UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
FLEMING COMPANIES, INC., *et al.*,	:	
Debtors.	:	Case Number 03-10945 (MFW)
	:	Jointly Administered

Hearing Date: September 18, 2003 @ 2:00 P.M.
Objection Deadline: September 11, 2003 @ 4:00 P.M.

OBJECTION OF THE ACTING UNITED STATES TRUSTEE TO THE APPLICATION OF MORGAN STANLEY & CO. FOR ALLOWANCE AND PAYMENT OF AN ADMINISTRATIVE EXPENSE CLAIM (DOCKET ENTRY # 3286)

In support of her objection to the application of Morgan Stanley & Co. for allowance and payment of an administrative expense claim, Roberta A. DeAngelis, Acting United States Trustee for Region 3 ("UST"), by and through her counsel, avers:

INTRODUCTION

1. This Court has jurisdiction to hear and determine this objection.

2. Under 28 U.S.C. § 586, the UST has an overarching responsibility to enforce the laws as written by Congress and interpreted by the courts. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., 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").

3. Under 11 U.S.C. § 307, the UST has standing to be heard on the issues raised in this objection.

GROUNDS/BASIS FOR RELIEF

Background

4. On or about June 24, 2002, Fleming Companies, Inc. ("Fleming") caused to be filed a "Current Report" (Form 8-K) with the Securities and Exchange Commission ("SEC"). In the report, Fleming disclosed that it completed the acquisition of Core-Mark International, Inc. ("Core-Mark"). In connection with the Core-Mark acquisition, Fleming completed the sale of $200 million principal amount of its 9.25% senior notes due 2010 and 9.2 million shares of its common stock. A copy of the report is attached as Exhibit A.

5. Copies of Exhibits 1.1 and 1.2 to the June 24, 2002 Current Report indicate that Morgan Stanley & Co. ("Morgan Stanley") was a signatory to both of the underwriting agreements in its capacity as a representative of the underwriters listed on Schedule 1 to the respective agreements. Schedule 1 to the respective Exhibits was not available on the SEC's EDGAR database. A copy of Exhibits 1.1 and 1.2 are attached as Exhibits B and C, respectively, to this objection.

6. Morgan Stanley served as an underwriter for securities of Fleming in 2002. The UST has not fully investigated whether Morgan Stanley served as an investment banker for other outstanding securities of the Debtor and reserves the right to address this subject at or prior to the hearing. By copying this objection to counsel for Morgan Stanley and counsel for the Debtors, the UST requests that Morgan Stanley and the Debtors produce (a) any and all copies of the draft retention application referenced in Paragraph 9 of the application and any accompanying affidavits and (b) any correspondence between Morgan Stanley and the Debtors (including their respective representatives) related to the draft retention application.

Analysis

7. The petitions initiating the above-captioned cases were filed on April 1, 2003.

8. Under 11 U.S.C. § 1101(1), "debtor in possession" means "debtor except when a person that has qualified under [11 U.S.C. § 322] is serving as trustee in the case."

9. Under 11 U.S.C. § 1107(a), a debtor in possession generally has the rights and duties of a trustee serving in a chapter 11 case.

10. 11 U.S.C. § 327(a) allows a trustee to retain persons that are "disinterested persons" and that "hold or represent an interest adverse to the estate"

11. 11 U.S.C. §§ 101(14)(B) and 101(14)(C) provide that a "disinterested person" is (a) a person that "is not and was not an investment banker for any outstanding security of the debtor" and (b) a person that "has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor."

12. Under 11 U.S.C. § 101(49), the term "security" includes "note," "stock," "treasury stock," "bond" and "debenture."

13. In these cases, Morgan Stanley underwrote the sale of Fleming's senior notes and common stock in 2002. The Debtors are not permitted to retain Morgan Stanley under 11 U.S.C. §§ 327(a) and 101(14). The senior notes and common stock were outstanding as of the Petition Date.

14. Additionally, it appears that the September 25, 2001 amendment to the original engagement letter terminated Fleming's obligation to pay Morgan Stanley fees upon the consummation of a Transaction. The September 25th amendment provided for a fixed sum on a date

certain – $1 million on March 31, 2003. Thus, as of the Petition Date, Morgan Stanley had a pre-petition, unsecured claim pursuant to the September 25 amendment to the engagement letter (see Exs. A, B to Mot.).

15. To the extent that this Court finds that the engagement letter, as amended, permits the Debtors to compensate and reimburse Morgan Stanley for post-petition services, the Debtors would have to retain Morgan Stanley under 11 U.S.C. § 327(a) prior to paying any fees. However, Morgan Stanley cannot be retained under 11 U.S.C. § 327(a). Thus, Morgan Stanley would not qualify for professional compensation under 11 U.S.C. §§ 330(a) and 503(b)(2).

16. Morgan Stanley's request to be compensated under 11 U.S.C. §§ 503(b)(3)(D) and 503(b)(1)(A) raises the issue of whether this Court is prohibited from allowing Morgan Stanley's request because Morgan Stanley does not qualify for compensation under 11 U.S.C. §§ 330(a) and 503(b)(2). The UST submits that, in view of the policies underlying the professional retention and compensation provisions of the Bankruptcy Code, Morgan Stanley's attempt to end-run the strictures of professional qualification is barred. The United States Courts of Appeals for the Third and Seventh Circuits have specifically rejected the argument that professionals ineligible for employment under 11 U.S.C. § 327 may obtain an administrative expense under 11 U.S.C. §§ 503(a) and 503(b)(1)(A) notwithstanding 11 U.S.C. §§ 330(a) and 503(b)(2). *See In re Milwaukee Engraving Co., Inc.*, 219 F.3d 635, 637 (7th Cir. 2000) (holding "[o]ne might as well erase § 503(b)(2) from the statute if attorneys may stake their claims under § 503(b)(1)(A) even when ineligible under §§ 327, 330, and 503(b)(2)"); *In re Singson*, 41 F.3d 316, 320 (7th Cir. 1994) (same); *In re F/S Airlease II, Inc. v. Simon*, 844 F.2d 99, 108-09 (3d Cir. 1988) ("[t]he authority to pay administrative expenses for professionals, and a real estate broker, like an attorney, is a professional, is found not in section

503(b)(1)(A) but in section 503(b)(2)"); *see also In re Albrecht,* 233 F.3d 1259, 1261 (10th Cir. 2000); *In re Office Prods. of America*, 136 B.R. 675, 687 (W.D. Tex. 1992).

