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**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

In re

PILGRIM'S PRIDE CORPORATION, *et al.*,

Debtors.

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Chapter 11

Case No. 08-45664 (DML)

JOINTLY ADMINISTERED

**DEBTORS' OBJECTION TO THE FIRST AMENDED MOTION
OF TITUS COUNTY TAXING ENTITIES TO DETERMINE AND
TO ORDER PAID REMAINING INTEREST AND PENALTIES OWING
ON TAX CLAIMS OF TITUS COUNTY TAXING ENTITIES**

(Related to Docket Nos. 3556 and 3477)

TO THE HONORABLE D. MICHAEL LYNN,
UNITED STATES BANKRUPTCY JUDGE:

Pilgrim's Pride Corporation ("PPC") and its affiliated debtors in the above-referenced chapter 11 cases, as debtors and debtors in possession (collectively, the "Debtors"),¹ in support of their objection to the First Amended Motion to Determine and to Order Paid Remaining Interest and Penalties Owing on Tax Claims of Titus County Taxing Entities (the "Motion")², respectfully represent:

Tax Claims

1. On December 1, 2008 (the "Commencement Date"), the Debtors each commenced with this Court voluntary cases under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). On March 11, 2009, upon a motion of the Debtors [Docket No. 761] (the "Tax Motion"), the Court entered the Order Pursuant to Sections 363(b) and 105(a) of the Bankruptcy Code Authorizing Payment of Certain Real Property and Personal Property Taxes [Docket No. 1134] (the "Tax Order"). The Tax Order authorized the Debtors, but did not require the Debtors, to pay certain prepetition real property and personal property taxes. As described in more detail in the Tax Motion, on the Commencement Date, the Debtors owed approximately \$19.8 million in prepetition real property and personal property taxes (the "Prepetition Taxes"). Because these Prepetition Taxes are secured by property of the Debtors' estates pursuant to various state tax laws, they are arguably entitled to postpetition interest under section 506(b) of the Bankruptcy Code. Accordingly, the Debtors requested, and received,

¹ The Debtors in these cases are PPC; PFS Distribution Company; PPC Transportation Company; To-Ricos, Ltd.; To-Ricos Distribution, Ltd.; Pilgrim's Pride Corporation of West Virginia, Inc.; and PPC Marketing, Ltd.

² The Amended Motion amends the Motion to Determine and Order Paid Remaining Interest and Penalties Owing on Tax Claims of Titus County Taxing Entities [Docket No. 3477].

authority, in their discretion, to pay such claims early so as not to accrue postpetition interest on such claims.

2. Although the Debtors received authority from the Court to pay the Prepetition Taxes in March 2009, pursuant to the postpetition financing agreement (the “DIP Credit Agreement”), the Debtors are restricted to paying only approximately \$1 million of the Prepetition Taxes per week. Because of this budget limitation, the Debtors had to prioritize which Prepetition Taxes to pay first. As fiduciaries, the Debtors decided on the order of payment based on what would be in the best interests of the Debtors’ estates and their creditors. Accordingly, the Debtors made a business decision to determine which Prepetition Taxes to pay first depending on which taxing authorities offered the Debtors greater savings with respect to the Prepetition Taxes. For example, the Debtors asked various taxing authorities to waive payment of any accrued interest and penalties on the Prepetition Taxes. Many taxing authorities accepted the Debtors’ offer and accordingly were among the first to be paid their Prepetition Taxes.

Negotiations with MPISD

3. Around March 2009, the Debtors commenced discussions with representatives of the Mount Pleasant Independent School District (“MPISD”) regarding payment of Prepetition Taxes owed by the Debtors to the MPISD (the “MPISD Tax Claim”). Although the Debtors offered to pay the MPISD Tax Claim earlier pursuant to the Tax Order if the MPISD were to waive its claims for interest and penalties, the MPISD refused this offer. Instead, counsel for the MPISD sent an email to William K. Snyder, PPC’s Chief Restructuring Officer, stating in relevant part:

Waiving penalty or interest is a very dangerous precedent for a small district like Mount Pleasant. Everyone will know if Pilgrim’s gets a break and everyone will

start asking for similar breaks. This is a slippery slope for MISD that they best avoid.

