UNITED STATES BANKRUPTCY COURT
FOR THE
WESTERN DISTRICT OF MISSOURI

In re	:	Chapter 11
	:	
FARMLAND INDUSTRIES, INC. *et al.*,	:	Case Number 02-50557
	:	Jointly Administered
Debtors	:	
	:	

UNITED STATES TRUSTEE'S OBJECTION TO MOTION FOR AN ORDER DIRECTING APPOINTMENT OF AN EQUITY SECURITY HOLDERS COMMITTEE

In support of his Objection to Shareholders' Motion for Order Directing the Appointment of an Equity Security Holders Committee (the "Motion"), Joel Pelofsky, United States Trustee for Region 13 ("UST"), by and through his undersigned counsel, states as follows:

1. This Court has jurisdiction to hear the above-referenced Objection.

2. Pursuant to 11 U.S.C. § 307, the UST has standing to be heard with regard to the above-referenced Objection.

3. Pursuant to 28 U.S.C. § 586, the UST is charged with the administrative oversight of cases commenced pursuant to Title 11 of the United States Bankruptcy Code. This duty is part of the UST's responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts. *See United States Trustee v. Columbia Gas System, Inc. (In re Columbia Gas System, Inc.),* 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that UST has "public interest standing" under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the UST as a "watchdog").

4. On June 3, 2002, the UST appointed an official committee of unsecured creditors, as is mandated by 11 U.S.C. § 1102(a)(1). On the recommendation of the Debtor, and in an

exercise of his discretion, he also appointed an official committee to represent the bondholders in this case. Based on information provided by the Debtor, creditors, and parties requesting formation of an equity committee, the UST declined requests to form an official committee of equity holders.

5. In Chapter 11 cases, Congress has vested the UST with discretion to appoint additional official committees, other than an official committee of unsecured creditors. The specific language of the statute states that the UST "*may* appoint additional committees of creditors or of equity security holders *as the United States Trustee deems appropriate*." 11 U.S.C. § 1102(a)(1) (emphasis added). The plain language of the statute indicates that the appointment of an equity committee is a discretionary act of the UST. *In re Williams Communication Group, Inc.,* 281 B.R. 216, 219 (Bankr. S.D.N.Y. 2002).

6. The Hartford Steam Boiler Inspection and Insurance Company, John Hancock Life Insurance Company, Commerce Indemnity Company, Erie Insurance Company, Flaherty & Crumrine, and FCA Post-confirmation Trust as successor to The Farmers Cooperative Association (hereinafter "Movants") subsequently filed their motion requesting this Court to direct appointment of an official committee of equity security holders.

7. At 11 U.S.C. § 1102(a)(2), Congress has given this Court the power, on motion of a party in interest, to direct the UST to appoint a committee of equity security holders if the Court finds the appointment of such a committee is "necessary to assure adequate representation of...equity security holders." *See generally*, Bankruptcy Rule 2020 (proceedings to contest any act or failure to act by UST is governed by Rule 9014).

8. It is well established that the standard of review to be exercised by the Court in reviewing the acts of the UST is the abuse of discretion standard. *In re Columbia Gas Systems, Inc.*,133 B.R. 174, 175 (Bankr. D. Del. 1991); *In re Sharon Steel Corp.*, 100 B.R. 767, 776 (Bankr. W.D. Pa. 1989). The abuse of discretion standard is deferential and creates a high hurdle; a reviewing court will not substitute its judgment for that of the UST. *In re Columbia Gas System, Inc., supra*. An "abuse of discretion" "will be found if [a decision-maker] acted in an irrational, arbitrary, or capricious manner, 'clearly contrary to reason and not justified by the evidence.'" *In re Pierce*, 237 B.R. 758, 754 (Bankr. E.D. Cal. 1999) (brackets in original, *quoting* Norton Bankruptcy Law Practice 2d, § 148:37). "A decision is not 'arbitrary and capricious' unless it is based on an erroneous conclusion of law, a record devoid of evidence on which the decision maker could rationally have based its decision, or it is otherwise patently unreasonable, arbitrary or fanciful." *In re Barney's, Inc.*, 197 B.R. 431, 439 (Bankr. S.D.N.Y. 1996).

9. Movant does not and cannot allege that the UST abused his discretion in declining to appoint an equity committee. Indeed, quite the opposite is true: the UST's decision not to appoint an equity committee reflects the UST's careful balancing of facts and application of his Congressionally granted discretion. The UST has fully analyzed the request to appoint an equity committee and has decided, in light of all the facts and circumstances within his knowledge, that such a committee should not be appointed at this juncture of the case.

