease was calculated by him to be the amount he needed to service the debt on all of the properties that were to be included in the Lease.

However, when the express terms of the Lease are considered, along with the circumstances surrounding the extension of the original lease term and FFP becoming a party to the Lease, there is significant evidence suggesting that the parties intended that the Lease be severable. For the reasons explained more fully below, and after weighing the conflicting evidence, the Court finds that the parties intended that the Lease be severable.

Various provisions of the Lease support this finding. For example, Neutze has the right to sell any of the properties covered by the Lease provided that it offers its lessee a right of first refusal. *See* Neutze Exhibit 1, ¶ 32. Thus, Neutze can sell one or more of the properties during the term of the Lease to a third party (provided that the lessee does not elect to exercise the right of first refusal) and that sale does not terminate the Lease with respect to the remaining properties. Standing alone, this provision suggests that a property can be severed from the Lease without affecting the balance of the Lease.³

Moreover, the destruction and condemnation provisions of the Lease reflect an intent to form

³However, Neutze argues that the right of first refusal provision must be read in conjunction with paragraph 29 of the Lease and, when read together, provides a limit on Neutze's right to sell. *See* Neutze Exhibit 1, ¶29. In short, Neutze contends that it can only sell a property to a third party subject to its obligation to provide "quiet possession" of the property to its lessee. In essence, Neutze argues that it must sell a property subject to the lessee's rights under the Lease. The Court disagrees. Paragraph 29 does not modify paragraph 32.

a severable contract. If one or more pieces of real property covered by the Lease is damaged or destroyed, the Lease is not terminated. *See* Neutze Exhibit 1, ¶ 17. Instead, upon damage to, or the destruction of, one or more pieces of real property, rent is reduced under the Lease based upon the proportionate rent charged for that property. *Id.* Similarly, if a property included in the Lease is condemned then “this lease shall, at the option of the Lessor, cease and terminate as to such portion only...” *Id.* at ¶ 18.

Neutze argues that these Lease terms do not evidence an intent to enter into a severable contract, pointing first to the fact that there is only a singular reference to a “lease” throughout the Lease, not “leases.” Moreover, Neutze argues that the destruction and condemnation provisions of the Lease simply reflect an intent to address two possible contingencies that might arise with respect to some of the properties during the Lease term, and should not be construed to reflect an intent to enter into a severable contract. Finally, Neutze argues that the default provision of the Lease is inconsistent with a severable contract. *See* Neutze Exhibit 1, at ¶ 19. This provision states that in the event of the lessee’s default, the

Lessor may thereupon re-enter the leased premises, take possession of said premises... and may elect to either cancel this lease or relet the premises as agent for the Lessee or otherwise and receive the rent therefor, applying the same first to the payment of such expenses as the Lessor may be put to in entering and letting and then to the payment of the rent payable under this lease and fulfillment of the Lessee’s covenants hereunder, the balance (if any) to be paid to the Lessee who shall remain liable for any deficiency.”

Id. Thus, under the Lease, if the lessee defaults with respect to any property, Neutze has an option – it can terminate the Lease in its entirety or it can re-enter the property that has precipitated the default and relet it as agent for the lessee, while the lessee remains liable for any shortfall in rent income.

On balance, however, and after considering all of the evidence, the Court is not persuaded by Neutze's arguments. First, while the Lease does make singular references to "lease" within it, paragraph 26 of the Lease is a "use of words" provision that states that "words used in the singular shall include the plural, and visa versa, *as may be appropriate to the context.*" See Neutze Exhibit 1, ¶ 26 (emphasis added). The phrase "as may be appropriate to the context" further implies that even if a provision references only a "lease," it could mean "leases."

Second, with respect to the condemnation and destruction provisions of the Lease, as the *Convenience USA* court concluded:

With respect to the two contingencies, the parties had two choices. The parties could have elected to provide in the lease that if one of the leased properties were sold, condemned, or destroyed, the entire lease would terminate. Presumably, the parties would have made this election if the economic realities had dictated such a resolution upon the loss of one or more of its properties. The parties did not elect such a provision. Instead, the parties elected to have a contract under which the lease of some of the properties may be terminated without effecting the continuing lease of the remaining properties. Choosing such terms reflects an intent to have a divisible contract.

2002 WL 230772, at *5. Relying on the reasoning of the *Convenience USA* court, this Court is not persuaded by Neutze's argument that the parties were only trying to create severability in isolated circumstances. Instead, this Court finds that the destruction and condemnation provisions of the Lease evidence an intent to create a severable contract.