My client is inclined to wait this matter out and simply let the interest and penalties accrue.

Email dated Mar. 27, 2009 from James V. Hoeffner to William Snyder, attached hereto as

Exhibit A (the "Hoeffner Email").

4. Indeed, MPISD waited the matter out and did not reach agreement on payment of the MPISD Tax Claim until late June 2009. On September 15, 2009, the Court entered an order approving the stipulation between MPISD and PPC (the "MPISD Stipulation"), pursuant to which the Debtors paid all taxes owed to MPISD for the year 2008, save and except for interest and penalties for the year 2008. The Debtors paid the MPISD Tax Claim (less any interests or penalties) in full on June 30, 2009.

Taxing Entities' Motion

5. On October 1, 2009, MPISD along with Titus County, Titus County Hospital District, and Chapel Hill Independent School District (collectively, the "Taxing Entities") filed the Motion seeking payment from the Debtors of \$160,449.37 in penalties that accrued from February 2009 through June 2009 (the "Penalties") and \$89,138.55 in interest that accrued from February 2009 through June 2009 (the "Accrued Interest") with respect to Prepetition Taxes owed to the Taxing Entities. The Taxing Entities contend that pursuant to Section 32.01 of the Texas Tax Code, their claims are secured by a statutory lien. Motion at ¶ 6. The Taxing Entities also contend that they are entitled to payment of interest and penalties on delinquent taxes pursuant to Section 33.01 of the Texas Tax Code. Motion at ¶ 9. For the reasons set forth below, the Taxing Entities are not entitled to payment of Penalties or the Accrued Interest on the Prepetition Taxes owed to the Taxing Entities.

Objection

Claims for Penalties Should Be Disallowed As Unreasonable

6. The Debtors object to payment of the Penalties. The Taxing Entities assert that they are entitled to payment of the Penalties under section 506(b) of the Bankruptcy Code, which provides:

To the extent that an allowed secured claim is secured by property the value of which, after any recovery. . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any *reasonable* fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

11 U.S.C. § 506(b) (emphasis added). Even if penalties constitute “fees, costs, or charges” under section 506(b), which is far from settled, it is clear that such “fees, costs, or charges” if awarded must be reasonable. The Penalties asserted by the Taxing Entities are not reasonable in the context of these chapter 11 cases.

7. Section 33.01 of the Texas Tax Code provides for a penalty of 6% of the amount of the tax for the first calendar month it is delinquent plus 1% for each additional month or portion of a month the tax remains unpaid prior to July 1 of the year in which it becomes delinquent. Because five months have elapsed since the Prepetition Taxes owing to the Taxing Entities became due and when they were paid by the Debtors, the Taxing Entities claim that they are entitled to five month of penalties, which aggregate to approximately 11% of the Prepetition Taxes – or \$160,449.37. An 11% penalty for a five month delay in payment of a prepetition debt is unreasonable in the context of these chapter 11 cases for several reasons.

8. First, the Prepetition Taxes were not timely paid by virtue of the intervening chapter 11 filing and the prohibition in the Bankruptcy Code against paying prepetition claims. As soon as the Debtors received authority to pay Prepetition Taxes in March

2009, the Debtors reached out to the Taxing Entities to negotiate an agreement that would have resulted in payment of the Prepetition Taxes to such Taxing Entities, while still complying with the Debtors' DIP Credit Agreement. This is not a situation of an intentionally "delinquent" tax payer.

9. Second, to the extent the Taxing Entities are entitled to payment of interest, such payment will more than adequately compensate the Taxing Entities for lost revenue that they incurred during the five month delay in paying the Prepetition Taxes. Section 33.01 of the Texas Tax Code already provides that a delinquent tax accrues interest at 1% per month, thus resulting in approximately a 5% recovery in this case.

