

Hearing Date and Time: November 18, 2009
at 10:30 a.m. (Prevailing Eastern Time)

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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

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In re:	: Chapter 11
	: :
AGT ACQUISITION WIND-DOWN LLC, <u>et al.</u> ,	: Case No. 09-12889 (REG)
	: :
	: Jointly Administered
Debtors. ¹	: :
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DEBTORS' RESPONSE TO LIMITED OBJECTION OF 939 NORTH AVENUE COLLECTION, LLC TO DEBTORS' MOTION FOR ENTRY OF AN ORDER APPROVING THE ACQUISITION OF THE NORTH & SHEFFIELD CLUB AND EXTENDING THE DEADLINE TO ASSUME OR REJECT THE RELATED LEASE

¹ The Debtors in these cases are: AGT Acquisition Wind-Down LLC, Sports & Fitness Ventures LLC, AGT Services Wind-Down LLC, CFI Wind-Down, LLC, AGT Atlanta Wind-Down LLC, CFI Georgia Wind-Down, LLC, CFI Atlanta Wind-Down, LLC, AGT Crunch Chicago LLC, Crunch CFI GW, LLC, AGT Los Angeles Wind-Down LLC, AGT Union Street LLC, AGT Miami Wind-Down LLC, AGT New York Wind-Down LLC, Fort Greene Sports Club, LLC, Hauppauge Sports Club, LLC, CFI New York Wind-Down, LLC, Park Slope Sports Club, LLC, 113 4th Sports Club, LLC, AGT San Francisco Wind-Down LLC, CFI San Francisco Wind-Down, LLC, AGT Washington D.C. Wind-Down LLC, and The Silver Springs Sports Club, L.L.C.

The above-captioned debtors and debtors in possession (collectively, the “**Debtors**”), by and through their undersigned attorneys, hereby file this Response (this “**Response**”) to the Limited Objection (the “**Limited Objection**”) of 939 North Avenue Collection, LLC (“**NAC**”) to Debtors’ Motion (the “**Motion**”) for Entry of an Order Approving the Acquisition of the North & Sheffield Club and Extending the Deadline to Assume or Reject the Related Lease. In support thereof, the Debtors respectfully represent as follows:

Summary of Limited Objection

1. The Limited Objection raises two main points as to the Motion: (a) that the effective date of rejection of the NAC Lease (as defined in the Limited Objection) should not occur after Debtors’ aggregate statutory period under the Bankruptcy Code expires without its consent; and (b) that the Motion seeks to enjoin NAC’s rights to draw on the Letter of Credit (as defined in the Limited Objection) in violation of the “independence principle.” In addition, the Limited Objection seeks to reserve rights with respect to alleged unpaid postpetition rent.

Summary of Response

2. First, the Motion does not seek to extend the statutory period to assume or reject the NAC Lease without NAC’s consent to a time after the expiration of the full 210 day period under the Bankruptcy Code (assuming the Court finds cause), because the outside date for rejection under the proposed Order would be December 2, 2009 (i.e., 210 days from the May 6, 2009 petition date (the “**Petition Date**”).

3. Second, the Debtors are not seeking to enjoin the draw on the Letter of Credit by NAC from the issuing bank. Instead, the Debtors are simply proposing that NAC provide a specific statement of its damages before applying or retaining the proceeds of the Letter of Credit draw. As noted in the Motion, NAC has entered into a new lease with the Buyer

(as defined in the Motion), but the terms of which have not been shared with the Debtors or the official committee of unsecured creditors (the “**Committee**”). There is also a potential dispute as to NAC’s entitlement to postpetition rent. The law is clear that the independence principle does not insulate NAC from challenges to its substantive rights to retain the Letter of Credit proceeds.

4. Moreover, although not relevant to consideration to the Motion, the Debtors submit that they are current with respect to all postpetition rent under the NAC Lease per an understanding between NAC and the Debtors.

Response

5. For the reasons discussed in this Response, the Debtors respectfully request that the Court overrule the Limited Objection and grant the Motion.