Third, while the Court cannot fault Neutze's characterization of the default provision of the Lease as a "cross-default" clause, and its argument that the provision is inconsistent with a finding of severability, if the clause is enforceable against FFP in bankruptcy,⁴ its presence in the Lease is simply one fact that must be weighed with all of the other evidence when determining the parties'

⁴Cross-default provisions are closely scrutinized in bankruptcy cases. See *Liljberg v. Enters., Inc.*, 304 F.3d 410, 445 (5th Cir. 2002). The Court does not have to reach the issue of the enforceability of the provision here.

intent. The presence of this clause is simply not dispositive. *Convenience USA*, 2002 WL 230772, at * 7 (“in the bankruptcy context, it is well established that cross-default provisions do not integrate executory contracts or unexpired leases that otherwise are separate or severable”).

Finally, as time passed and the Lease was amended, the language used further reflects an intent to create a severable contract. In October 1996, Neutze and E-Z Serve Convenience Stores, Inc. (“E-Z Serve”) (successor to Minit Mart and predecessor to FFP) executed an Amendment to Sublease Agreement (the “Amendment”). *See* Neutze Exhibit 3. The Amendment provides the formula for calculating monthly rent for each year of the first five year renewal term (1997-2001) and states that “[m]onthly rent for lease year 1997 shall be paid in accordance with the schedule, attached hereto as Exhibit ‘B.’ ” *Id.* at ¶ 2. Exhibit B to the Amendment (like Exhibit B to the Lease), apportions the rent among the 21 properties still subject to the Lease.

Moreover, effective December 17, 1997, E-Z Serve’s interest in the Lease was assigned to FFP. *See* Neutze Exhibit 5. By letter dated February 24, 1998, Neutze’s counsel notified FFP of the annual rent adjustment effective January 1, 1998. In that letter Neutze’s counsel states “[i]f you want to prorate [the rent] by store, you can use the 1997 schedule increased by 1.7%.” *See* FFP Exhibit 2. Also attached to the letter are certain schedules showing the rent and related charges on a prorated basis by property. *See id.*

This evidence is persuasive to the Court. While Mr. Neutze may have intended to create a non-severable contract in 1986, there is no evidence to suggest that FFP was aware of his original intent when it became a party to the Lease in late 1997. Moreover, various provisions of the Lease and the amendment documents reflect an intent that the Lease be severable. It appears that FFP intended that the Lease be severable as it accounted for the properties on a property by property

basis. *See, e.g.*, FFP Exhibit 3.

After considering all of the evidence, this Court finds that the parties intended to create a severable contract.

Subject Matter of the Agreement

The second prong to be considered under Texas law in deciding whether a contract is severable is the subject matter of the agreement. In essence, this Court must decide if “the contract can be divided into two or more separate agreements that can be performed independent of each other.” *Convenience USA, Inc.*, 2002 WL 230772, at *6.

The type of agreement at issue here is a lease of real property. Specifically, the Lease now covers 20 separate convenience stores located on 20 separate parcels of real property located in 10 Texas cities. There is nothing in the record or in the Lease to suggest that the stores cannot be operated separately and independently of each other in accordance with the provisions of the Lease. In fact, insurance coverage for the properties has always been obtained by property because risks and value vary. *See* FFP Exhibit 7.

Based upon the nature of the properties and the terms of the Lease, the Court finds that the Lease can be divided into 20 separate leases – one for each of the properties. The subject matter aspect of the Texas test for determining severability weighs in favor of a finding that the Lease is severable.

Conduct of the Parties

The last prong to be considered under Texas law is whether the conduct of the parties indicates a severable contract. Relevant conduct can include the method of payment under the agreement. *See, e.g., Stewart Title Guar. Co.*, 83 F.3d at 740; *Ferguson*, 183 B.R. at 126. A court

will find a severable contract when “the performance by one party consists of several distinct and separate items and the price paid by the other party is apportioned to each item.” *Convenience USA, Inc.*, 2002 WL 230772, at *3; *Johnson*, 824 S.W.2d at 187.

Here, there are currently 20 separate properties covered by the Lease and, of significance according to Neutze, FFP pays rent monthly in a lump sum. FFP does not write 20 rent checks for the 20 properties.

