

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE**

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In re:	:	Chapter 11
	:	
	:	Jointly Administered
FLEMING COMPANIES, INC.	:	
<u>et al.</u> ,	:	Case No. 03-10945 (MFW)
	:	
Debtors.	:	<b>Hearing Date: 4/21/03 at 12:30 p.m.</b>
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**RESPONSE OF OFFICIAL COMMITTEE OF UNSECURED  
CREDITORS OF FLEMING COMPANIES, INC., ET AL. TO LIMITED  
OBJECTION OF SARA LEE BAKERY GROUP, INC. TO DEBTORS'  
EMERGENCY MOTION PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364,  
FED. R. BANKR. P. 4001(b) AND 9014, AND DEL. BANKR. LR 4001-2, (A) FOR  
INTERIM AND FINAL ORDER AUTHORIZING THE USE OF CASH  
COLLATERAL AND GRANT OF ADEQUATE PROTECTION *NUNC PRO  
TUNC* TO THE PETITION DATE, AND (B) APPROVING POST-PETITION  
FINANCING AND RELATED RELIEF  
(Re: Docket No. 264)**

The Official Committee of Unsecured Creditors (the "Creditors' Committee") of Fleming Companies, Inc. and its affiliated debtors and debtors in possession in the above-captioned cases (collectively, "Fleming" or the "Debtors"), submits this response (the "Response") to the Limited Objection Of Sara Lee Bakery Group, Inc. ("Sara Lee") To Debtors' Emergency Motion (the "Emergency Motion") Pursuant To 11 U.S.C. §§ 361, 362, 363 And 364, Fed. R. Bankr. P. 4001(b) And 9014, And Del. Bankr. LR 4001-2, (A) For Interim And Final Order Authorizing The Use Of Cash Collateral And Grant Adequate Protection Nunc Pro Tunc To The Petition Date, And (B) Approving Post-Petition Financing And Related Relief (the "Limited Objection"). In support hereof, the Creditors' Committee respectfully states as follows:

## I. PRELIMINARY STATEMENT

1. Sara Lee improperly objects to the Emergency Motion on the basis that a portion of the Debtors' cash should be set aside for Sara Lee under a theory of constructive trust. Sara Lee, however, does not meet — and has not even alleged -- any of the requirements necessary for the imposition of a constructive trust for funds held by the Debtors. First, Sara Lee does not allege that the Debtors committed any fraud or breached any fiduciary duty owed to Sara Lee. Second, Sara Lee does not demonstrate that the Debtors have been unjustly enriched by using funds allegedly belonging to Sara Lee. Third, Sara Lee fails to show that the funds for which it seeks a constructive trust are even traceable.

2. Having failed even to allege facts sufficient to satisfy the elements necessary to establish a constructive trust, Sara Lee cites no caselaw in its Limited Objection, and thus provides no legal or factual analysis demonstrating how it meets the burdens necessary to impose a constructive trust.<sup>1</sup>

3. In addition, many courts, including in this District, have held that constructive trusts are anathema to the Bankruptcy Code's policy of ratable distribution among creditors. Therefore, Sara Lee should not be entitled to receive its requested relief even if Sara Lee had alleged and satisfied the requirements for the imposition of a

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<sup>1</sup> The burden of demonstrating that funds are held in constructive trust falls squarely on the creditor claiming to be the beneficiary of the trust. See 11 U.S.C. § 363(o)(2) ("the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest"); In re Haber Oil Co., Inc., 12 F.3d 426, 436 (5th Cir. 1994) ("The burden of establishing the existence of the constructive trust rests on the claimant, as does the burden of identifying or tracing the trust property"). Indeed, were it otherwise, then any creditor could restrict the Debtors' use of cash simply by making unsubstantiated assertions, as Sara Lee does here.

constructive trust. Finally, Sara Lee's Limited Objection should also fail on the basis of its procedural deficiencies.

## **II. INTRODUCTION**

4. On April 1, 2003 (the "Petition Date"), the Debtors filed voluntary petitions for reorganization under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101-1330 (as amended, the "Bankruptcy Code").

5. On April 4, 2003, the Debtors filed the Emergency Motion seeking an order authorizing the use of certain cash collateral and approving post-petition financing. Sara Lee filed the Limited Objection to the Emergency Motion on April 14, 2003.

6. On April 10, 2003, the United States Trustee duly appointed the Creditors' Committee in these cases.

7. Before the Petition Date, Sara Lee and the Debtors entered into a billing arrangement pursuant to which the Debtors collected amounts due Sara Lee on sales of goods from Sara Lee to certain customers for a fee of two percent of the collected amounts (the "Billing Program"). Limited Objection at ¶ 2. Sara Lee alleges that the Debtors owe Sara Lee approximately \$2.6 million pursuant to the Billing Program. Id. at ¶ 3. The Debtors commingled the funds it collected pursuant to the Billing Program with its regular operating funds. Id. at ¶ 5.