10. Finally, disallowance of the Taxing Entities' claims for Penalties is appropriate because such claims would not be allowed even in a chapter 7 liquidation. Section 726(a)(4) of the Bankruptcy Code provides for payment of only those penalties arising "before the earlier of the order for relief and the appointment of a trustee" to the extent such penalties "are not compensation for actual pecuniary loss suffered by the holder of such claim." 11 U.S.C. § 726(a)(4). No other claims for penalties are entitled to distribution under section 726 of the Bankruptcy Code. Because the Taxing Entities' claims for penalties arose after the Debtors failed to pay the Prepetition Taxes on January 31, 2009 – that is, postpetition—their claims for Penalties are not entitled to any distribution under section 726.

11. The Taxing Entities' sole authority for their proposition that the Penalties should be paid is a citation to *In re Jones*, 368 B.R. 602, 605 (Bankr. S.D. Tex. 2007), a case that is neither controlling in this jurisdiction or even on point. Although in *In re Jones*, the court allowed a claim for prepetition taxes under Section 33.01 of the Texas Tax Code, which included a penalties component, the issue of whether such penalties were appropriate under section 506(b)

of the Bankruptcy Code was not before the court. Accordingly, the *In re Jones* court did not analyze whether penalties under Section 33.01 of the Texas Tax Code were reasonable, either in the context of that case or otherwise. In addition, there was no mention in *In re Jones* of whether the failure to pay the prepetition taxes occurred prior to the chapter 13 case or as a result of it – a factor that, as discussed above, should play a role in determining whether penalties are reasonable in a particular case.

12. Accordingly, for all the foregoing reasons, the Taxing Entities' claims for penalties are unreasonable and should be disallowed.

Claim for Accrued Interest and Penalties Should Be Disallowed on Equitable Grounds

13. The Debtors also object to the Taxing Entities' claim for Accrued Interest and Penalties on equitable grounds. Based on the Hoeffner Email, MPISD intentionally delayed resolution of its Prepetition Claim in order to accrue interest and penalties. It would be inequitable to reward MPISD's conduct by awarding it the accrued interest and penalties that MPISD caused itself to accrue.

14. As the Supreme Court in *Pepper v. Litton* held,

[A] bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence.

...

[T]he bankruptcy court in passing on allowance of claims sits as a court of equity. . . . In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate.

308 U.S. 295, 305, 307-08 (1939) (citations omitted).

15. Thus, section 105(a) of the Bankruptcy Code empowers the Court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions

of [the Bankruptcy Code].” 11 U.S.C. § 105(a); *see, e.g., B-Real, LLC v. Chausse (In re Chausse)*, 399 B.R. 225, 240-41 (B.A.P. 9th Cir. 2008) (stating that “bankruptcy courts possess authority pursuant to § 105(a) to impose sanctions for a pattern of bad faith conduct that transcends conduct addressed by particular rules or statutes.”). Moreover, section 502(b)(1) grants the Court authority to disallow a claim that is deemed to be unenforceable against a debtor. 11 U.S.C. § 502(b)(1). *Id.* at 234.

16. As discussed above, the Debtors made attempts to engage in negotiations with the Taxing Entities. In light of the Debtors’ budgetary constraints, the terms of these negotiations were reasonable as a number of other taxing authorities accepted the Debtors’ offer to waive payment of accrued interest and penalties. Yet, MPISD deliberately “wait[ed] this matter out” in order to accrue three extra months of interest and penalties on the Prepetition Taxes. *See* Hoeffner Letter at 2. It would be inequitable to award the Taxing Entities, and especially the MPISD, the Accrued Interest or the Penalties that they themselves caused to be accrued. Accordingly, the Taxing Entities’ claims for payment of Accrued Interests and Penalties should be disallowed pursuant to sections 105(a) and 502(b) of the Bankruptcy Code.

