

**THE UNITED STATES BANKRUPTCY COURT  
FOR THE WESTERN DISTRICT OF MISSOURI  
WESTERN DIVISION**

<b>IN RE:</b>	)	<b>In Proceedings Under Chapter 11</b>
	)	
<b>FARMLAND INDUSTRIES, INC., et al.,</b>	)	<b>Case No. 02-50557-JWV</b>
	)	<b>Jointly Administered</b>
	)	
<b>Debtors.</b>	)	

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**APPLICATION OF SAFECO INSURANCE COMPANY OF AMERICA  
FOR ALLOWANCE OF REJECTION CLAIM PURSUANT TO 11 U.S.C. § 365(g)(1) WITH  
RESPECT TO SAFECO SURETY BOND NO. 5985802 (RE: COFFEYVILLE PETROLEUM  
COKE GASIFICATION TO NITROGEN FERTILIZER FACILITY)**

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COMES NOW, Safeco Insurance Company of America (“Safeco”), by and through its undersigned counsel, and hereby petitions this Honorable Court for allowance and payment of a rejection claim, pursuant to 11 U.S.C. § 365(g)(1). Safeco also files, simultaneously herewith, its Fourth Amended Proof of Claim indicating its claim for rejection damages, as requested herein. In support hereof, Safeco would respectfully submit to this Honorable Court the following:

**SUMMARY**

Safeco previously filed its Comment to Debtor’s Motion for Order (1) Approving Auction and Bid Procedures; (2) Approving Break-up Fee; (3) Approving the Form and Manner of Notice; (4) Authorizing the Sale of Assets Free and Clear of Liens, Claims, and Encumbrances, Subject to Higher or Better Offers; and (5) Approving Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with Such Sale (respectively, the “Sale Motion” and “Limited Objection”)(the “Comment”). Therein, Safeco suggests to this Court and parties in interest that the proposed structure of the transactions contemplated thereby may discharge and release Safeco under certain of its surety bonds issued on behalf

of the Debtors. To the extent that Safeco may not be so discharged, Safeco hereby makes claim for the relief requested herein as heretofore and hereinafter described.

Safeco further previously filed its Application of Safeco Insurance Company of America for Payment of Cure Claim Pursuant to 11 U.S.C. § 365(b)(1), or in the alternative For Allowance of Administrative Class Claim Pursuant to 11 U.S.C. § 503(b)(3)(D), which is still pending before this court (the "Cure Claim"). Safeco files this Rejection Claim in response to this Court's direction pursuant to Section B(1)(c) of the Findings of Fact, Conclusions of Law and Order Confirming Debtors' Second Amended Joint Plan of Reorganization dated December 19, 2003 (the "Confirmation Order"), and reserves all rights, remedies, and defenses, including, without limitation, those asserted in the aforementioned Comment and Cure Claim. To the extent that Safeco may not be discharged of its obligations under the Bond (defined *infra*), and to the extent Safeco is not granted a cure or administrative class claim as requested in the Cure Claim, Safeco requests allowance of a rejection claim as set forth herein.

## **BACKGROUND**

1. On May 31, 2002, Farmland Industries, Inc. ("Farmland" or "Debtor"), a Debtor herein, filed its voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code, commencing this case.

2. During the early months of 1999, Farmland was in the process of constructing a Petroleum Coke Gasification to Nitrogen Fertilizer Facility (the "Facility") in Coffeyville, Kansas. The operation of the Facility, once completed, was dependent upon a sufficient supply of electric power. The City of Coffeyville, Kansas (the "City") owned or controlled the transmission lines where the Facility was located and was the sole source for electrical power to the Facility. In order to provide the needed electricity to the Facility, the City needed to build a new substation to handle the increased demand created by the Facility. The City

proposed to finance the construction of the new substation through the issuance of certain industrial revenue bonds (the "IRBs"). In order to ensure payment of the IRB obligations and to ensure the supply of electricity needed for the operation of the Facility, the City and Farmland entered into the Petroleum to Coke Gasification to Nitrogen Fertilizer Facility ESA dated March 31, 1999 (the "ESA"). Revenues paid by Farmland under the ESA were used to pay expenses associated with the generation of electricity and to service the debt evidenced by the IRBs. To assure the continuing performance of Farmland under the ESA, Farmland was required to provide either a letter of credit or a surety bond in the amount of \$12 million to cover, *inter alia*, certain charges for electricity used by Farmland and to cover the aggregate debt service under the IRBs.

3. Prior to the petition date, and at the request and behest of Farmland in conjunction with the requirements of the ESA, Safeco issued Surety Bond No. 5985802 in the amount of \$12 million naming Farmland as Principal and the City, as Obligee (the "Bond").

4. At the time of filing of Farmland's petition for relief, Farmland was indebted to The City under the terms of the ESA for amounts due for the month of May, 2002, in the amount of \$1,343,303.20, plus late charges at a rate of 10% for the past due balance. On or about May 28, 2003, the City, as Obligee under the Bond, filed a motion with this Court to obtain relief from the automatic stay to notify Farmland of a potential default and related cure period under the ESA so as to allow the City to make demand upon Safeco under the Bond.

