IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

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| In re: | ) | Chapter 11 |
| | ) | |
| Fleming Companies, Inc., et al., [1] | ) | Case No. 03-10945 (MFW) |
| | ) | (Jointly Administered) |
| Debtors. | ) | |
| | ) | **Hearing Date: November 25, 2003, 9:30 a.m. (EST)** |
| | | **Related Docket Item: 4011** |

SUPPLEMENTAL REPLY OF THE PRE-PETITION AGENTS TO OBJECTIONS TO JOINT MOTION OF DEBTORS AND PRE-PETITION AGENTS FOR AUTHORIZATION TO PAY AMOUNTS TO THE PRE-PETITION AGENTS ON BEHALF OF THE PRE-PETITION LENDERS

Deutsche Bank Trust Company Americas ("Deutsche Bank"), in its capacity as Administrative Agent (in such capacity, the "Administrative Agent") and Collateral Agent ("Collateral Agent"), and JPMorgan Chase Bank ("JPMorgan Chase"), in its capacity as Syndication Agent (in such capacity, the "Syndication Agent" and, together with the Administrative Agent and Collateral Agent, the "Pre-Petition Agents"), on behalf of themselves and on behalf of those certain pre-petition secured lenders (the "Pre-Petition Lenders"), by and through their undersigned counsel, hereby submit this supplemental reply (the "Reply") to certain of the objections filed against the joint motion of the above-captioned debtors and

[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.; 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.

debtors-in-possession (collectively, the "Debtors")[2] and the Pre-Petition Agents requesting authorization, pursuant to Sections 363(b) and 105(a) of title 11 of the United States Code (the "Bankruptcy Code"), to pay to the Pre-Petition Agents for the benefit of the Pre-Petition Lenders $325 million of the approximately $607 million in funds held by the Debtors as of November 14, 2003[3] (the "Motion")[4], and respectfully represent as follows:

**Preliminary Statement**

1. Various parties in interest in these Chapter 11 cases have filed objections to the Motion in an attempt to block the relief requested therein on the grounds that such relief would somehow prejudice their alleged claims against the Debtors. While the Pre-Petition Agents take no position at this time regarding the validity of any such claims, the Pre-Petition Agents do point out that the relief requested in the Motion will provide a benefit to the Debtors and their estates, is not out of the ordinary in Chapter 11 cases, and will not adversely impact any such claims in contravention of the provisions of the Bankruptcy Code.

2. First, as testified to by the Debtors' representative at the November 4, 2003 hearing, which testimony was not contradicted, the Debtors and their estates will save approximately $1.0 million per month in interest costs as a result of the contemplated reduction in the Pre-Petition Indebtedness. Thus, even the continuation of the hearing on the Motion from November 4th to November 25th cost the Debtors and their estates almost $1.0 million.

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[2] Dunigan Fuels, Inc. ("Dunigan Fuels"), one of the Debtors, is excluded from the Motion.

[3] Since the date the Motion was filed, the Debtors' cash balance has increased from approximately $575.1 million to approximately $607 million.

[4] Capitalized terms used but not defined herein shall have the respective meanings ascribed to such terms in the Motion.

3. Second, the Pre-Petition Agents submit that the pay down of secured indebtedness out of the proceeds of sales of collateral is not an unusual occurrence in Chapter 11 proceedings. In fact, the Pre-Petition Agents submit that such payment usually takes place simultaneously with the closing of any substantial asset sale. However, as indicated at the November 4th hearing, in light of the need to quickly consummate the sale of the wholesale distribution business to C&S Acquisition LLC ("C&S") and the desire to avoid further complicating such sale, the Pre-Petition Lenders agreed to defer seeking such pay down until after the sale to C&S was consummated.