17. WHEREFORE the Debtors request that the Court deny the Motion in its entirety and grant the Debtors such other and further relief as is just.

Dated: October 22, 2009
Fort Worth, Texas

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Attorneys for Debtors and
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Exhibit A

Email to Mr. William Snyder

From: [William Snyder](#)
To: [Philip Spear](#)
Subject: FW: Pilgrims and Mount Pleasant Independent School District
Date: Tuesday, March 31, 2009 5:39:22 PM

From: Hoeffner, James V. [mailto:JHoeffner@gdhm.com]
Sent: Friday, March 27, 2009 3:38 PM
To: William Snyder
Subject: Pilgrims and Mount Pleasant Independent School District

Dear Mr. Snyder,

Thank you for returning my call yesterday. As you are aware, the undersigned attorney represents Mount Pleasant Independent School District. ("MISD"). I am communicating directly with you per the instructions I received at the first meeting of creditors.

I have reviewed the docket and I have read the order that provides that Pilgrims may pay the ad valorem tax liens through its debtor in possession account. As you are probably aware, MISD has a tax claim that became due on January 31, 2009. Penalty and interest is now accruing on such claim and it is secured by the collateral upon which your dip lender has a junior lien.

Per your message yesterday, you have stated there is approximately \$25,000,000 outstanding on these liens and that your lender is permitting you to pay \$1 million a week on this tax debt. You have further stated that those who waive penalty and interest are paid first.

There are a couple of matters I want to point out.

(a) Your DIP financing has an interest factor that is less than the MISD interest and penalty accrual. It is therefore within the best interest of Pilgrim's reorganization to pay MISD the full interest and penalty now, especially because the penalty and interest will take another jump on April 1. It is not prudent of the debtor to delay further.

(b) MISD is educating the children of Pilgrim's employees. MISD needs the money to pay teachers, fund programs etc. If there is a negative impact upon MISD through delayed payment, how do you suggest that the Board address

its constituency when it is crystal clear that:

- (1) Pilgrims has the lending facility to do so,
- (2) It is within Pilgrim's financial best interest to borrow the money from its lending facility at a cheaper rate, and
- (3) It is within the lending facilities best interest to protect their lien position and immediately take out the advalorem tax lien.

(c) Waiving penalty or interest is a very dangerous precedent for a small district like Mount Pleasant. Everyone will know if Pilgrims gets a break and everyone will start asking for similar breaks. This is a slippery slope for MISD that they best avoid.

My client is inclined to wait this matter out and simply let the interest and penalty accrue. Nevertheless, there are questions I need to ask in order for me to fill my duties:

- (a) If penalty and interest is waived, when does my client receive the check,
- (b) If penalty is waived, when does my client receive the check, and
- (c) If nothing is waived, when does my client receive the check?

I don't know whether you are familiar with people from East Texas or not, but there are some things you should know: East Texas people are team players. They operate out of positions of trust They are loyal and reasonable to a fault. They are the first to give you the shirt off their back.

And they expect others to be the same way with them.

For the benefit of Pilgrims, the children of Pilgrims, and the children of Mount Pleasant, my client respectfully requests that Pilgrims cuts and delivers the check for the full amount of principal, interest, and penalty prior to April 1 and deliver the same.

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TO COMPLY WITH IRS RULES, WE MUST INFORM YOU THAT ANY TAX ADVICE CONTAINED IN THIS MESSAGE (INCLUDING ANY ATTACHMENTS) WAS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF AVOIDING PENALTIES UNDER FEDERAL TAX LAW, OR TO PROMOTE, MARKET OR RECOMMEND TO ANOTHER PARTY ANY TRANSACTION OR MATTER ADDRESSED HEREIN. PLEASE CONTACT US IF YOU HAVE ANY QUESTIONS REGARDING THESE RULES.