### III. **SARA LEE DOES NOT SATISFY ELEMENTS FOR CONSTRUCTIVE TRUST<sup>2</sup>**

8. Courts typically turn to state law to determine whether a party has met its burden to impose a constructive trust. In re Southmark, 49 F.3d 1111, 1118 (5th Cir. 1995); City of Farrell v. Sharon Steel Corp., 41 F.3d 92, 95 (3d Cir. 1994). In order to impose a constructive trust under Texas<sup>3</sup> law, three requirements must be satisfied: (i)(A) actual fraud or (B) a breach of either a fiduciary relationship or a relationship of special trust or confidence, (ii) the unjust enrichment of the wrongdoer, and (iii) tracing the property to a *res*. Haber Oil, 12 F.3d at 436.

#### A. **Actual Fraud or Breach of Duty**

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<sup>2</sup> Although this Court's decision in In re Mariner Post-Acute Network, Inc., 267 B.R. 46 (Bankr. D. Del. 2001), suggests that financing motions do not necessarily determine the validity or extent of an asserted interest in property (there too, constructive trust ownership interest), the circumstances here are distinguishable. First, unlike in Mariner, Sara Lee has in fact made its asserted interest known at the time of the financing motion by filing its objection (thus, the question of fair notice is completely absent here). Second, unlike in Mariner, Sara Lee's constructive trust allegations can be summarily dismissed at the final financing hearing on the merits for the reasons stated above.

<sup>3</sup> There are three states that arguably would be used to determine whether Sara Lee satisfied the elements of a constructive trust. These states are Texas (Fleming's principal place of business), Missouri (Sara Lee's principal place of business), and Delaware (the forum for these cases). The elements necessary to impose a constructive trust in each of these three states are very similar. To impose a constructive trust under Missouri law, a claimant must demonstrate (1) proof of some wrongdoing or fraud, and (2) evidence indicating that some specific property now in the hands of the alleged wrongdoer can be traced to funds originally controlled by the claimant. In re The Landing, 160 B.R. 820, 823 (Bankr. E.D. Mo. 1993). Delaware law requires a showing of (1) unjust enrichment, (2) fraudulent or unfair and unconscionable conduct on the part of the defendant, and (3) the existence of a duty between the parties. Adams v. Jankouskas, 452 A.2d 148, 152 (Del. 1982). In addition, Delaware law requires that the funds for which a constructive trust is sought must be traceable. Id. at 152. The Creditors' Committee has analyzed the elements for imposing a constructive trust under Texas, Missouri, and Delaware state law and concluded that Sara Lee does not meet the standards for a constructive trust in any of the states. For purposes of this Response, the Creditors' Committee analyzes the law of constructive trust under Texas law.

### Actual Fraud

9. Under Texas law, a party must establish six elements to demonstrate actual fraud: (i) a material representation; (ii) a false representation; (iii) knowledge of the false representation at the time it was made; (iv) the speaker made the representation with the intent that it be relied upon by the party; (v) the party acted in reliance on the misrepresentation; and (vi) the party thereby suffered injury. Haber Oil, 12 F.3d at 437.

10. Sara Lee has not made any allegations that the Debtors have committed any actual fraud. Moreover, Sara Lee has not provided a single fact to demonstrate that it has satisfied the actual fraud element of constructive trust.

### Fiduciary Duty

11. Texas courts recognize two types of fiduciary relationships, formal and informal. Swinehart v. Stubbeman, McRae, Sealy, Laughlin & Browder, Inc., 48 S.W.3d 865, 878 (Tex. Ct. App. 2001). Formal fiduciary relationships are those that arise as a matter of law, such as relationships between principal and agent. Informal fiduciary relationships may arise from "a moral, social, domestic or purely personal relationship of trust and confidence." Id.; see also In re Monnig's Dep't Stores, Inc., 929 F.2d 197, 201 (5th Cir. 1991) ("In recognizing a constructive trust, the critical requirement for purposes of this case is that the parties have a confidential or fiduciary relationship *prior to and apart from the transaction in question*") quoting Harris v. Sentry Title Co., Inc., 715 F.2d 941, 946 (5th Cir. 1983) (emphasis in original). However, when parties deal at arm's-length, no confidential relationship exists. Biesel v. Furrh, 1995 WL 447532, 2 (Tex. App.-Dallas).

