Co-operative Failures Hurt: Farmers, Workers, and Members

With the Failures of:

- NORPAC
- Pendleton Grain Growers
- Malin Potato

Now is the Time for Co-Op Reform!

Testimony of Matt Cyrus, president
Oregon Family Farm Association
Senate Committee on Labor & Business
March 9, 2021
Re: SB 468, 469, and amendments reflecting SB 775

OREGON FAMILY FARM ASSOCIATION
For Family Farmers by Family Farmers

Chair Riley and members of the Senate Committee on Labor and Business:

Thank you for holding a public hearing today on SB 468 and SB 469. For the record, I am Matt Cyrus of Cyrus Family Farms. I am speaking today as the president of the Oregon Family Farm Association. OFFA is dedicated to protecting the heritage of Oregon's family farm, helping farmers and educating the public about the health and future of family farming in Oregon.

Our organization asked fellow farmer and State Senator Chuck Thomsen to introduce these bills to begin a conversation in the Oregon Legislature. These proposals are in reaction to the significant financial impact of the recent collapse of several long-time agriculture marketing cooperatives around the state of Oregon.

I have attached two articles that summarize the critical need for agricultural cooperative reform:
1) Article appearing in the Center for the Study of Co-Operatives and the Plunkett Foundation *"When Big Co-ops Fail."*

READ ARTICLE

2) Opinion piece I submitted that appeared in the Capital Press: *"Ag co-ops in crisis – it's finally time for reform."*

READ ARTICLE

We believe that these three legislative concepts are an important start in protecting Oregon family farmers, ag cooperative employees, local communities, unsecured creditors, and other stakeholders of an agricultural cooperative. We also believe that these reforms will strengthen ag cooperatives and empower the members to be better equipped as responsible managers of their farm businesses.

There are others attending today's meeting who will go into a deeper look at these issues and give you additional background. I am available at your convenience to discuss any proposed changes, amendments or suggested improvements to the bills.

Again, thank you to the Chair and this committee for taking the time to consider the consequential issue of Ag Cooperative reform by the Oregon Legislature.

