IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

IN RE:	)	
	)	
FLEMING COMPANIES, INC., et al.,	)	**JOINTLY ADMINISTERED**
	)	**CASE NO. 03-10945 (MFW)**
	)	
DEBTORS.	)	**Hearing Date: May 19, 2003 at 12:30 p.m.** **Objection Deadline: May 14, 2003** **(extended by agreement)**

LIMITED OBJECTION OF XL SPECIALTY INSURANCE COMPANY AND ONEBEACON INSURANCE COMPANY TO DEBTORS' MOTION FOR ENTRY OF AN ORDER AUTHORIZING THE DEBTORS TO CONDUCT STORE CLOSING SALES PURSUANT TO SECTION 363 OF THE BANKRUPTCY CODE AND ABANDONING INCONSEQUENTIAL ASSETS RELATED TO THE CLOSING LOCATIONS

XL Specialty Insurance Company ("XL") and OneBeacon Insurance Company ("OneBeacon") (collectively, "Sureties") hereby object to the Debtors' Motion for Entry of an Order Authorizing the Debtors to Conduct Store Closing Sales Pursuant to Section 363 of the Bankruptcy Code and Abandon Inconsequential Assets Related to the Closing Locations filed on April 25, 2003 (the "Debtors' Motion"). In support thereof, the Sureties assert and allege as follows:

INTRODUCTION

1. On April 1, 2003, (the "Petition Date"), Fleming Companies, Inc. and certain of its subsidiaries and affiliates (collectively, "Debtors"), filed petitions for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§101-1330 (as amended, the "Code") commencing these proceedings.

2. No trustee has yet been appointed and the Debtors continue to operate their businesses as debtors-in-possession pursuant to §§ 1107(a) and 1108 of the Code.

3. Prior to the Petition Date, OneBeacon, formerly known as CGU Insurance Company, issued numerous surety bonds in favor of various state taxing authorities (the "Bonds") at the request of Fleming. The Bonds provide indemnity to the taxing authorities in the event that Fleming defaulted in its obligation to pay for tax stamps related to Fleming's sale of tobacco products. In conjunction with the issuance of the Bonds, Fleming executed the Continuous Contract of Indemnity dated April 4, 2003 (the "Indemnity Agreement"), in which Fleming agreed to indemnify XL, Greenwich Insurance Company and their affiliated, associated and subsidiary companies, and the successors and assigns of the same for any payments made pursuant to Bonds.

4. At present, Sureties have maximum penal exposure under the outstanding bonds in excess of $6 million.

5. The Debtors' Motion seeks court approval of certain store closing sales, including a store closing sale for the Food 4 Less store in Tucson, Arizona. The Sureties have issued a cigarette tax bond in favor of the State of Arizona on behalf of the Debtors with a penal amount of $726,000.

ARGUMENT

6. The Sureties object to the Debtors' Motion to the extent that it fails to provide for the segregation of proceeds from the sale of cigarettes and other tobacco products at the Food 4 Less store in Tucson, Arizona. In light of the Debtors' stated intent to default on their tax bonds, the Debtors remaining inventory of cigarettes and tobacco products are to be held in trust in favor of the taxing authorities and the Sureties, to the extent the Sureties are required to make payment under the Bonds. Additionally, by failing to pay the tax funds which were held in trust by the Debtors, the Debtors have forfeited their interest in any remaining cigarette or tobacco

revenue. *See cf. In re Modular Structures*, 27 F.3d 72, 77-78 (3d Cir. 1994). Consequently, the Debtor is obligated to hold all future proceeds of cigarette and tobacco sales in trust for the benefit of the taxing authority and, in accordance with the principles of equitable subrogation, the Sureties. *See* 11 U.S.C. § 541(d); *cf. In re Gittens & Sprinkle Enterprises, Inc.*, 960 F.2d 366, 373 (3d Cir. 1992).

WHEREFORE, XL and OneBeacon respectfully request that the Court deny the Debtors' Motion, or alternatively, grant the motion only on the condition that all cigarette and tobacco related revenue from the Tucson, Arizona Food 4 Less store is segregated and held in trust for the benefit of the State of Arizona and the Sureties, and grant such other relief as is appropriate.

Respectfully submitted,

/s/Richard W. Riley

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