12. Sara Lee has not alleged any breach of a fiduciary relationship by the Debtors. Moreover, the Debtors are not a fiduciary of Sara Lee based on the fact that the Debtors collected certain accounts receivable on behalf of Sara Lee. Cf. Ames Dept Stores, Inc., 274 B.R. 600, 630 (Bankr. S.D.N.Y. 2002) (requirements to turn over particular net proceeds from sales to licensor simply creates debtor-creditor relationship). Sara Lee has failed to establish that its relationship with the Debtors was anything other than an arm's-length contractual arrangement to make certain payments based on the Debtors' collections. See id. Indeed, Sara Lee itself characterizes its relationship with the Debtors as "a billing arrangement." Limited Objection at ¶ 2. Accordingly, the present relationship between Sara Lee and the Debtors is simply that of debtor-creditor.

**B. Unjust Enrichment**

13. Under Texas law, the second element required to impose a constructive trust is a showing that the party holding the property would profit by a wrong or would be unjustly enriched if allowed to keep the property. Monnig's, 929 F.2d at 201. However, Texas courts do not reach the second element – unjust enrichment – if the first requirement of actual fraud or breach of a fiduciary duty has not been shown. Southmark, 49 F.3d at 1111. A constructive trust will only be imposed when there is "wrongdoing greater than the nonpayment of a monetary debt." Monnig's, 929 F.2d at 203.

14. Since there is little Texas caselaw addressing what constitutes unjust enrichment when seeking to impose a constructive trust, it is useful to examine cases in other jurisdictions. In Ames, the court applied New York's principles of unjust enrichment in an analogous situation. Ames, 274 B.R. at 625-31.

15. In that case, pursuant to a license agreement between the debtor, an operator of department stores, and the claimant, a shoe retailer that sold shoes in the debtor's stores under a "store-within-a-store" format, the debtor was required to pay the claimant the net proceeds from the claimant's shoe sales each week, after deducting the debtor's share of the proceeds. During the week before bankruptcy, however, the debtor failed to make any payments to the claimant: the claimant sought the imposition of a constructive trust for the net shoe sale proceeds the debtor owed the claimant pursuant to the license agreement. The court held that no fiduciary duty existed and that no conversion occurred. Id. at 607-13. The court further stated:

The existence of unjust enrichment is essentially a legal inference drawn from the circumstances surrounding the transfer of property and the relationship of the parties. The relationship between [the debtor] and [the claimant] is arms-length and contractual in nature. Both [the claimant] and [the debtor] are sophisticated corporate entities with millions of dollars in revenues. . . . [T]he commercial relationship between [the debtor] and [the claimant] is indistinguishable from . . . that of debtor-creditor. Under the circumstances of this case and considering the sophistication of both [the debtor] and [the claimant], the Court finds that it would be equitable for [the debtor] to retain the benefits of the [net shoe sale proceeds].

Id. at 630-31.<sup>4</sup>

16. Sara Lee and the Debtors are both sophisticated corporate entities. Furthermore, there is no evidence to suggest that the Billing Program was not negotiated at arm's length. Sara Lee only expressed its dissatisfaction with Billing Program one week before the Debtors filed for bankruptcy, when Sara Lee terminated the Billing

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<sup>4</sup> More recently, the examiner appointed by the bankruptcy court in Enron's cases thoroughly reviewed the very limited circumstances in which constructive trusts have been found. In re Enron Corp., et al., Case No. 01-16034, Docket No. 10105 (Gonzalez, J.) (Bankr. S.D.N.Y. April 7, 2003).

Program. It is disingenuous for Sara Lee to now complain that the Billing Program amounted to a fraud resulting in the unjust enrichment of the Debtors after only complaining about the Billing Program on the eve of the Debtors' bankruptcy.

**C. Tracing the Res**

17. The third element required to impose a constructive trust under Texas law is that the funds sought must be traceable. Monnig's, 929 F.2d at 201. If funds that a claimant seeks to impose a constructive trust over cannot be traced, then the claimant only has a general unsecured claim against the debtor's estate. In re Schick, 234 B.R. 337, 342 (Bankr. S.D.N.Y. 1999).

18. Sara Lee has not demonstrated that the funds for which it seeks to impose a constructive trust are traceable. In fact, Sara Lee alleges exactly the opposite to have occurred by asserting that the funds that the Debtors collected in the Billing Program were commingled with the Debtors' operating funds. Limited Objection at ¶ 5.