Sincerely,

Matt Cyrus

Oregon Family Farm Association

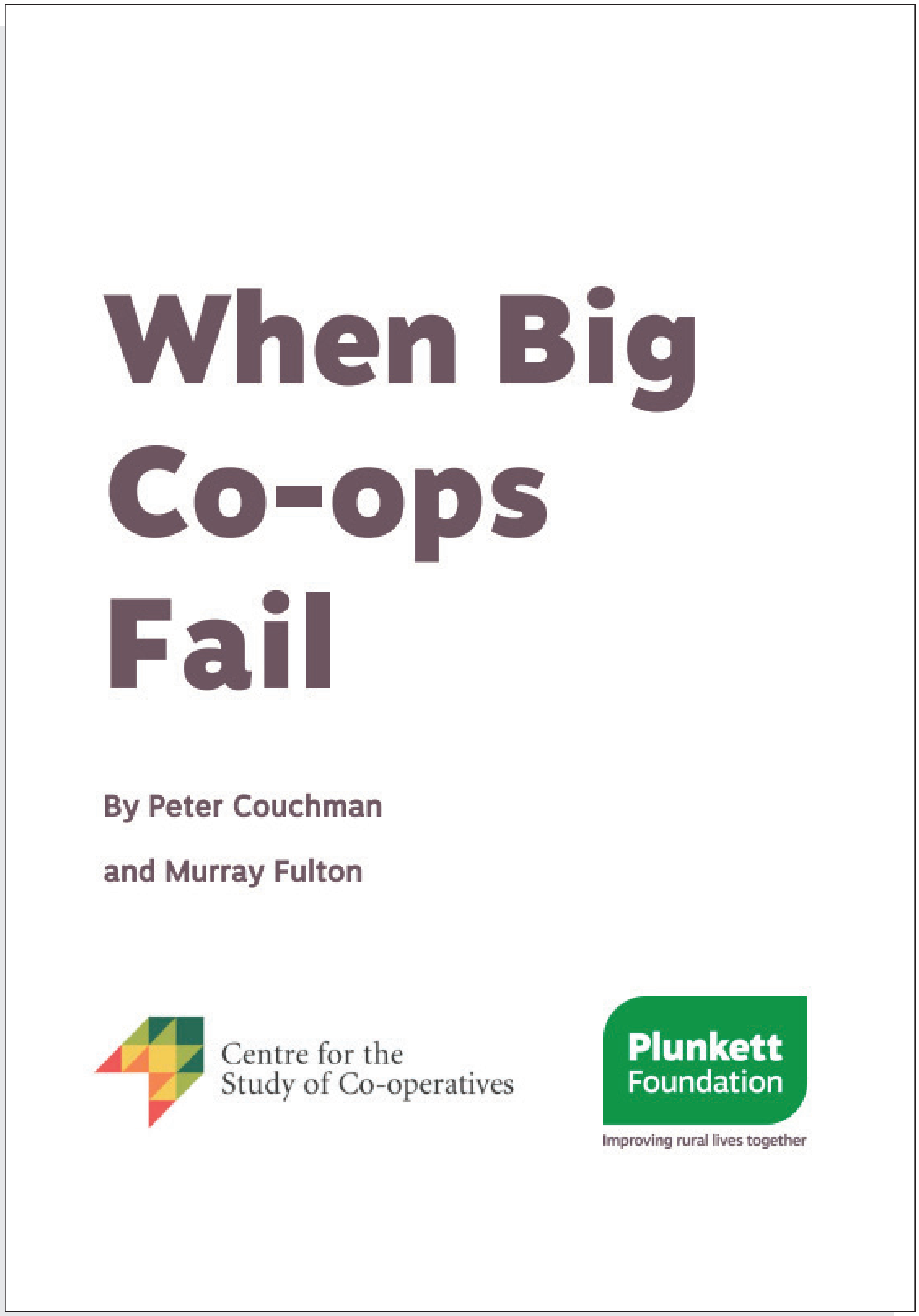
PO Box 23504 · Tigard, Oregon 97281 · OregonFamilyFarm.com · Facebook.com/OregonFamilyFarmer

WHEN BIG CO-OPS FAIL

Executive Summary

The international co-operative movement has been a series of catastrophic failures of large scale co-operatives in recent decades, such as the Saskatchewan Wheat Pool, retail co-ops in Germany, France and Atlantic Canada, banking in Austria and the near meltdown of the Co-operative Group in the UK. Yet our co-operative culture has not been one of seeking to understand the factors which are common in these events, if understood, could be used to prevent such collapses in the future.

READ ARTICLE



When Big Co-ops Fail

By Peter Couchman

and Murray Fulton

Centre for the Study of Co-operatives

Plunkett Foundation

Improving rural lives together

OREGON FAMILY FARMER

The Oregon Family Farm Association has been ahead of these co-operative failures for many years, providing critical insights needed to address potential warning signs through a series called, *"Pay Attention to your Co-Op,"* to help farmers understand the risks and responsibilities of investing in cooperatives. These articles, *Sun Sets on 55-Year Malin Potato Co-Op* and *What Ever Happened to Pendleton Grain Growers*, share real life stories on how the mismanagement of co-operatives has devastated Oregon farmers.

SUN SETS ON 55-YEAR MALIN POTATO CO-OP

SUN SETS ON
55-YEAR POTATO CO-OP

SERIES: PAY ATTENTION TO YOUR CO-OP

WORDS: MITCH LIES • PHOTOS: LYNNPHOTO.COM

The mood was upbeat and confident at the Malin Potato Cooperative in February of 2015. The Merrill, Oregon, agricultural co-op was preparing to open a brand-new, $7 million state-of-the-art potato packing plant. The co-op's members had been convinced the investment would provide a much-needed lift with the promise of high efficiency and new organic markets.

"It's exciting," says Dave Cacka (pronounced "choch-ka"), the co-op's general manager at the time, in a *Klamath Herald and News* story picked up by the national press, including the *Washington Times*. "We're looking forward to getting this operational."

Today, only four years later, with the packing plant shuttered, the co-op disbanded, one of the co-op's eight members in Chapter 11 bankruptcy, and another now farming for someone else, that mood appears only a distant memory.

