

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

In re:)	Chapter 11
)	
FLEMING COMPANIES, INC., et al.,)	Case No. 03-10945 (MFW)
)	
Debtors.)	Jointly Administered
)	
)	Hearing Date: February 17, 2004 at 3:00 p.m.
)	Obj. Deadline: February 10, 2004 at 4:00 p.m.
)	Regarding Docket No. 4958

**OBJECTION OF XL SPECIALTY INSURANCE COMPANY TO DISCLOSURE
STATEMENT IN SUPPORT OF DEBTORS' AND OFFICIAL COMMITTEE OF
UNSECURED CREDITORS' JOINT PLAN OF REORGANIZATION OF
FLEMING COMPANIES, INC. AND ITS FILING SUBSIDIARIES UNDER
CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE**

XL Specialty Insurance Company ("XL"), by and through its undersigned counsel, respectfully submits this Objection to Disclosure Statement in Support of Debtors' and Official Committee of Unsecured Creditors' Joint Plan of Reorganization of Fleming Companies, Inc. and Its Filing Subsidiaries Under Chapter 11 of the United States Bankruptcy Code filed on December 12, 2003 (the "Disclosure Statement"). In support of its objection, XL asserts and alleges as follows:

JURISDICTION

1. This Court has jurisdiction over this "core" proceeding pursuant to 28 U.S.C. §§ 157 and 1334.
2. Venue lies properly in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

FACTUAL BACKGROUND

3. 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. The Debtors continue to operate their businesses and manage their properties as debtors-in-possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

4. In addition to its wholesale supply business, Fleming operates retail grocery stores and convenience marts throughout the United States and Canada. A primary staple of its business is the sale of cigarettes and other tobacco products. The sale of cigarettes and tobacco products is highly regulated and taxed in each state which Fleming operates. Although each state's regulatory scheme is distinct, most, if not all, of the states require Fleming to pay a tax on each pack of cigarettes to be sold. In some states, Fleming is required to pass that tax on to its retail customers. In the event that the cigarettes are not sold, Fleming can usually obtain a refund of the tax.

5. By Order dated May 22, 2003, Fleming obtained Court authority to pay all of its outstanding pre-petition cigarette and tobacco tax liability. A copy of the Order is attached as **Exhibit "A"**.

6. Many, if not all, states in which Fleming sells cigarettes and tobacco products allow Fleming to obtain cigarette tax stamps on credit upon posting of a bond. In order to allow Fleming to obtain cigarette and tobacco tax stamps on credit, XL, from time to time, issued certain cigarette and tobacco tax bonds in favor of various state taxing authorities (the "Bonds"). A listing of the Bonds is attached as **Exhibit "B"**.

7. Prior to the commencement of these cases, on or about April 4, 2001, Fleming executed a certain Continuous Contract of Indemnity dated April 4, 2001 (the "Indemnity Agreement") in favor of XL. A true and correct copy of the Indemnity Agreement is attached hereto and incorporated herein as **Exhibit "C"**.

8. Pursuant to the Indemnity Agreement, Fleming, individually and on behalf of all of the Debtors, agreed, *inter alia*, to exonerate, indemnify, keep indemnified, and save XL harmless from any and all loss, damage or expense by reason of XL executing or delivering bonds on behalf of any of the Debtors or for performing any of its obligations due and owing under such bonds.

OBJECTIONS

9. The Disclosure Statement fails to fully disclose the Debtors' intended treatment of tax claims for which surety bonds have been issued. In section VI(C)(I)(b) of the Disclosure Statement, the Debtors state that all priority tax claims will either be paid in full on the Effective Date, or will be paid in full with interest within six years of the date of assessment of the tax, or will receive such other treatment as agreed to by the parties. Upon information and belief, the Debtors have been in discussions with various taxing authorities seeking an agreement from such authorities to take less than the full amount of their tax claim or to require the taxing authorities to make claims under outstanding bonds. XL, through its right of equitable subrogation, objects to any treatment of the taxing authorities that does not contemplate payment of the tax claim in full from assets of the estate or the Reorganized Debtors in accordance with 11 U.S.C. § 1129(a)(9).

10. Pursuant to the Indemnity Agreement and principles of equitable subrogation, to the extent that XL is required to make payment under the Bonds, XL is subrogated to the rights of the taxing authority(ies) as against Fleming, including the right to enforce the provisions of 11 U.S.C. § 1129(a)(9). In essence, XL steps into the shoes of the taxing authorities and may assert the rights and remedies of the taxing authorities

with respect to the claim. *See Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962). If the Plan contemplates that any part of the taxing authorities' claims will be paid by XL under the Bond, XL, through its right of equitable subrogation, becomes the party that has authority to consent to less than full payment of the tax claim under § 1129(a)(9). The Disclosure Statement should clearly disclose the Debtors' intention with respect to the tax claims so that XL will have sufficient information to make a determination whether confirmation of the Plan is in XL's best interests.