17. If this Court finds that Morgan Stanley's ineligibility for employment under 11 U.S.C. § 327 does not bar its request for allowance of an administrative expense claim under 11 U.S.C. §§ 503(b)(3)(D) and 503(b)(1)(A), Morgan Stanley clearly cannot meet the criteria for allowance under those respective subsections. 11 U.S.C. § 503(b)(3)(D) permits this court to allow the "actual, necessary expenses, other than compensation and reimbursement specified in [11 U.S.C. § 503(b)(4)" of "a creditor, an indenture trustee, an equity security holder, or an [unofficial] committee representing creditors or equity security holders ... in making a substantial contribution in [a chapter 11] case."

18. The leading Third Circuit case on the issue, *Lebron v Mechem Financial, Inc.*, 27 F.3d 937 (3d Cir. 1994), makes it clear that 11 U.S.C. § 503(b)(3)(D) was not intended to be used to compensate an investment bank that provided professional services to the Debtors. In *Lebron*, the court observed that 11 U.S.C. § 503(b)(3)(D) reconciles two conflicting objectives of the reorganization process: on the one hand, ensuring meaningful creditor participation in the reorganization process and, on the other hand, keeping professional fees/administrative expenses at a minimum to provide the largest possible return to creditors. *See id.* at 944. The Third Circuit concluded its analysis of 11 U.S.C. § 503(b)(3)(D) by stating that activities which primarily further the self-interest of the applicant do not merit reimbursement:

> Most activities of an interested party that contribute to the estate will also, of course, benefit that party to some degree, and the existence of self-interest cannot in and of itself preclude reimbursement. Nevertheless, the purpose of section 503(b)(3)(D) is to encourage activities that will benefit the estate as a whole, and in line with the

> twin objectives of § 503(b)(3)(D), "substantial contribution" should be applied in a manner that excludes reimbursement in connection with activities of creditors and other interested parties which are designed primarily to serve their own interests and which, accordingly, would have been undertaken absent an expectation of reimbursement from the estate. *Id*. at 943-44 (citations omitted, emphasis added).

19. In *Lebron*, the Third Circuit also provided specific guidance to the bankruptcy court regarding the conduct of the "substantial contribution" inquiry. The bankruptcy court should *presume* that the applicant for "substantial contribution" reimbursement was acting in its own interest unless the court finds that the applicant's actions "were designed to benefit others who would be foreseeably be interested in the estate." *Id.* at 946. The Third Circuit specifically commanded that, if the applicant fails to overcome this presumption, *"*there can be no award of expenses even though there may have been an incidental benefit to the chapter 11 estate.**"** *Lebron*, 27 F.3d at 946 (emphasis added).

20. *Lebron* stands for the proposition that a "creditor" that qualifies for compensation under 11 U.S.C. § 503(b)(3)(D) may seek reimbursement for activities taken *in its capacity as a creditor* in connection with the bankruptcy case. Here, Morgan Stanley is attempting to bend the statute. Section 503(b)(3)(D) was not intended to allow Morgan Stanley, an investment banker (a) whose claim is based upon the provision of professional services for the Debtors and (b) that is not qualified to provide post-petition services to the Debtors under 11 U.S.C. § 327(a), to get paid 65 cents on the dollar on account of its pre-petition claim in a situation where unsecured creditors are faced with the prospect of a minimal recovery. Allowing Morgan Stanley's administrative expense claim will elevate Morgan Stanley's claim above other unsecured claims, but it will not "ensur[e]

meaningful creditor participation in the reorganization process."[1/]

21. 11 U.S.C. 503(b)(1)(A) permits this Court to allow the "actual, necessary costs of preserving the estate." As noted above, the UST maintains that this subsection cannot be used to circumvent the professional retention provisions of the Bankruptcy Code. In the event that this Court disagrees, the UST leaves Morgan Stanley to its burden on the merits to prove its claim. The UST submits that the engagement letter, as amended, suggests that the parties believed that Morgan Stanley's work was substantially complete as of the Petition Date. Further, the UST questions whether other professionals retained in these cases (specifically, Blackstone and/or Food Partners) are entitled to compensation and/or have been compensated for services rendered in connection with the Rainbow transaction.

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As an aside, the UST notes that the phrase "actual, necessary expenses ..." in 11 U.S.C. § 503(b)(3)(D) does not encompass the payment of compensation to an investment banker. Given that the plain language of 11 U.S.C. § 503(b)(4) does not permit compensation of an investment banker, the UST submits that it would be improper to read 11 U.S.C. § 503(b)(3)(D) to permit that which its related subsection precludes. *See In re Keene Corp.*, 208 B.R. 112, 116 (Bankr. S.D.N.Y. 1997).

CONCLUSION

WHEREFORE the UST requests that this Court issue an order denying the application.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

BY: /s/ Joseph J. McMahon, Jr.

Joseph J. McMahon, Jr., Esquire
Trial Attorney
United States Department of Justice
Office of the United States Trustee
J. Caleb Boggs Federal Building
844 King Street, Room 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (Fax)

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