While it is true that FFP does not write a separate rent check for each property, the rent can be apportioned among the properties pursuant to certain rent allocation schedules provided by Neutze and/or its counsel from time to time during the Lease term. *See* Neutze Exhibit 1, Exhibit B; Neutze Exhibit 3; and FFP Exhibit 2. As the *Convenience USA* court noted, “[with] such an allocation in place, making a single payment into the sweep account had little significance since such payments could be allocated at any time using an allocation that was in place for such purpose.” 2002 WL 230772, at *6.

Other conduct of the parties in this case reflects an intent to create a severable contract. Two (2) properties have been severed out of the Lease without affect upon the remaining properties covered by the Lease. Moreover, shortly after FFP became lessee, it was advised of the rent increase effective January 1, 1998 and was told that it could “prorate [rent] by store” according to the “1997 schedule.” *See* FFP Exhibit 2. Finally, Neutze was aware that FFP calculated and tracked store rent (and other charges) by property. *See, e.g.*, FFP Exhibit 3.

Having considered the intent of the parties, the subject matter of the agreement, and the conduct of the parties as Texas law requires, the Court finds that the Lease is severable and that each of the 20 properties may be considered as subject to a separate unexpired lease for purposes of

section 365 of the Bankruptcy Code.

Neutze's Alternative Request for Relief – Reformation

In its response in opposition to the Motion, Neutze asked for alternative relief. Specifically, Neutze asked that the Court reform the 20 separate leases that would flow from a severability determination to include a cross-default provision so that each of the severed leases was cross-defaulted with the other 19 leases. Neutze's intent by this request was clearly articulated by its counsel at the hearing – *i.e.*, if FFP ever seeks to assume any of the 10 leases that will remain if the Motion is granted (and FFP is permitted to reject the 10 leases that are the subject of the Motion), Neutze will then argue that the cost of assumption will be to cure all defaults on the rejected leases, thereby elevating Neutze's unsecured rejection damage claim to a cost of administration claim.⁵ *See* 11 U.S.C. §§ 365(b)(1), (g)(1).

For the reasons explained more fully below, the Court concludes that reformation is not an appropriate remedy here. If a written contract fails to conform to the parties' intent, reformation may be an appropriate remedy. *See Thalman v. Martin*, 635 S.W.2d 411, 413 (Tex. 1982). However, contracts can only be reformed in Texas when there is: “(1) an original agreement and (2) a mutual mistake, made after the original agreement, in reducing the original agreement to writing.” *Cherokee Water Co. v. Forderhause*, 741 S.W.2d 377, 379 (Tex. 1987) (citing *Sun Oil Co. v. Bennett*, 84 S.W.2d 477, 451 (Tex. 1935)). There is insufficient evidence in the record from which the Court can find a mutual mistake of the parties. While there may be evidence that Neutze's intent was not captured in the Lease, there is no credible evidence in the record that Minit Mart shared Neutze's original intent. And, there is no evidence in the record that the amendment documents

⁵If the Court determines that reformation is an appropriate remedy, FFP wishes to withdraw the Motion. Neutze does not oppose a withdrawal of the Motion under those circumstances.

(when signed by E-Z Stores and/or FFP) contain mutual mistakes warranting reformation.

Finally, the addition of such a cross-default provision would undermine the analysis required by the Texas severability test. As noted previously, to determine if a contract is severable under Texas law, courts are required to consider several factors: (1) the intent of the parties (determined from all of the provisions of the agreement), (2) the subject matter of the agreement, and (3) the conduct of the parties. *See supra* pp. 4-11. After considering all of these factors and weighing all of the evidence (including all of the provisions of the Lease and the amendment documents), the Court has concluded that the Lease is severable. The practical effect of adding the requested cross-default provision to each of the 20 severed leases through “reformation” causes the default provision of the Lease to control the outcome of the severability analysis. That result is inconsistent with Texas law.

Rejection of the 10 Leases

While Neutze opposes the Motion for the reasons discussed previously, it does not dispute the proper exercise of the Debtor’s business judgment in deciding to reject the 10 properties at issue in the Motion. Moreover, the Debtor has carried its burden of proof and has demonstrated that rejection of those properties is in the best interests of the estate.

Conclusion

In accordance with Texas law, the Court finds that the Lease is severable. In addition, the Court concludes that reformation is not an appropriate remedy. Finally, the Court concludes that rejection of the 10 leases that are the subject of the Motion is proper. For these reasons, the Motion should be granted. It is therefore

ORDERED that the Motion is granted.

End of Order