IN THE UNITED STATES BANKRUPTCY COURT

WESTERN DISTRICT OF MISSOURI

In re:	)	
	)	
FARMLAND INDUSTRIES, INC., et al.,	)	**In Proceedings Under Chapter 11**
	)	
Debtors,	)	**Case No.: 02-50557-JWV**
	)	**Joint Administration**

OFFICIAL COMMITTEE OF BONDHOLDERS STATEMENT IN SUPPORT OF DEBTOR'S OBJECTION TO JOINT APPLICATION FOR ALLOWANCE AND PAYMENT OF ADMINISTRATIVE EXPENSE CLAIM PURSUANT TO SECTION 503(B) OF THE BANKRUPTCY CODE

The Official Committee of Bondholders (the "Committee"), by its undersigned counsel, submits its Statement in Support of Debtors' Objection to Joint Application for Allowance and Payment of Administrative Expense Claim (the "Application"). In support hereof, the Committee respectfully represents as follows:

SUMMARY OF APPLICATION AND OBJECTION

The Application

On January 17, 2003, River Barge and CIT (collectively, "Applicants") filed their Application seeking allowance and payment of a claim in excess of $18 million, plus interest (the "Claim"). (Debtors' Objection ¶1.) The Applicants' claim arises out of an alleged Novation Agreement and leveraged lease which were entered into prepetition. The Applicants assert that they are entitled to an administrative expense claim because a condition precedent to operation of the Novation Agreement occurred post petition and obligated Farmland Industries, Inc. under an alleged new lease ("New Charter") with terms materially identical to the prior lease, except that

Farmland Industries, Inc. would be primarily liable under the New Charter rather than Pinnacle (an entity in which Farmland Industries, Inc. has a 50% interest).

The Debtors' Objection to the Application

On January 27, 2003, the Debtors filed their objection to the Application, objecting to the Application because it does not meet the burden of proof under Bankruptcy Code § 503(b)(1). The Debtors stated that the Applicants' claim is "one arising from a pre-petition contract (the Novation Agreement) which has not been assumed by the Debtors" and that "the estates have received no direct and tangible benefit" as required for allowance of an administrative claim under Bankruptcy Code § 503(b)(1). (Debtors' Objection, ¶7.) The Debtors noted that those cases upon which Applicants rely are inapposite because those cases involved tortious conduct engaged in by the debtor post-petition.

THE COMMITTEE'S POSITION

The Committee supports the Debtors' Objection to the Application. First, the Application fails to show liability on the part of the post-petition Debtors-in-Possession. Second, the Application fails to meet the burden under Bankruptcy Code § 503(b)(1)(A) and seeks the Court to approve a liquidated damages clause without submitting any proof that the payment of the liquidated damages are actual, and necessary expenses of the preservation of the estate.

THE APPLICATION FAILS TO SHOW LIABILITY ON THE PART OF THE DEBTORS IN POSSESSION AS ADMINISTRATORS OF THE ESTATE

Upon and after filing of their petitions under chapter 11: Farmland Foods, Inc.; Farmland Industries, Inc.; Farmland Transportation, Inc.; SFA, Inc.; and Farmland Pipeline Company began operating the assets of Farmland Industries, Inc. and related *debtors'* properties as Debtors in Possession ("DIP") with rights and duties identical to that of a trustee of a bankruptcy estate, with the exception of the duty to investigate the debtor. See Bankruptcy Code § 1107(a). Under

the Code, the DIP and the prepetition debtor are treated as distinct entities. For a DIP's estate to be bound under a lease or contract, two requirements must be met. First, the DIP must affirmatively act to assume the contract entered into by the prepetition debtor; and second the assumption must be approved by the Court. See Bankruptcy Code § 365(a) (stating: that the "trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor").

The Joint Application asserts that without any affirmative act by the DIP and without any court approval, the estate became liable under the terms of the "New Charter" as a result of the happening of certain 'novation events' under the prepetition "Novation Agreement." See (Suggestions in Support of Application at 4.)

As the Applicants admit, the Novation Agreement which contained the 'novation events' that acted to create the "New Charter" was entered into by the prepetition debtor — Farmland Industries, Inc. See (Application, ¶9). As the Applicants admit, the creation of the "New Charter" was a term under the prepetition Novation Agreement. Id. As the Applicants admit, the DIP expressly rejected the notion that the Estates intended to assume the Novation Agreement or the "New Charter" purportedly created under the Novation Agreement. See (Suggestions in Support of Application at 12.)

As the Applicants admit, the Applicants effected the Novation Agreement unilaterally, without any court approval or affirmative act by the DIP. See (Suggestions in Support of Application 27) (stating "…it is technically the case that River Barge…effected the Novation through their voluntary act..."). Such unilateral action cannot usurp the Court's exclusive jurisdiction to allow the DIP to assume an executory contract or unexpired lease.