5. Upon demand by the City, under a reservation of rights, Safeco made payment to the City in the amount of \$1,477,633.52 in satisfaction of all amounts in which Farmland was then in default under the ESA.

6. On or about October 7, 2003, this Court entered an Order granting the Debtors' Motion for Order (1) Approving Auction and Bid Procedures; (2) Approving Break-up Fee; (3) Approving the Form and Manner of Notice; (4) Authorizing the Sale of Assets Free and Clear of Liens, Claims, and Encumbrances, Subject to Higher or Better Offers; and (5) Approving Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with Such Sale. Pursuant to said Order, this Court approved the Asset Sale and Purchase Agreement, subject of Farmland's aforesaid Motion (the "Purchase Agreement").

7. Pursuant to Section 2.6 of the Purchase Agreement, Farmland initially sought to assume and assign to the Purchaser the Assumed Contracts specifically described in Schedule 2.6 thereto. Schedule 2.6 listed, among other contracts, the ESA. Further, under the terms of the Purchase Agreement, approved by order of this Court dated October 10, 2003, such assumption was mandatory.

8. Notwithstanding court approval of a Purchase Agreement mandating assumption of the ESA, Farmland subsequently amended Section 2.6 of the Purchase Agreement to provide that the ESA is not a contract required to be assumed by the purchaser. Ultimately, the ESA was not assumed under the Purchase Agreement, as amended, and was deemed rejected by Farmland by order of this court entered on or about November 7, 2003.

9. Farmland's rejection of the ESA constitutes, under § 365(g)(1), a material breach thereof and ostensibly requires Safeco to perform on behalf of the Debtors, pursuant to the Bond. Pursuant to the order confirming Farmland's plan of reorganization, Safeco is required to file a "Rejection Claim" for damages suffered by reason of Farmland's rejection of the ESA or be "forever barred" from pursuing same against the Debtors, notwithstanding prior filings of contingent claims, including this Claim, and the establishment of a \$46,485,950.87 reserve under the Confirmation Order.

10. Safeco has asserted in its Cure Claim that it is entitled to an administrative class claim in an amount up to \$12,000,000 pursuant to 11 U.S.C. § 503(b)(3)(D) as the surety credit extended under the Bond has increased the effective sales price to be realized by the Debtor's estates or, alternatively, a cure claim up to the penal sum of the Bond, \$12,000,000, as the Debtor's have assumed the ESA, *de facto*. To the extent Safeco is (a) not discharged; or (b) not awarded an administrative or cure claim as requested therein, Safeco is entitled to an allowed unsecured claim for damages incurred by reason of Farmland's rejection of the ESA.

11. Safeco and Farmland have negotiated the reservation of funds in the amount of \$46,485,950.87 as a claims reserve on account of all claims asserted by Safeco, including the Claim which is the subject of this Application, regardless of statutory classification or other denomination.

### **RELIEF REQUESTED**

12. By this Motion, Safeco seeks allowance and payment from Farmland of a rejection claim pursuant to 11 U.S.C. § 365(g)(1) in an amount not to exceed \$12,000,000, with a liquidated amount not less than \$1,477,633.52, and the remainder contingent, but subject to amendment.

### **BASIS FOR RELIEF REQUESTED**

13. Pursuant to § 365(g)(1), Farmland's rejection of the ESA "constitutes a breach of such contract...immediately before the date of the filing of the petition."

14. Without conceding Safeco's arguments with regard to classification of its claims, Safeco's obligations under the Bond arguably arise at the time of Farmland's rejection of the ESA, and rejection of the ESA creates a pre-petition breach thereof. Therefore, Safeco's loss incurred on account of satisfaction of said obligations is treated as having arisen pre-petition.

15. Safeco has already incurred a liquidated loss in the amount of \$1,477,633.52 on account of its payment in partial satisfaction of its obligations under the Bond, and is thus entitled to the allowance of a liquidated rejection claim in like amount. However, at this time, Safeco's remaining obligations under the Bond, if not discharged, have not matured, but likely will, if at all, within the near future; as such, Safeco is entitled to a contingent rejection claim in like amount to the remainder of the Bond's penal sum.

### **RESERVATION OF RIGHTS**

16. Safeco makes this claim in the event it is not ultimately deemed discharged, in whole or in part, of its obligations under the Bond, and expressly subject to the relief requested in its Cure Claim, ~~and~~ under a full reservation, without limitation, of its rights, remedies, and defenses, including the right to later amend this claim.

**WHEREFORE, PREMISES CONSIDERED**, Safeco prays that this Honorable Court grant it an allowed rejection claim pursuant to 11 U.S.C. §365(g)(1) in the total amount of \$12,000,000, with a liquidated amount not less than \$1,477,633.52, and the remainder contingent but subject to amendment, and for such other further relief as may be just and proper.

Respectfully Submitted,

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A copy of the foregoing was served through the electronic  
case filing system on January 14, 2004.

/s/ Bruce E. Strauss