11. The Debtors, as principals under the Bonds, cannot compel the taxing authorities, as obligees under the Bonds, to make claim against XL, as surety. The Debtors have primary liability for the unpaid taxes. There is simply no mechanism, equitable or legal, under which the Debtors can compel the taxing authorities to make a claim against the Surety under the Bonds. Additionally, the taxing authorities could not voluntarily agree to release the Debtors from all or any portion of their direct liability for the tax claims without simultaneously causing the Surety to be released from any and all liability under the Bonds. *See Bier Pension Plan Trust v. Estate of Schneierson*, 545 N.E.2d 1212, 1214 (N.Y. 1989).

12. Even if the Debtors could compel the taxing authorities to make a claim under the Bonds, the tax claim against the estate will not be diminished – the Debtors are still required to pay the full amount of the claim with interest pursuant to 11 U.S.C. § 1129(a)(9). Put simply, any payment by the Surety to a taxing authority under one of the Bonds simply changes the holder of the tax claim, not the character of the tax claim. Section 1129(a)(9) provides that, with respect to pre-petition tax claims of the kind at issue, the "**holder of such claim** will receive on account of such claim deferred cash

payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim." Accordingly, a change in the holder of the claim does not affect the requirement that the holder of the claim must be paid in full with interest under the plan. The Disclosure Statement should not be approved unless or until the Disclosure Statement and Plan specifically state that the tax claims will be paid in full with interest from assets of the Estate or the Reorganized Debtor. The Plan and Disclosure Statement should further provide that, to the extent that any tax authority is paid by a Surety relating to a tax claim, the payments that would otherwise be made to the taxing authority under the Plan, shall be made to the Surety.

13. The Disclosure Statement improperly provides for the release of certain third-parties (the "Releasees") with respect to claims addressed under the Plan. Certain of these Releasees are officers and directors of the Debtors who may have personal liability for certain unpaid taxes under various state tax laws. A Plan cannot release these non-Debtors from liability for the tax claims and is not confirmable with such a provision. To the extent that the Disclosure Statement describes a plan that is unconfirmable, the Disclosure Statement should not be approved.

14. The Disclosure Statement fails to describe how the Debtors will distribute the pre-petition and cigarette tax collections that are to be held in trust. Under certain applicable state law, the cigarette and tobacco taxes constitute "trust fund" type taxes. *See* Ariz. Rev. Stat. Ann. § 42-3208(A) (West 2003); Fla. Stat. Ann. § 210.02 and 210.04 (West 2003); 35 Ill. Comp. Stat. Ann. 135/3 (2003). Under these state statutes, Fleming was required by law to pass the tax on to its customers. Upon information and belief,

Fleming passed the cigarette and tobacco taxes on to its customers even though Fleming never paid the tax to the taxing authorities. Taxes that are collected from a third party by the Debtor and for which the Debtor is directly liable resemble social security taxes and taxes withheld from wages and, as such, are deemed "trust fund taxes" regardless of whether the taxes are labeled as sales taxes, excise taxes, or other. *In re St. Hilaire*, 135 B.R. 186, 189 (Bankr. D. Mass. 1991) (citing *Rosenow v. State of Illinois Dept. of Revenue*, 715 F.2d 277 (7th Cir. 1983)). In this case, the cigarette and tobacco taxes were collected from the Debtors customers but were not delivered to the taxing authorities. Accordingly, the taxing authorities have an interest in the cigarette and tobacco sales proceeds and such interest is protected by the provisions of 11 U.S.C. § 363(e). The Disclosure Statement does not describe how the taxing authorities' interests in these "trust funds" will be treated.

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WHEREFORE, XL Specialty Insurance Company respectfully requests that the Disclosure Statement not be approved unless or until XL's objections, as set forth above, are remedied and that the Court grant such other relief as is appropriate.

Respectfully submitted,

Dated: January 14, 2004
Wilmington, Delaware

/s/ Richard W. Riley
Richard W. Riley (DE I.D. 4052)
Duane Morris LLP
1100 North Market Street, Suite 1200
Wilmington, DE 19801
Telephone: (302) 657-4900
Facsimile: (302) 657-4901
E-mail: rwiley@duanemorris.com

-and-

OF COUNSEL:

J. Michael Franks (TN I.D. 2641)
Thomas T. Pennington (TN I.D. 9605)
Michael E. Collins (TN I.D. 16036)
MANIER & HEROD,
a Tennessee Professional Corporation
150 4th Avenue North, Suite 2200
Nashville, Tennessee 37219
Telephone: (615) 244-0030

ATTORNEYS FOR XL SPECIALTY
INSURANCE COMPANY