

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE:

Chapter 11

FLEMING COMPANIES, INC., et al.,

Debtors.

Case No. 03-10945 (MFW)
(Jointly Administered)

Hearing: January 5, 2004 at 4:00 pm
Objection Date: December 29, 2003

**Local Texas Tax Authorities Objection to Debtors' Motion for an Order
(I)(A) Authorizing Debtors to Obtain Replacement Post-Petition Financing Under
11 U.S.C. § 364 and Bankruptcy Rule 4001(c) and Del. Bankr. LR 4001-2 and Assign the
Existing Secured Lenders' Liens to the Replacement Lenders, and (B) Authorizing Debtors
to Pay Certain Commitment and Related Fees and Expenses Relating to the Replacement
Post-Petition Financing, (II) Granting Adequate Protection Pursuant to 11 U.S.C. §§ 361
and 363; and (III) Authorizing Debtors to Repay Certain Outstanding Obligations Under
the Pre-Petition Credit Agreement and the Post-Petition Loan Agreement**

Now come Dallas County, City of El Paso, Grayson County, Gregg County, Harris
County, City of Houston, Houston ISD, Hidalgo County, McAllen, McLennan County, Rockwall
County, Rockwall County, and Tarrant County (jointly the **Local Texas Tax Authorities** or **Tax
Authorities**) and object to the relief sought by the Debtors' Motion for an Order (I)(A)
Authorizing Debtors to Obtain Replacement Post-Petition Financing Under 11 U.S.C. § 364 and
Bankruptcy Rule 4001(c) and Del. Bankr. LR 4001-2 and Assign the Existing Secured Lenders'
Liens to the Replacement Lenders, and (B) Authorizing Debtors to Pay Certain Commitment and
Related Fees and Expenses Relating to the Replacement Post-Petition Financing, (II) Granting
Adequate Protection Pursuant to 11 U.S.C. §§ 361 and 363; and (III) Authorizing Debtors to
Repay Certain Outstanding Obligations Under the Pre-Petition Credit Agreement and the Post-
Petition Loan Agreement (the **Motion**). In support of their objection, the Local Texas Tax
Authorities would show the Court as follows:

1. The Texas Tax Authorities are holders of secured claims for unpaid ad valorem taxes for the 2002 and 2003 tax years. These taxes are secured by priority perfected liens on the real and personal property of the Debtors' estates pursuant to Tex. Prop. Tax Code § 32.01 and 32.05. In re: Winn-Dixie Stores, Inc., 177 B.R. 253 (Bankr. W.D. Tex. 1995) (Texas tax liens are non-avoidable in bankruptcy); Central Appraisal District of Taylor County v. Dixie-Rose Jewels, Inc., 894 S.W. 2d 841 (Tex. App. - Eastland 1995) (Texas tax liens are senior to liens of any consensual lender). These liens are *in solido* and attach on January 1 of each year to all personal property of the property owner, and to property subsequently acquired. In re: Universal Seismic Associates, Inc., 288 F.3d 205 (5th Cir. 2002); City of Dallas v. Cornerstone Bank, N.A., 879 S.W. 2d 264 (Tex. App. - Dallas 1994). The Texas Tax Authorities' claims total in excess of \$1,600,000.¹

2. Further, on January 1, 2004, the Tax Authorities will have valid, perfected, first-priority secured administrative expense claims for taxes for the 2004 tax year. Tex. Prop. Tax Code § 32.01; 11 U.S.C. § 506(b); 11 U.S.C. § 362(b)(18).

¹The Texas Tax Authorities claims actually may be substantially higher because they are still working to locate all property owned by the Debtors.