As the Applicants admit, the Novation Agreement, was central to the "Old Charter," and was executed contemporaneously therewith. See (Application, ¶9). The Novation Agreement rather is a specialized term of the "Old Charter," an executory contract, assumable by the estate solely under the strictures of Bankruptcy Code § 365(a) which requires at the very least this Court's approval.

THE APPLICATION FAILS TO MEET THE BURDEN UNDER § 503(B)(1)(A)

"Since an administrative expense constitutes a priority claim any recovery must be subject to strict scrutiny by the court." In re Food Barn Stores, Inc., 175 B.R. 723, 726 (Bankr. W.D. Mo. 1994) (quoting In re Patch Graphics, 58 B.R. 743, 745 (Bankr. W.D. Wis. 1986)). As such, "[t]he party seeking an administrative expense claim has the burden to prove by a preponderance of the evidence that it is entitled to such claim." Id. (citing In re TransAmerican Natural Gas Corp., 978 F.2d 1409, 1416 (5th Cir. 1992)); see also In re Naughton, 227 B.R. 527, 529 (Bankr. W.D. Mo. 1998).

a. The Expenses Allegedly Incurred By the Applicants Do Not Constitute "Actual, Necessary Costs And Expenses Of Preserving The Estate[s]" As Required By § 503(b)(1)(A).

Section 503(b) of the Bankruptcy Code provides, in pertinent part, "After notice and a hearing, there shall be allowed administrative expenses . . . including the actual necessary costs and expenses of preserving the estate[s] . . . for services rendered after the commencement of the case." Bankruptcy Code § 503(b)(1)(A). In determining if a claim is entitled to administrative priority, a claim must satisfy the following two-pronged test: "(1) the right to payment arose from a postpetition transaction with the debtor estate, rather than from a prepetition transaction with the debtor, and (2) the consideration supporting the right to payment was beneficial to the estate of the debtor." In re Food Barn Stores, Inc., 175 B.R. at 726 (quoting In re Hemingway Transp., Inc., 954 F.2d 1, 5 (1st Cir. 1992)); see also In re Williams, 246 B.R. 591, 594 (B.A.P.

8th Cir. 1999) (test is "whether (1) the expense arose from a transaction with the estate and (2) whether it benefited the estate in some demonstrable way"); In re Jefferson Investment Co., 151 B.R. 920, 922 (Bankr. E.D. Mo. 1993) (administrative expense priority is afforded to those who aid in preservation and administration of estate or who aid in debtors' rehabilitation to the benefit of all creditors).

It is not enough for the Applicants to aver generally that the Farmland Estates received some benefit by having the ability to use the barges. Instead, "[s]ection 503(b)(1)(A) requires the creditor to demonstrate that the expenses provided a **tangible benefit** to the bankruptcy estate before they may be granted administrative expense status." Williams, 246 B.R. at 594 (citing In re Wedemeir, 239 B.R. 794, 798 (B.A.P. 8th Cir. 1999)) (emphasis added). Moreover, "[t]he terms 'actual' and 'necessary' contained in 11 U.S.C. § 503(b)(1)(A) must be narrowly construed in order to keep administrative expenses at a minimum and thus preserve the estate for the benefit of all creditors." Food Barn, 175 B.R. at 726 (quoting In re Patch Graphics, 58 B.R. 743, 745 (Bankr. W.D. Wis. 1986)).

Acknowledging the fact that no additional benefit has been conferred upon the estates different than that which existed at the time of the Bankruptcy filing– the Applicants attempt to identify themselves with quasi-tort claimants by citing cases where the trustee or the DIP has engaged in tortious, negligent, or nuisance causing activities during the post petition period. See (Application, ¶25). These cases are not applicable to the facts of the Application, because the Applicants' claim is based entirely upon damages from an alleged contractual breach.

Even if the breach of Pinnacle's obligation to make quarterly pre-payments under the Leveraged Lease could somehow be translated into a tort injury to the Applicants — the *injury arises from prepetition activities* under any reading of the facts. Even in tort cases, if the claim is

grounded in a breach of duty that arose prepetition, the fact that a prerequisite to suit happened post-petition does not convert a prepetition claim into an administrative expense. See McSherry v. Trans World Airlines, 81 F.3d 739 (8th Cir. 1996); In re Wisconsin Barge Lines, 91 B.R. 65, 68 (Bankr. E.D. Mo. 1988). In McSherry, the Eighth Circuit found that a claim under the ADA was prepetition unsecured even though the right to sue letter, which was a threshold requirement demonstrating an exhaustion of administrative remedies, was received by the plaintiff post petition. 81 F3d at 739. Here any duties that may have been breached were the duties in honoring terms in the Novation Agreement.