4. Finally, as demonstrated at the November 4th hearing and for the reasons set forth below, the Pre-Petition Agents submit that the relief requested in the Motion will not prejudice the rights of any of the objectors in a manner inconsistent with the Bankruptcy Code or applicable law. To the extent that the claims of the objectors may be pari passu with or senior to the Pre-Petition Indebtedness, the Pre-Petition Lender Replacement Liens (as defined in the Final DIP Order) and the Pre- and Post-Petition Lender Superpriority Claims (each as defined in the Final DIP Order), or are alleged trust claims, as demonstrated by the Debtors at the November 4th hearing, the Debtors will have sufficient funds on hand to satisfy such claims even after giving effect to the relief requested. As set forth in the Motion and as demonstrated at the November 4th hearing, after payment of the $325 million, the Debtors are retaining (a) sufficient funds to fund their operations through March 2004, (b) the amounts required to be escrowed by the Debtors pursuant to Court order, (c) sufficient funds to fund non-escrowed potential senior claims and (d) a sizeable cash cushion. Even if the Court doubles the amount set aside for alleged DSD claims and retailer ad funds (which the Agents submit is not justified), the Debtors still will have

sufficient funds on hand to satisfy the relief requested, fund their budget, set funds aside for any such claims and retain a considerable cash cushion.

5. To the extent that the claims of the objectors are junior to the Pre-Petition Indebtedness, the Pre-Petition Lender Replacement Liens and the Pre- and Post-Petition Lender Superpriority Claims (such as the asserted reclamation claims), they are not entitled to any payment until the Pre-Petition Lenders are paid in full. To hold otherwise would directly contravene the priority scheme set forth in the Bankruptcy Code as well as well-established common law precedent. Moreover, as will be demonstrated below, the Pre-Petition Lenders are under no duty, and cannot be compelled, to marshal their collateral for the benefit of the unsecured objectors. Accordingly, to the extent that the funds retained by the Debtors after giving effect to the relief requested in the Motion are insufficient to satisfy reclamation claims, the holders thereof are not being prejudiced anyway since they have no entitlement to such funds until after the Pre-Petition Lenders are paid in full.

6. This reply supplements the Motion and the Initial Reply (as defined below) to address in more detail some of the issues raised at the November 4th hearing.[5] For the reasons set forth below as well as in the Motion and the Initial Reply, the Pre-Petition Agents submit that the relief requested is justified and should be approved.

## Background

7. On or about October 10, 2003, the Debtors and the Pre-Petition Agents filed the Motion seeking authority for the Debtors to pay $325 million to the Pre-Petition Agents for the benefit of the Pre-Petition Lenders in partial satisfaction of the Pre-Petition Indebtedness. Thereafter, various parties filed objections to the Motion (the "Objections"). In response thereto,

[5] This Reply does not replace, but only supplements, the Motion and the Initial Reply and the arguments set forth therein are expressly incorporated herein.

on or about October 30, 2003, the Pre-Petition Agents filed an omnibus reply to the Objections (the "Initial Reply").

8. A hearing on the Motion was held on November 4, 2003. At the conclusion of the November 4th hearing, the Debtors and the Pre-Petition Agents determined to continue the hearing on the Motion to November 25, 2003 so that they could have time to adequately respond to certain statements made by the Court at the November 4th hearing. For the reasons set forth below as well as in the Motion and the Initial Reply, the Pre-Petition Agents submit that the relief requested is appropriate and should be granted and that the Objections should be overruled.

## Response

### I. The Objections of the Reclamation Claimants Should be Overruled as the Relief Requested Does Not Prejudice the Reclamation Claimants

A. The Reclamation Claimants are Subject to the Rights of the Pre-Petition Lenders

9. Section 2-702(3) of the Uniform Commercial Code (the "U.C.C.") as codified and adopted in most states provides that a "seller's right to reclaim under subdivision (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this subdivision." U.C.C. § 2-702(3) (emphasis added). Accordingly, to the extent that the Pre-Petition Lenders are determined to be good faith purchasers, the rights of the reclamation creditors to the goods at issue are subject to the liens of the Pre-Petition Lenders on such goods.

10. It is well settled law, including holdings by this Court, that "absent a showing of bad faith, a creditor with a prior perfected security interest in inventory which contains an after-acquired property clause is a good faith purchaser under [Section 2-702(3)] of the UCC." In re Primary Health Systems, Inc., 258 B.R. 111, 114-15 (Bankr. D. Del. 2001); In re ARLCO, Inc., 239 B.R. 261, 267 (Bankr. S.D.N.Y. 1999); In re Victory Markets Inc., 212 B.R. 738, 742 (Bankr. N.D.N.Y. 1997) (absent a "showing of bad faith, a holder of a prior perfected, floating

lien on inventory will be treated as a good faith purchaser with rights superior to those of a reclaiming seller."); In re Leeds Building Products, Inc., 141 B.R. 265, 268 (Bankr. N.D. Ga. 1992).