10. The burden of establishing a need for an official committee of equity security holders is a heavy one. "Appointment of committees of equity security holders is the exception rather than the rule in chapter 11 cases." 7 King, *Collier on Bankruptcy* ¶ 1102.03[2] at 1102-22

(15th Ed. Rev. 2001). "Ordering the appointment of additional committees, particularly given that the matter is often first reviewed and addressed by the U.S. Trustee, is an extraordinary remedy." *In re Enron Corp.,* 279 B.R. 671, 685 (Bankr. S.D.N.Y. 2002).

11. In considering whether to direct appointment of a committee of equity security holders courts have generally structured their analysis around the number of shareholders, the complexity of the case, whether the cost (both financial and intangible) of additional committees significantly outweighs the concern for adequate representation, and the major factor of whether or not the debtor is solvent. *In re Williams Communications,* 281 B.R. at 220.

12. The UST took the following actions in evaluating the request to form an equity committee:

(a) Examined the capital structure, organizational structure and financial posture of the debtors-in-possession as reported by them in their bankruptcy petitions and schedules, in financial data submitted in connection with the Debtors' motions for approval of debtor-in-possession financing, and in testimony at court hearings and the meeting of creditors held pursuant to 11 U.S.C. § 341;

(b) Discussed with the Debtor the composition of its board of directors and the numbers and size of the entities that hold its common and preferred stock;

(c) Noted comments from both the Debtors and other parties about the desirability of appointing an equity committee; and

(d) Telephonically conferred several times with Movants' counsel and considered their oral and written comments.

13. Based on information received and reviewed, it appears to the UST that:

(a) Farmland's common shares are held by its member co-ops and individual producer members.

(b) Farmland's 22-member board of directors is made up of 11 member co-op executives and 11 producer members, who are drawn from 10 geographic districts. Except that each district shall have at least one director and no district will have more than four directors, the number of directors allotted to each district is proportional to the amount of member stock.

(c) Farmland's preferred equity is owned by a few large entities (e.g., John Hancock Insurance, which told the UST it holds 25 percent of such shares) and additional holders whom the UST is not able to identify as their shares are held in street name. Representatives of the Debtor told the United States Trustee they did not believe the preferred stock to be widely held but they were not able to provide a list of individual holders; they have identified nine financial institutions that hold the stock in street name. Soliciting potential committee members from a body of investors when shares are held in street name is time-consuming , expensive, and frequently less than representative, as institutional holders typically refuse to disclose the identities of the parties whose stock they hold. Self-identification of stockholders is particularly helpful, but in this case, in contrast to a large numbers of trade creditors, former employees, and bond holders, no holders of preferred stock except the Movants have contacted the office of the United States Trustee.

(d) Even if there were a large number of preferred shareholders, not every case with a large number of shareholders requires an official equity committee. Otherwise, such

appointment would be mandatory rather than submitted to the discretion of the UST. *In re Williams Communications,* 281 B.R. at 223.

(e) It is unlikely the holders of equity security interests will receive anything in a distribution under a plan of reorganization as the Debtors' schedules of assets and liabilities demonstrate that the net book value of the Debtors' assets on a going concern basis (which is in and of itself more optimistic than a liquidation valuation) is less than the Debtors' liabilities. After adjusting for duplicate debt, Debtor's Amended Schedules, which were filed July 26, 2002, show a combined negative equity of $198, 961, 943.00 (See Summary at Exhibit A) . The Motion sets out no facts more current than Debtors' schedules from which the Court could find that the Debtors' assets are worth significantly more, or that the Debtors' liabilities are significantly lower, than the scheduled amounts. From this financial posture, the UST has appropriately inferred that under present circumstances, equity, as the most junior class of claims and interests, will receive nothing in these Chapter 11 cases. Because the equity holders have nothing to protect or to be adequately represented by a committee, there is no meaningful negotiation to be done by an equity committee.

(f) In an equity committee were to be appointed, the fees and expenses of its members and professionals would contribute substantial additional cost to the Debtors' estates and, ultimately, the creditors, without foreseeable corresponding benefit in light of the Debtor's questionable solvency.

(g) Since Farmland's Board is made up of producer and co-op owners of common stock, that group of claimants is sufficiently represented in the case.

(h) The large holders of preferred stock, which the Debtor reports are few in number, appear to be in a better financial position to shoulder the costs of their professional representation than is Farmland. If they made a substantial contribution to the case they could seek to have their professionals paid pursuant to 11 U.S.C. § 503(b).

14. The UST respectfully submits that there is no simple formula to follow in performing this analysis and that the steps taken, as set forth above, are a reasonable, balanced method of determining whether to appoint an equity committee.

15. In performing his review, the UST has considered the comments and opinions of the parties in interest, including the Debtors and the Official Committees.

16. Movants do not point to any facts which suggest, let alone establish, that Farmland's management is unable or unwilling to discharge its fiduciary duties to all of its constituencies, including equity . It is a fundamental axiom of bankruptcy jurisprudence that absent creditor consent, management cannot preserve anything for the benefit of shareholders unless and until it fully satisfies creditors, who occupy a superior position in the distribution hierarchy as a matter of law.