**IV. CONSTRUCTIVE TRUST INCONSISTENT WITH BANKRUPTCY POLICY**

19. Several courts have held that the imposition of a constructive trust in bankruptcy violates the Bankruptcy Code's system of ratable distribution. In re Omegas Group, Inc., 16 F.3d 1443, 1453 (6th Cir. 1994) ("[t]o permit a creditor, no matter how badly he was 'had' by the debtor, to lop off a piece of the estate under a constructive trust theory is to permit that creditor to circumvent completely the Code's equitable system of distribution"); In re Braniff Int'l Airlines, Inc., 164 B.R. 820, 827 (Bankr. E.D.N.Y. 1994) (stating that imposition of a constructive trust runs counter to bankruptcy principle of equal distribution among the creditors); In re Behring Int'l, Inc.,

61 B.R. 896, 902 (Bankr. N.D. Tex. 1986) ("Imposition of a constructive trust clearly thwarts the policy of ratable distribution and should not be impressed cavalierly").

20. While acknowledging that a debtor's property rights are determined according to state law, the court in Omegas held that state law must be applied in a manner consistent with federal bankruptcy law. Omegas, 16 F.3d at 1450 (citation omitted). In addition, the Sixth Circuit noted that "the equities of bankruptcy are not the equities of the common law." Id. at 1452. Holding that a constructive trust is anathema to the equities of bankruptcy, the Omegas Court emphasized that a constructive trust in bankruptcy burdens competing creditors and not the offending debtor. Id. at n.10.

21. This District expressly adopted the reasoning of Omegas in In re Paul J. Paradise & Associates, Inc. 217 B.R. 452, 456 (Bankr. D. Del. 1997) ("Paul J. Paradise") (granting summary judgment and declining to impose equitable trust). In fact, the court in Paul J. Paradise quoted Omegas at length for the proposition that constructive trusts "are anathema to the equities of bankruptcy. . ." Id. quoting Omegas, 16 F.3d at 1451.

22. Based on the foregoing, this Court should find the constructive trust that Sara Lee seeks to impose inconsistent with the policies of the Bankruptcy Code.

**V. ESTABLISHMENT OF CONSTRUCTIVE TRUST MUST AWAIT DETERMINATION IN SARA LEE ADVERSARY PROCEEDING**

23. An adversary proceeding is "a proceeding to recover money or property. . ." Fed. R. Bankr. P. 7001(1). An adversary proceeding is commenced by filing a complaint. Fed. R. Bankr. P. 7003. Sara Lee's request for a constructive trust in its Limited Objection is procedurally deficient. Sara Lee was required to commence an adversary proceeding to impose a constructive trust over certain of the Debtors' assets.

24. Acknowledging this procedural infirmity, Sara Lee recently commenced an action, see Complaint For Declaratory Relief, Injunctive Relief And Accounting, dated April 17, 2003 (the “Adversary Proceeding”), seeking the imposition of a constructive trust and other injunctive relief.<sup>5</sup> Sara Lee, however, has not filed any motion for a temporary restraining order or preliminary injunction, and the mere filing of the Adversary Proceeding (without more) is insufficient to obtain the injunctive relief sought. See, e.g., In re Sabratek Corp., 257 B.R. 732, 735 (Bankr. D. Del. 2000) (reviewing requirements for preliminary injunctive relief, including: likelihood plaintiff will succeed on the merits at final hearing; extent to which plaintiff is being harmed by the conduct complained of; the extent to which defendant will suffer irreparable harm if preliminary injunction is granted; and the public interest.) (citing Duraco Products, Inc. v. Joy Plastic Enterprises, Ltd., 40 F.3d 1431, 1438 (3d Cir. 1994)).

25. Alternatively, if the Court determines that Sara Lee's allegations have raised sufficient facts to merit some interim relief pending a full evidentiary hearing, the question is how to adequately protect Sara Lee's purported interest (i.e., constructive ownership) until a determination can be made. The Creditors' Committee respectfully submits that Sara Lee can be more than adequately protected by providing for a contingent administrative expense claim in the event Sara Lee successfully establishes the elements of constructive trust in the Adversary Proceeding.

26. Here, the property is nothing more than cash -- which is fungible -- and an administrative expense claim would be equivalent to the actual property claimed.

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<sup>5</sup> The Creditors' Committee intends to file motions to intervene and dismiss the Adversary Proceeding pursuant to Rule 7024 of the Federal Rules of Bankruptcy Procedure and sections 105(a) and 1109(b) of the Bankruptcy Code.

To permit Sara Lee any greater relief would be tantamount to granting Sara Lee an injunction merely for claiming an asserted interest in the Debtors' property. Sara Lee has not even raised facts or law sufficient to withstand even a summary dismissal; thus, it cannot be said that Sara Lee has met its burden for demonstrating entitlement to injunctive relief.

**VI. CONCLUSION**

WHEREFORE, the Creditors' Committee respectfully requests that the Court enter an order overruling the Limited Objection.

Dated: April 18, 2003  
Wilmington, Delaware

Respectfully submitted,

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