The Applicant's claim is predicated upon damages allegedly caused to the Applicants by Farmland's purported breaches of the Novation Agreement, rather than any value conferred upon the Farmland estate. Perhaps the most instructive case regarding the treatment of an administrative claim incurred post-petition and pre-rejection is the Eighth Circuit Court of Appeals' decision in U.S. v. Dewey Freight System, Inc., 31 F.3d 620 (8th Cir. 1994). Dewey Freight noted that "[i]f the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay *for the reasonable value of those services* . . . ." Id. at 624 (quoting NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531 (1984)) (emphasis in original). "Where no benefits are received by the bankrupt estate or its representative under the contract, and the contract is not assumed, the creditor's claim is not entitled to priority . . . ." Id. at 625 (quoting American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A., 280 F.2d 119, 125-25 (2d Cir. 1960)).

The Applicant's claim hinges not on the services *actually used* by the Farmland estate during the post-petition period, but on services the Applicant's felt that the Farmland *estate*

should have used. See (Suggestions in Support of Application 23) (stating that administrative priority should apply based on Farmland's opportunity to use the leased property, "even if it did not"). Under the Bankruptcy Code, however, Farmland's estate is obligated only to pay for the reasonable value of services it actually received and used. U.S. v. Dewey Freight System, Inc., 31 F.3d 620, 624 (8th Cir. 1994).

b. The Applicants' Calculation Of Alleged Damages Is Improper.

The River Barge Application requests over 56% of the original purchase price for a six year old fleet of barges. See (Affidavit of Shane Connell in Support of Request for Allowance and Payment of Administrative Expense Claim Pursuant to Section 503(B)(1)(A) of Bankruptcy Code, ¶6).

Over $15 Million of the Applicants' claim arises from a liquidated damages clause spelled out in the terms of a contract negotiated and entered into prepetition. The liquidated damages bear no reasonable relation to actual damages let alone any reasonable value to the estate. Rather, the liquidated damages claimed are based on "…an amount equal to (A) any Charter Hire due for the barges that were past due, plus (B) an amount equal to the excess of the Stipulated Loss Value of the Barges as of the appropriate Stipulated Loss Value Date over the Fair Market Sales Value of the Barges." See (Suggestions in Support of Application 22-23).

Even *if* the Estate had used the barges, the *fair and reasonable* value of the actual use of the barges after the prepayment period had run out has not been proffered. River Barge asserts that it should be paid for merely making available the barges since the May 31, 2002 petition date. River Barge had already been pre-paid through July 2002 by Pinnacle.

Assuming any use of the barges post-petition, the maximum period that Farmland would be liable to River Barge (rather than Pinnacle) must begin on the day that the Pinnacle pre-payment was exhausted — July 10, 2002 and *must* end when the barges were no longer available

— August 16, 2002, the date that this Court entered relief from the automatic stay in favor of River Barge. Rather than requesting an amount equal to the reasonable value of the barges *actually used* between the date of Pinnacle's default and the date that River Barge obtained relief from the automatic stay, the application requests the full contractual 'liquidated damages', storage costs, quarterly rent, and interest without any deduction for sums received from any reletting of the barges after relief from the automatic stay was obtained. In fact, under River Barge's calculations relief from the automatic stay afforded no benefit to them in mitigating their claim.

Bankruptcy Code § 502(g) expressly provides the remedy for damages based on the rejection of an executory contract under Bankruptcy Code § 365 or by confirmation of a plan — is a prepetition claim. Section 502(g) reads in relevant part:

> A claim arising from the rejection, under section 365 of this title or under a plan under chapter…11…of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

Id.

The commitments under the Novation Agreement arose prepetition and are necessarily 'vanilla prepetition unsecured'. See In re Food Etc., L.L.C., 281 B.R. 82, 88-89 n.4 (Bankr. S.D. Ala. 2001) "If the commitments of the parties arose prepetition, and the creditor merely sat back and allowed the debtor to continue to use the property then there is no administrative expense status."); see also In re Wisconsin Barge Lines, 91 B.R. 65 (Bankr. E.D. Mo. 1988). Instructive also is In re Trans World Airlines, 275 B.R. 712, 723-24 (Bankr. D. Del. 2002) [hereinafter "TWA"]. The Court in TWA found that indemnity provisions of a prepetition contract are prepetition unsecured not administrative claims. Id. at 721. To raise to the level of

administrative claim, the court in TWA held that the creditors' conduct must benefit the estate in a manner that created some "new" benefit, or something more than the status quo existing at the time of the petition. Id. at 724.

No matter how cleverly labeled, the Novation Agreement is a prepetition agreement conferring on River Barge only a prepetition unsecured claim for its breach.

Wherefore, the Committee respectfully requests that the Court deny the Joint Application for Administrative Expense.

Respectfully submitted,

POLSINELLI SHALTON & WELTE, P.C.
A PROFESSIONAL CORPORATION

By: /s/ James E. Bird

James E. Bird (MO#28833)
Daniel J. Flanigan (MO#26229)
700 West 47th Street, Suite 1000
Kansas City, Missouri 64112
(816) 753-1000
Fax no. (816) 753-1536

ATTORNEYS FOR THE OFFICIAL
COMMITTEE OF BONDHOLDERS OF
FARMLAND INDUSTRIES, INC., et al.