17. While cost is not the only factor taken into consideration, the economics of bankruptcy cases dictate that committees should only be appointed when there is a purpose to be served. "Generally no equity committee should be appointed when it appears that a debtor is hopelessly insolvent because neither the debtor nor the creditors should have to bear the expense of negotiating over the terms of what is in essence a gift." *In re Emons Industries, Inc.*, 50 B.R. 692, 694 (Bankr. S.D.N.Y. 1985); *In re Johns-Manville Corp.*, 68 B.R. 155, 160 (Bankr.

S.D.N.Y. 1986), *See also* D.A. Skeel, *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 Va. L.Rev. 461 (1992).

18. It is well recognized that most official committees exercise their rights to retain counsel to assist them in discharging their fiduciary responsibilities. In cases as large as this one it is not uncommon for each committee also to retain its own accountant and/or financial analyst to aid it in its mission. 11 U.S.C. § 1103(a). Under the Code, the cost of these professionals is borne by the estate. 11 U.S.C. §§ 328(a), 330(a), 503(b)(2). However, if there is no reasonable position for the committee to advocate, the establishment of a committee and the not inconsequential expenses that flow from the retention of professionals serve only to further dissipate assets of the estate.

19. Although the Movants are not entitled to the appointment of an official committee, equity security holders are not voiceless in this case. Any party in interest has standing to be heard pursuant to 11 U.S.C. § 1109(b). Indeed, equity security holders can assert a collective voice through an unofficial committee, and seek reimbursement of their costs and attorneys' fees under 11 U.S.C. § 503(b)(3) if their actions result in a substantial contribution in the case. *In re Johns-Manville Corp.*, 68 B.R. 155 (S.D.N.Y. 1986); Movants should not confuse the right to be heard with the right to charge a debtor's estate for the cost of its professionals. *In re Hills Stores Co.*, 137 B.R. 4, 7 (Bankr. S.D.N.Y. 1992).

20. The UST respectfully submits that this is an appropriate situation for interested equity security holders to assert their right to be heard under 11 U.S.C. § 1109(b), whether individually or collectively and, if their position proves meritorious in retrospect, to seek reimbursement under 11 U.S.C. § 503(b)(3).

21. Equity security holders may be displeased at the prospect of receiving nothing on account of their interests, or of being required to fund their own expenses while participating in this case. However, neither the facts nor the law support the appointment of a committee of equity security holders. To appoint an equity committee at this time would serve only to transfer additional financial burdens to the Debtors and indirectly to the unsecured creditors of the estate.

WHEREFORE, the UST requests that this Court issue an order denying the Motion in its entirety and/or granting other relief that this Court deems appropriate.

JOEL PELOFSKY
UNITED STATES TRUSTEE

PAULA C. ACCONCIA
ASSISTANT UNITED STATES TRUSTEE

BY: /s/ Paula C. Acconcia
Paula C. Acconcia # 32893
Office of the United States Trustee
Charles Evans Whittaker Courthouse
400 East 9th Street, Ste 3440
Kansas City, MO 64106
Tel: (816) 512-1940
Fax: (816) 512-1967
ustpRegion13.KC.ECT@usdoj.gov

EXHIBIT A

(Summary from Schedules of 5 Farmland Debtors)

	Schedules
Farmland Industries, Inc.	
Total Assets	$1,127,773,209
Total Liabilities	$1,473,856,487
Less Duplicate Debt	$ -0-
Net Liabilities	$1,473,856,487
Net-Equity	$ (346,083,278)
Farmland Foods, Inc.	
Total Assets	$ 315,500,895
Total Liabilities	$ 758,995,697
Less Duplicate Debt	$ (566,380,249)
Net Liabilities	$ 192,615,448
Net-Equity	$ 122,885,447
Farmland Transportation, Inc.	
Total Assets	$ 10,482,518
Total Liabilities	$ 570,109,995
Less Duplicate Debt	$ (566,380,249)
Net Liabilities	$ 3,729,746
Net-Equity	$ 6,752,772
Farmland Pipe Line Company	
Total Assets	$ 7,642,516
Total Liabilities	$ 566,461,005
Less Duplicate Debt	$ (566,380,249)
Net Liabilities	$ 80,756
Net-Equity	$ 7,561,760
SFA, Inc.	
Total Assets	$ 13,011,121
Total Liabilities	$ 569,470,014
Less Duplicate Debt	$ (566,380,249)
Net Liabilities	$ 3,089,765
Net-Equity	$ 9,921,356
Total - 5 Entities	
Total Assets	**$ 1,474,410,258**
Total Liabilities	**$ 3,938,893,198**
Less Duplicate Debt	**$(2,265,520,996)**
Net Liabilities	**$ 1,673,372,202**
Net-Equity	**$ (198,961,943)**

Prepared by John T. Church 8/1/02