

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:) Chapter 11
)
FLEMING COMPANIES, INC., et al.¹,) Case No. 03-10945 (MFW)
) (Jointly Administered)
)
Debtors.)

**AFFIDAVIT OF DAVID SMITH IN SUPPORT
OF OBJECTION OF FLEMING COMPANIES TO MOTION
FOR RELIEF FROM AUTOMATIC STAY, OR IN THE ALTERNATIVE,
TO COMPEL REJECTION OF CERTAIN EXECUTORY CONTRACTS**

STATE OF TEXAS)
)
COUNTY OF DENTON) ss.

I, David Smith, declare as follows:

1. I am the Sales Support Manager with Fleming's Nashville, Tennessee division. I have been employed by Fleming for 16 years. The Nashville division includes approximately 380 customers and has more than 400 employees. I have responsibility for all sales, gross margins and selling expenses of the division. I also oversee all customer relationships. In addition, for the past year I have had operational

¹ The Debtors are the following entities: Core-Mark International, Inc.; Fleming Companies, Inc.; ABCO Food Group, Inc.; ABCO Markets, Inc.; ABCO Realty Corp.; ASI Office Automation, Inc.; C/M Products, Inc.; Core-Mark Interrelated Companies, Inc.; Core-Mark Mid-Continent, Inc.; Dunigan Fuels, Inc.; Favar Concepts, Ltd.; Fleming Foods Management Co., L.L.C.; Fleming Foods of Texas, L.P.; Fleming International, Ltd.; Fleming Supermarkets of Florida, Inc.; Fleming Transportation Service, Inc.; Food 4 Less Beverage Company, Inc.; Fuelserv, Inc.; General Acceptance Corporation; Head Distributing Company; Marquise Ventures Company, Inc.; Minter-Weisman Co.; Piggly Wiggly Company; Progressive Realty, Inc.; Rainbow Food Group, Inc.; Retail Investments, Inc.; Retail Supermarkets, Inc.; RFS Marketing Services, Inc.; and Richmar Foods, Inc.

responsibility for the entire division whenever there is an absence of the division president, Milton Milam.

2. I make the following affidavit of my own personal knowledge, or on information and belief where indicated. I can and would testify competently to these facts in a court of law.

3. The Movants are companies operated by Mr. Ken Kelley. I was personally involved in negotiating with Mr. Kelley over the terms of the FSAs with each Movant. In addition, I have overseen Fleming's sale of goods to all its Nashville division customers, including the Movants' stores.

4. The only agreement submitted by Movants that has any requirement with respect to Fleming's service level (a measurement of the percentage of orders filled by Fleming) is a March 11, 1998 FSA with W.K. Corporation attached by Movants as Exhibit 1, Exhibit D (the "1998 FSA"). However, W.K. Corp.'s 1998 FSA was superceded in its entirety on March 15, 2002 by a different FSA, a true and correct copy of which is attached hereto as Exhibit 3.

5. The three 2002 FSAs are all in the same basic form. True and correct copies are attached hereto as Ex. 1 (Kelley Foods FSA), Ex. 2 (L&K FSA), Ex. 3 (W.K. Corp. FSA). A true and correct copy of the still-operative 1999 FSA with T & K Foods, LLC is attached hereto as Ex. 4. Neither the 2002 nor the 1999 FSAs require Fleming to maintain any particular service level.

6. Exhibit B to the FSAs is a “Nashville Division Sell Plan and Support Program” that sets forth additional detail regarding Fleming’s terms of sale. The version attached to the original FSAs is dated June 8, 1998; however, the plan is subject to amendment from time to time. *See, e.g.*, Ex. 3 hereto at ¶ 2 (W.K. Corp. FSA). The Sell Plan attached to the FSAs submitted to the Court by Movants in their Exhibit 1 are no longer in effect. Those Sell Plans were amended and replaced effective August 4, 2002. Mr. Kelley executed the new Sell Plan on July 15, 2002. A true and correct copy of the executed Sell Plan (entitled Fleming FlexMate Marketing Plan) is attached as Exhibit 5 hereto. The master Sell Plan is customized for the Movants’ stores, which all operate under the same terms. This can be seen in Attachment A to the Sell Plan, which refers to the PW [Piggly Wiggly] and H.G. Hill store numbers at the top of the page. *Id.* (The reference to PW store #41 is a typographic error and should be #21.).