11. In the instant case, it is clear that the Pre-Petition Lenders are good faith purchasers. Moreover, no party has disputed this contention. First, an Article 9 secured party, such as the Pre-Petition Lenders, are covered by the term "purchaser" as contained in Section 2-702(3) of the U.C.C. See In re ARLCO, 239 B.R. at 268 (referring to the definitions of "purchase" and "purchaser" contained in sections 1-201(32) and 1-201(33) of the U.C.C., respectively). Second, the Pre-Petition Lenders gave "value" as value includes rights acquired "as security for or in total or partial satisfaction of a pre-existing claim." See U.C.C. § 1-201(44); see also In re ARLCO, 239 B.R. at 268. Third, the Pre-Petition Lenders hold a prior perfected security interest in the Debtors' inventory which contains an after-acquired property clause. See Security Agreement, dated as of June 18, 2002, among Fleming Companies, Inc. ("Fleming"), certain subsidiaries of Fleming and Deutsche Bank, as Collateral Agent (the "Pre-Petition Security Agreement"), at § 1.1. Thus, absent a showing of bad faith, the Pre-Petition Lenders satisfy the requirements of Section 2-703 of the U.C.C. and well-established precedent such that any asserted reclamation claims are subject to the claims of the Pre-Petition Lenders.

12. Good faith is defined as "honesty in fact". See U.C.C. § 1-201(19). For purposes of Article Two of the U.C.C., good faith is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." See § 2-103(1)(b); see also In re ARLCO, 239 B.R. at 271 (citations omitted). The party challenging the lenders' good faith has the burden of proof on this point. See, e.g., In re Quality Stores, Inc., 289 B.R. 324, 334 n.18 (Bankr. W.D. Mich. 2003); Mitsubishi Consumer Elec. America, Inc. v. Steinberg's Inc. (In re

Steinberg's, Inc.), 226 B.R. 8, 11 (Bankr. S.D. Ohio 1998); Waslow v. MNC Commercial Corp. (In re M. Paolella & Sons, Inc.), 161 B.R. 107, 123 (E.D. Pa. 1993).

13. The objectors have failed to satisfy this burden. First, no party in the Chapter 11 cases, including the objectors, has asserted any sort of misconduct or bad faith on the part of the Pre-Petition Agents or the Pre-Petition Lenders. Second, no party, other than a so-called Unofficial Committee of Unsecured Creditors of Dunigan Fuels, has challenged the Pre-Petition Lenders' liens or claims.[6] Moreover, the period to challenge the Pre-Petition Lenders' liens and claims has expired so no further challenges can be made. See Final DIP Order ¶ 48. Thus, the Pre-Petition Agents submit that this requirement has also been satisfied and, as such, that the Pre-Petition Lenders are good faith purchasers for purposes of Section 2-703 of the U.C.C.

14. Thus, as the Pre-Petition Lenders are good faith purchasers, the rights of the reclamation claimants to the goods at issue are subject to the liens of the Pre-Petition Lenders on such goods regardless of whether the Pre-Petition Lenders are ultimately determined to be oversecured or undersecured as to the Debtors' inventory. See In re Victory Markets, Inc., 212 B.R. at 742 ("[s]ince there are prior perfected security interests in the Goods that Imperial seeks to reclaim, Imperial's claim is necessarily subordinated, but is not automatically extinguished.") (emphasis added). The Pre-Petition Lenders are therefore entitled to be paid out of the proceeds of such goods notwithstanding any asserted reclamation claim with respect thereto.[7]

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[6] As set forth in the Motion, the Pre-Petition Agents submit that the challenge by this self-named unofficial committee should not prevent the relief requested as the Debtors will retain sufficient funds to satisfy any judgment granted in their favor since any recovery by them should be limited to the lesser of the amount of their allowed claims (no more than $10.7 million – the amount asserted in their complaint) and the value of Dunigan Fuels' assets as of the Petition Date.

[7] As will be discussed below, the reclamation claimants also cannot force the Pre-Petition Lenders to marshal their collateral in order to preserve the goods at issue for the reclamation claimants.