Argument

The Motion Does Not Seek to Extend The Statutory Period to Assume or Reject the NAC Lease

6. Pursuant to section 365(d)(4)(B)(i) of the Bankruptcy Code, the Court may extend the Debtors time within which to assume or reject the NAC Lease for cause for a period of not longer than 210 days from the Petition Date. Two hundred and ten days from the Petition Date is December 2, 2009.

7. NAC does not object to the extension of the statutory time period, but it states that the effective date of rejection of the NAC Lease should not occur after the expiration of this time period, which could not occur without its consent under section 365 of the Bankruptcy Code.

8. Notably, the explicit terms of the proposed Order state that effective date of rejection of any nonresidential real property lease (including the NAC Lease) would be the

earlier of the sale closing date or December 2, 2009. Thus, if for a hypothetical reason the closing occurred after December 2, 2009, the NAC Lease would be deemed rejected as of that date by operation of law. Accordingly, NAC's concerns have been already addressed by the Debtors' initial filings.

The Procedures for Reconciliation of
NAC's Damages are Lawful, Reasonable, and Appropriate

9. Next, NAC argues that the Debtors are attempting to improperly enjoin its ability to draw on the Letter of Credit. That assertion is incorrect, and the procedures for which the Debtors seek approval are fair and appropriate in the context of this contested matter.

10. The Motion and the proposed Order do not seek to enjoin the actual "draw" by the beneficiary on the Letter of Credit from the issuing bank, but rather would require NAC to provide the Debtors and the Committee a statement specifically identifying its damages (after factoring into account any mitigation for rent received under its new lease following the closing date) prior to "applying" the proceeds of such Letter of Credit to NAC's damages, including rejection damages.

11. Such a procedure is in accordance with applicable case law and the facts of these cases. In other contexts, courts have held that notwithstanding the "independence principle," a letter of credit beneficiary is not entitled to retain the payment that it received from an issuing bank when its claim may not be allowable under applicable law.

See, e.g., Demczyk v. Mutual Life Ins. Co. (In re Graham Square), 126 F.3d 823, 827-28 (6th Cir. 1996) ("[T]he doctrine of independence protects only the distribution of the proceeds of the letter of credit. It prohibits an attack on the issuing bank's distribution to the beneficiary and does not address claims respecting the underlying contract."); accord Papio Keno Club, Inc. v. City of Papillion (In re Papio Keno Club, Inc.), 262 F.3d 725, 731 (8th Cir. 2001); see also In re

Builders Transport, Inc., 471 F.3d 1178, 1186 (11th Cir. 2006) (“[O]nce the proceeds of a letter of credit have been drawn down, the underlying contracts become pertinent in determining which parties have a right to those proceeds. In other words, an irrevocable standby letter of credit does not nullify the obligations set forth in the underlying contracts.”)

12. Here, the Debtors are not attacking NAC’s rights to draw on the Letter of Credit from the issuing bank. However, the Debtors are seeking the Court to approve procedures to determine the extent of NAC’s allowable claim before NAC may apply the proceeds of the Letter of Credit.

13. The Debtors’ proposed procedures are reasonable and appropriate. NAC and the Buyer indicated that they have entered into a new lease for the North & Sheffield Club premises; however, this new lease and the terms thereof have not been shared with the Debtors or the Committee.

14. Moreover, unlike the “Grand & Wabash” Order to which NAC refers -- which did not require as specific of a statement indentifying damages but still requires the landlord to certify damages -- NAC may have to mitigate its claim under applicable state law against rent received under the new lease. At this time, the estates have no information as to the amount and the extent of NAC’s claim.

Notice

15. Notice of this Response has been provided to all ECF participants in the Debtors’ cases. In addition, a copy of this Response has been provided via email to counsel to NAC, the Office of the United States Trustee, counsel to the Committee, and counsel to CH Fitness Investors, LLC.

Conclusion

For all of the foregoing reasons, the Debtors respectfully request that the Court grant the Motion and overrule the Limited Objection.

Dated: November 14, 2009
New York, New York

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