7. The FSAs require that any amendments to the Sell Plan “shall be applicable to all similarly situated customers of Fleming purchasing inventory pursuant to such Selling Plan.” Ex. 3, ¶ 2 (W.K. Corp. FSA). The two primary criteria that establish whether customers are similarly situated are volume and location. Based on my personal knowledge of Fleming’s sales of goods to customers under FSAs, Fleming has applied its Sell Plan consistently to customers who are similarly situated.

8. I am aware that Movants contend Fleming has breached the FSAs by failing to maintain “Retail Pricing Zone 7.” This claim refers to Fleming’s optional Retail Pricing Maintenance service. As part of the Retail Pricing service, Fleming

establishes retail prices for products based on the retail prices offered by targeted competing retailers in the market and the performance criteria set for each of the specific retail zones (such as their requested gross margin on sales) and then Fleming provides these suggested selling prices to the customers subscribing to the service.

9. Movants' contention that Fleming has breached the FSAs by failing to maintain Retail Pricing Zone 7 is untrue for multiple reasons. First, the Retail Pricing service is not covered by the FSA. Nothing in the FSAs mentions Retail Pricing Zones or requires Fleming to provide them. Fleming makes the Retail Pricing service available to its customers as an additional service that is separate from the FSAs. This service is independently negotiated and separately billed to the customer.

10. Second, Movants' claim that Fleming has not maintained Retail Pricing Zone 7 is incorrect. Fleming provides the Retail Pricing service to all of the six stores that are subject to the FSAs at issue. I have verified with Alan Brosche, our Retail Pricing Manager, and records contained in our computer system that Fleming has at all times maintained the proper Retail Pricing Zone consistent with the performance criteria set for each of the provided Retail Pricing Zones, including Zone 7.

11. Additionally, according to our records, Movants' stores have not purchased the Retail Pricing for Zone 7 service from Fleming for several months to one year, depending on the store. Movants have moved their stores to different pricing zones.

12. Movants also claim that Fleming has not passed on to them "significant" vendor discounts. Under the current Sell Plan (Ex. 5 hereto), Fleming

agrees to pass on to its Retailers three types of vendor discounts that are described on the first page of the Sell Plan (non-performance allowances, bill-back allowances, and vendor lump sums). *See* Ex. 5 at 1, ¶¶ 1-3. In addition, Fleming agrees to pass on other allowances “specifically designated herein [by the vendor] to be passed on to the retailer,” but “any other vendor funds received by Fleming will be retained by Fleming at its sole discretion.” *Id.* at ¶ 4. Consequently, Fleming is not required to pass on all vendor discounts to the Retailers. Fleming has properly accounted for all vendor discounts with respect to Movants’ stores. Fleming has a computer-based tracking system to ensure that Fleming properly passes on to the Retailers all of the required vendor discounts in the amount, quantity and time required. Using this system, I have personally verified that as of the date of this affidavit, Fleming has passed on all required vendor discounts to the Movants and to all other customers.

13. Movants’ claim that Fleming’s prices are uncompetitive is also wrong. While Fleming is certainly not contractually required to maintain pricing competitiveness, we strive to be very competitive with all of our direct competitors in the marketplace and periodically conduct internal comparisons to ensure our position. Movants’ claim that we have increased our pricing 8% above our competitors is untrue and their supporting illustrations (marked as Exhibit 4, Price Comparison Between Fleming and Competitor) are critically flawed in factual content and methodology. First, they compared some items that were entire pallet quantities from Fleming versus a single case from the “price competitor.” A prime example is found on page 3 of Exhibit 4

where they list Fleming's price for BY Charcoal as \$120.13 and the "Price Competitor" price as \$17.22. This single mistake accounts for \$102.91 of the total alleged difference between Fleming and the Price Competitor's prices (\$409.18), or 25.15% of the aggregate difference. Furthermore, because Movants fail to include pack and size information (which is the industry standard practice for comparing like items), many more errors may be present.

14. Secondly, Fleming is the exclusive distributor of Natures Finest™, BestYet® and Exceptional Value™ Brands, each with unique quality specifications set by Fleming. Because there are no exact comparables available from any competing supplier, all of these products should have been omitted from the comparison.