## II. The Pre-Petition Lenders Cannot be Compelled to Marshal

15. Finally, the Pre-Petition Lenders are under no obligation to marshal and the reclamation claimants cannot compel them do so. Thus, the objections of the reclamation claimants cannot prevent the relief requested as they are junior to the Pre-Petition Lenders.

A. The Requirements for Marshaling Have Not Been Met

16. In order for marshaling to apply in a particular situation, the following three elements must be established: "(1) the existence of two secured creditors with a common debtor, (2) the existence of two funds belonging to the debtor, and (3) the right of the senior secured creditor to receive payment from more than one fund while the junior secured creditor can only resort to one fund." In re ARLCO, 239 B.R. at 274 (citing Chittenden Trust Co. v. Sebert Lumber Co. (In re Vermont Toy Works, Inc.), 135 B.R. 762, 767 (D. Vt. 1991)); see also Herkimer County Trust Co. v. Swimelar (In re Prichard), 170 B.R. 41, 45 (Bankr. N.D.N.Y. 1994) (under New York law) (citation omitted). [8] Moreover, these elements "have been strictly construed in the bankruptcy context." In re ARLCO, 239 B.R. at 274 (citing Wurst v. City of New York (In re Packard Properties, Ltd.), 112 B.R. 154, 158 (Bankr. N.D. Tex. 1990)); see also In re San Jacinto Glass Indus., Inc., 93 B.R. 934 (Bankr. S.D. Tex. 1988).

17. In the instant case, marshaling is improper as the reclamation claimants are not secured creditors. In In re ARLCO, the only published decision squarely on point, the court held that although a reclamation claimant might have a higher priority than a general unsecured creditor, it does not have a secured claim and, therefore, the senior secured creditor in that case

[8] Marshaling is a state law doctrine and whether or not it is applicable in a particular circumstance is determined by reference to state law. See, e.g., Craner v. Marine Midland Bank, N.A. (In re Craner), 110 B.R. 111, 122 (Bankr. N.D.N.Y. 1988) ("[s]tate law governs the application of marshalling since it is concerned with the competing property interests of liens") (citations omitted), rev'd in part on other grounds, IRS v. Craner (In re Craner), 110 B.R. 124 (N.D.N.Y. 1989). To that end, both the Pre-Petition Credit Documents and the DIP Credit Agreement are governed by New York law.

could not be compelled to marshal. 239 B.R. 261 (Bankr. S.D.N.Y. 1999).[9] In ARLCO, Galey & Lord, Inc. ("Galey"), an entity which had sold textile goods to Arley Corporation (one of the debtors), commenced an adversary proceeding against Arley prior to a sale of substantially all of the debtors' assets under Section 363 of the Bankruptcy Code, seeking reclamation of textile goods it had provided to Arley pre-petition. See id. at 265. By then, CIT Group/ Business Credit, Inc. ("CIT") held a perfected security interest in substantially all of the debtors' assets, including inventory and accounts receivable. Galey moved for summary judgment, maintaining that it had complied with all of the statutory requirements for establishing its reclamation claim. See id. Ultimately, the trustee prevailed in his opposition to the summary judgment motion.

18. After finding that CIT constituted a good faith purchaser for purposes of Section 2-702(3) of the U.C.C., as the Pre-Petition Lenders are here, the court addressed whether relief based on a marshaling theory was appropriate given that it appeared that CIT would be able to satisfy its security interest through the continued liquidation of collateral other than the reclamation seller's goods. See id. at 273. The Court reasoned that Galey, the reclamation claimant, could not compel marshaling because it was not a secured creditor. See id. at 274. In arriving at the conclusion that marshaling was inapplicable, the court rejected Galey's argument that it had a higher priority than general unsecured creditors and therefore that its claim was "akin to a secured claim." Id. Thus, as in the ARLCO case, the reclamation claimants here do not have standing to compel the Pre-Petition Lenders to marshal as such claimants are not secured creditors.

[9] It has also been held generally in other contexts that unsecured creditors do not have standing to invoke marshaling. See, e.g., In re Prichard, 170 B.R. at 45 (citation omitted); see also Vermont Toy Works, 135 B.R. at 768 (only secured creditors can invoke marshaling).