3. The Tax Authorities object to the ~~A~~Security and Priority~~@~~o be granted GE Capital under the terms of the new DIP loan. The Motion requests the Court to grant the new DIP lenders ~~A~~Assignment of the Existing Liens and . . . first priority security interests in all of the existing and after acquired real and personal . . . assets~~@~~f the Debtors. It further provides that ~~A~~all Collateral will be free and clear of liens, claims, and encumbrances, except for encumbrances permitted by the final Replacement DIP Credit Facility Documents. . . .~~@~~(Motion, pg. 21). Finally, the new DIP lenders are to be granted superpriority administrative expense claims under ~~■~~ 364(c)(1) and 364(d).² (Motion, pg. 22)

4. Although the relief sought by the Debtors would substantially impair the Tax Authorities, nowhere in the Motion do the Debtors provide any adequate protection for the liens and claims of the Tax Authorities which they are attempting to subordinate or even avoid. Although it appears that the new DIP lenders~~=~~superpriority administrative expense claims are to be subject to ~~A~~Senior Claims~~@~~s defined in the Replacement DIP Credit Facility Loan Documents, the definition of ~~A~~Senior Claims~~@~~oes not clearly encompass the pre- and post-petition liens and claims of the Tax Authorities. Further, as set forth on pages 21 and 22 of the Motion, whatever protections are granted to holders of ~~A~~Senior Claims~~@~~oes not include retaining the senior priority status of their liens.

5. It is the Debtors burden to prove that the Tax Authorities~~=~~will remain adequately protected, and absent such a showing the relief requested in the Motion must be denied. 11

²The reference to ~~■~~ 364(d) is somewhat confusing because that section refers only to granting senior liens, not to administrative expense priority.

U.S.C. §§ 363(e) and 364(d)(2).

6. The Texas Tax Authorities also object to provision which allow the Debtors to use the proceeds from the sale of their collateral to repay any creditors prior to paying their first priority secured claims. The Motion requests that proceeds from the sale of the Tax Authorities' collateral may be used to pay down the Pre-Petition Lenders and the Prior DIP Lenders, as well as certain expenses of the GE Capital (the proposed new DIP lender), and that once so used, the proceeds would cease to be subject to the Tax Authorities' liens. The Tax Authorities object to this use of their cash collateral. The Tax Authorities' liens and claims are senior in priority and should be paid first from the sale proceeds. The Debtors give no good reason why they are preferring junior lienholders over the Tax Authorities, other than that the Pre-Petition Lenders are pressuring them to be repaid prior to confirmation of a plan. So long as they are adequately protected by their liens, the Pre-Petition Lenders have no right under the Bankruptcy Code to seek payment prior to and outside the plan confirmation process. The Pre-Petition Lenders have already received substantial payments from the Debtors and they should have to wait for final payment with everyone else.

7. Alternatively, if the Court is inclined to approve payment of the Pre-Petition Lenders, the senior secured claims of the Local Texas Tax Authorities should be paid first. The Tax Authorities' pre-petition claims are accruing interest at the rate of 12% per annum as allowed under 11 U.S.C. § 506(b). It would be in the best interest of the estate to pay these claims as soon as possible in order to cease the accrual of interest, which would of course result in more funds available for other creditors.

8. To the extent the Court allows the Debtors to use the proceeds from the sale of any

property in Texas to pay any claimant or creditor other than the Local Texas Tax Authorities, the Tax Authorities request that the Court require the Debtors to submit evidentiary proof that they retain sufficient funds from the proceeds of the sale of the Tax Authorities' collateral to continue to fully secure their claims, including accruing interest. Absent such a showing, the requirements for adequate protection are not met.

9. The Tax Authorities object to the relief sought to the extent it could be construed as attempting to subordinate their administrative expense claims to those of any other creditor. The Tax Authorities' 2004 tax liens will arise on January 1, 2004, prior to the hearing on this matter and prior to the closing of this transaction (if approved). The Debtors and GE Capital give no reason why it is necessary that these tax claims be subordinated in priority of payment to their administrative expense claims.

Wherefore, based upon the foregoing, the Local Texas Tax Authorities request the Court to deny the relief requested by the Debtors and to grant them such other and further relief to which the Court may find they are entitled.

Respectfully submitted,

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