15. Thirdly, Movants include other items that are of random weight (each package will have a different weight) such as Whiting Filets (page 4 of Exhibit 4), which makes fair comparisons nearly impossible without controlling for weight. The chart also attempts to compare commodity-type products that have a wide array of quality, growing region, color, type, and size criterion that will have a substantial and material effect on the ultimate price (for instance Medium White Onions, 12 ct Cantaloupes, Chilean White Grapes, FE shredded lettuce, 5# Red Potatoes, etc., on page 4 of Exhibit 4). Again, one cannot fairly compare these items without controlling for these variables. The industry standard is to compare only items that are of the same or comparable standards in all of these measurables and that all pack size and quantity measures also must match.

16. Based on these issues, Movants' price comparison Exhibit 4 is substantially inaccurate and misleading.

17. As a result of my experience in the Nashville division, I am aware that the Movants are part of a Retailer-run marketing group in Nashville. The group meets with vendors with the intention to collectively negotiate better deals than individual Retailers could obtain on their own. There are approximately 70 grocery stores in this group, all of which are Fleming customers.

18. Since filing the bankruptcy petition, Fleming's Nashville Division has offered to assist or make arrangements for alternate supply to all of our customers in an effort to minimize any disruption to our customers' businesses. One arrangement is known as cross-docking. Fleming has negotiated directly with two of its competitors (companies who, like Fleming, act as primary suppliers to grocery stores) to obtain supplemental goods Fleming otherwise would have difficulty supplying to its customers. These companies are Nash-Finch of Cincinnati, Ohio and Merchants Distributors, Inc. of Hickory, North Carolina. As part of cross-docking, Fleming picks up goods from these wholesalers, ships them at its expense to Fleming's warehouse, receives these goods into our facility and then transfers the goods to trucks bound for Fleming's customers. The customers pay the wholesalers directly; Fleming makes no profit on these goods, does not take title to them and bears the entire cost of shipping. This has proven to be a helpful temporary solution, even if it is less than perfect, and a number of

customers have indicated that they appreciate this effort because it has helped them maintain adequate stocks on their shelves.

19. In addition to the cross-docking arranged by Fleming on behalf of its customers, there are numerous secondary suppliers that Fleming's Nashville-area customers have dealt with directly to obtain supplemental goods. These companies include the following: Merchants Distributors, Inc. (Hickory, North Carolina), Mitchell Grocery Company (Albertville, Alabama), Laurel Grocery Corporation (East Bernstadt, Kentucky), Winkler Grocery (Evansville, Indiana), Grocers Supply (Indianapolis, Indiana), H.T. Hackney Company (Knoxville, Tennessee, Huntsville, Alabama, and Jellico, Tennessee), Nashville Egg Company (Nashville, Tennessee), B&W Tobacco Company (Murfreesboro, Tennessee), Charles C. Parks Grocery (Gallatin, Tennessee), Sherwood Meats (Cincinnati, Ohio), Supervalu (Anniston, Alabama), and many more.

20. When a grocery store changes primary suppliers it is known as "retagging" because the product reorder tags on the store shelves change to reflect the individual system used by the new primary supplier. Fleming is aware that five of the six stores at issue have recently been retagged (Nolensville, Tennessee; Riverside Drive, Nashville, Tennessee; Gallatin Road (Maplewood), Nashville, Tennessee; Clarksville, Tennessee; Shelby Avenue, Nashville, Tennessee). On information and belief, Fleming representatives have observed the changed tags on visits to these stores and they have seen delivery trucks from the new primary supplier, Piggly Wiggly Alabama Distributing, Inc., at the loading docks. This was reported to me by a member of my

sales support team, Michael McGuire, a Retail Counselor with Fleming, who observed the new tags and/or delivery trucks on May 29, 2003.

21. Based on changes in Fleming's credit situation and based on the volume of inbound products ordered in the last two weeks, I am confident that Fleming's service level will soon improve. On or about the time Fleming filed its petition, nearly all of Fleming's vendors suspended their customary credit terms. Purchases could only be made on a "cash wired in advance" basis, which greatly hindered Fleming's ability to maintain its customary level of goods in its warehouses and affected its service levels to customers. This situation changed dramatically a little over two weeks ago when the Court approved the Junior Trade Lien Program and the Critical Vendor Program. These programs have allowed Fleming to reestablish credit at a majority of its vendors, including a large percentage of its top vendors by volume. As of the date of this declaration, Fleming has reestablished credit with a substantial majority of its vendors nationwide (approximately 850).