B. Marshaling Is Improper as the Pre-Petition Lenders are Good Faith Purchasers

19. Second, "once an entity is characterized as a good faith purchaser, the remedies and defenses available against it are limited to whatever may be raised against a good faith purchaser. The equitable remedy of marshaling is not one such remedy." In re ARLCO, 239 B.R. 274-75. The rationale provided for this result is that to apply marshaling against a secured creditor that qualified as a good faith purchaser "would be to create distinctions and classes of good faith purchasers and alter their rights depending upon the manner in which they acquired that status." Id. at 275. Accordingly, since, as demonstrated above, the Pre-Petition Lenders are good faith purchasers, this defense cannot be raised against them.

C. Marshaling Is Improper as It Would Delay and Inconvenience the Pre-Petition Lenders

20. Third, a senior secured creditor cannot be compelled to marshal where it "would be delayed or inconvenienced in the collection of the debt owed to it." In re ARLCO, 239 B.R. at 274 (citation omitted); see also In re Prichard, 170 B.R. at 45 (holding under New York law that senior creditor would be delayed or inconvenienced if compelled to proceed first against property subject to foreclosure process and inventory rather than cash proceeds); In re High Strength Steel, Inc., 269 B.R. 560, 575 (Bankr. D. Del. 2001) (holding that senior secured creditor could not be compelled to marshal where it would be forced to disgorge funds and, therefore, "would be forced to incur delay and further costs of collection"); First City Nat'l Bank of Midland v. Mid-West Motors, Inc. (In re Mid-West Motors, Inc.), 82 B.R. 439, 442 (Bankr. N.D. Tex. 1988). "Moreover, the marshalling applicant must meet its burden of the absence of any prejudice by clear and convincing evidence." In re Craner, 110 B.R. at 123 (citing Vermont Toy Works).

21. In this instance, none of the objectors have provided any evidence demonstrating that the Pre-Petition Lenders would neither be delayed or inconvenienced in the collection of

their debt nor otherwise prejudiced. Furthermore, the Pre-Petition Agents submit that the objectors could not satisfy this burden in any event. Denial of the relief requested based on the objection of the reclamation claimants would delay and inconvenience the Pre-Petition Lenders in the collection of their debt as they would be forced to wait either until the issues surrounding the reclamation claims are resolved or other assets are sold. This would be especially prejudicial to the Pre-Petition Lenders as (a) the reclamation claimants are subordinate to the Pre-Petition Lenders and (b) the reclamation claimants do not even have standing to raise marshaling.[10] Such a situation is no different than those in Prichard and High Strength Steel.

D. The Governing Documents Expressly Provide for a Waiver of Marshaling

22. Finally, both the Pre-Petition Security Agreement and the Final DIP Order provide that the Pre-Petition Lenders may proceed against their collateral in any order, subject to a limited exception in the Final DIP Order with respect to the proceeds of avoidance actions. See Pre-Petition Security Agreement, at §§ 5.1, 5.2; Final DIP Order, at ¶ 43. Accordingly, to now require the Pre-Petition Lenders to marshal would not only contravene well established common law, but would also prevent the Pre-Petition Lenders from receiving the benefit of their bargain in making the Pre-Petition Loans to the Debtors as well as in consenting to the use of cash collateral post-petition. Moreover, the resulting lack of certainty with respect to the Final DIP Order would have adverse effects on the DIP financing industry as many potential lenders would be unlikely to lend without the necessary certainty of the orders approving such transactions.

[10] The ARLCO court went on to hold that in addition to marshaling itself, other "marshaling type remed[ies]" also could not have been imposed on the senior secured lender in that case as this would have "inconvenienced and delayed" the senior secured lender. See 239 B.R. at 276. The same is true in this case.

23. Accordingly, for the foregoing reasons, the Pre-Petition Lenders are under no obligation to marshal and, moreover, based on applicable case law, cannot be compelled to do so. Thus, such an argument should not prevent the relief requested in the Motion.

24. Finally, the Pre-Petition Agents note that the Debtors are co-movants on the Motion and the Official Committee of Unsecured Creditors has approved the relief requested in the Motion.

WHEREFORE, the Pre-Petition Agents request that the Court approve the Motion and overrule the Objections thereto and grant such other and further relief as this Court may deem just and proper.

Dated: November 20, 2003

Respectfully submitted,

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