22. With the new credit flexibility, we have been able to significantly increase our orders for the Nashville division. In fact, the weekly volume of actual products ordered and received has increased significantly. It has more than quadrupled to \$9 million since earlier in May. This recent rapid improvement can be seen in the following Grocery, Dairy and Frozen weekly orders processed for Nashville: in the week ending May 10 we ordered and/or paid for \$1.7 million; week ending May 17, \$2.2 million; week ending May 24, \$3.3 million and between May 25 and May 29 we have

ordered and/or paid for \$9.0 million in products for Nashville. Based on the increased volume of orders in the last two weeks and the number of trucks that are inbound to our Nashville warehouse from our vendors, I believe that our service level has bottomed out and will significantly improve in the coming weeks.

23. Based on my personal involvement in negotiating agreements with the Movants, I am aware that at the time they entered into them, the parties intended the agreements to stand or fall together; without the FSAs in place, Fleming would have had no motivation to enter into the related agreements. The related agreements -- promissory notes, subleases, sign leases and licenses -- substantially benefit Movants at Fleming's expense and risk. Fleming expected to earn a benefit by the fact that Movants agreed to purchase a majority of their goods from Fleming for an extended period of time (up to 10 years) pursuant to the FSAs. I address each of these agreements in turn below.

24. Mr. Ken Kelley is President of each of Movant companies. I negotiated with Mr. Kelley starting in 1998, when his companies first began to purchase their goods from Fleming. At that time, Mr. Kelley owned two stores. Today his holdings have grown to six stores. Fleming agreed on five separate occasions to loan money to Mr. Kelley's companies to enable him to purchase additional stores and remodel and/or expand his existing stores. In all but one instance, Fleming agreed to forebear from seeking repayment on the loans, provided that Mr. Kelley's companies continued to purchase goods from Fleming under the FSAs. Today, there are three outstanding promissory notes totaling an aggregate amount of \$638,267.63; Fleming has

agreed to forgive the repayment of each of these notes, provided the stores remain in good standing under their respective FSAs. True and correct copies of the promissory notes and loan forgiveness agreements are attached hereto as Ex. 6 (W.K. Corp. Note & Forgiveness letter), Ex. 7 (L&K Note & Forgiveness letter), Ex. 8 (Kelley Foods Note & Forgiveness letter). We would not have loaned substantial sums to Mr. Kelley's companies unless we were assured that we would be rewarded for the risks we had taken through the stream of revenue from the purchases under the FSAs.

25. Fleming also leased very successful store locations from a third party and then sublet and continued to renew subleases on those properties to W.K. Corporation, again contingent on Mr. Kelley using the locations as grocery stores and purchasing the majority of goods from Fleming. A true and correct copy of a sublease is attached hereto as Ex. 9 (W.K. Corp. lease). If W.K. Corporation is permitted to terminate its FSA but retain the sublease, Fleming could find itself as a sublandlord over a grocery store supplied by Fleming's competitor. This would be exactly the opposite of the parties' intentions when they entered into the sublease agreement.

26. In 1999, Fleming agreed to license a valuable tradename and trademark to one of Mr. Kelley's companies, T&K Foods, and to lease the sign at the store subject to an H.G. Hill Sign Lease Agreement. True and correct copies of these agreements are attached hereto as Exhibits 10 (T&K License) and 11 (T&K Signage lease). On March 15, 2002, in connection with the agreements described above, Fleming agreed to license another of Mr. Kelley's companies, Kelley Foods, to use the valuable

tradename and trademark and to lease the signage for use on another location. True and correct copies of these agreements are attached hereto as Exhibits 12 (Kelley License) and 13 (Kelley Sign lease). Fleming paid approximately \$5,000,000 in 1999 for the licensed tradename and trademark and associated goodwill, but charged T&K Foods, and Kelley Foods, L.L.C. nothing for their use.

27. A true and correct copy of the Supplier Agreement between Fleming and T&K Food's landlord, H.G. Hill Realty Company, dated April 19, 1999, is attached hereto as Ex. 14 (T&K Lease).