"Maybe there were some marketing mistakes," says Greg Carleton, a former member of the co-op, who lost his farm. "But it all reverted back to the amount of debt that we were trying to service. The costs of that building were overwhelming."

"It is the age-old story with agriculture: high debt with low prices," says Cacka, who left the co-op's general manager position in 2016 to hand the management to Larry Nixon.

Interestingly, despite the extensive media coverage and fanfare surrounding the opening of the new facility, even the local *Klamath Herald and News* did not cover the closure. Asked why, Editor Gerry O'Brien says, "That is a good question. We are pretty strapped for time here and some stuff might have slipped through the cracks."

Local and agricultural media rarely investigate these failures or report on co-op collapses. As a result, farmers never see the whole story or have a chance to evaluate and understand the risks and responsibilities of co-op ownership.

Coming just two years after the dissolution of the 87-year-old Pendleton Grain Growers (PGG) cooperative, the closure of the 55-year-old Malin co-op provides yet another cautionary tale for agricultural cooperatives. PGG's closure came after its grower-members invested in constructing a large grain storage facility at the Port of Umatilla. (Read "Whatever Happened to Pendleton Grain Growers" at www.oregonfamilyfarm.com.)

Going back further, Agripac, once a 200-plus-member farmer-owned cooperative based in Salem, declared bankruptcy and closed plants in the Willamette Valley in 1999, just three years after purchasing 350,000 square feet of frozen vegetable processing plants in Walla Walla and Grandview, Washington. Added to the purchases, the 80-plus-year-old co-op in 1996 completed the construction of 21,000 square feet of office and warehouse flex space in Salem.

Effects of the plant closures reverberated through the local farming industries.

"The closing of Agripac had a huge impact on food crop production," retired Oregon State University Extension agent Mark Mellbye, who at the time was working field crops in the Willamette Valley, told the Eugene *Register Guard* ("A Growing Advantage," Jan. 19, 2008). "Farmers say it was the biggest impact on their lives since the Great Depression. It just devastated the economic viability of a lot of those farms."

Nationally, other examples follow suit, including that of Farmland Industries, once the nation's largest and most successful farmer-owned co-op, when management decided to open a new headquarters in Kansas City in 2001, with deluxe executive suites in a glass-wrapped building, only to file for bankruptcy in 2002.

In the case of the Malin Potato Cooperative, the decline of potato acreage in the Klamath Basin is named as a contributing factor.

continued on next page...

The sun setting at the Malin railway line.

36 Oregon Family Farmer Spring 2019 · Oregon Family Farmer Spring 2019 37

READ ARTICLE

WHAT EVER HAPPENED TO PENDLETON GRAIN GROWERS?

WHAT EVER HAPPENED TO
PENDLETON
GRAIN GROWERS?

PAY ATTENTION TO YOUR CO-OP

WORDS: ERIC FRUITS, PH.D.

Eric Fruits, Ph.D. is chief economist and president at Economics International Corp. and an adjunct professor at Portland State University.

Farmland Industries was once the largest farmer-owned co-op in the United States. In 2001, it opened a new headquarters in Kansas City. The glass-wrapped building and deluxe executive suites told the world that Farmland had become an agribusiness giant. At the time, the co-op was racking up debt—building a big expensive fertilizer plant, upgrading older fertilizer plants, and spending nearly $100 million on new computer software. In 2002, Farmland filed for bankruptcy. By 2004, its last big asset had been sold off.

Closer to home, in 2011, Pendleton Grain Growers opened a large grain storage facility at the Port of Umatilla. However, audits revealed that during this period the co-op had actually overstated its earnings by $1.8 million in 2010 and $5.7 million in 2011.

In 2012 the U.S. Department of Agriculture suspended PGG's warehouse license for 44 days, citing inventory audit discrepancies. While PGG eked out a profit of $434,681 in 2012, financial statements show the co-op lost approximately $4.4 million in 2013 and $7.9 million in 2014. In 2016, the co-op's members voted to dissolve PGG after 86 years in business. The co-op's 1,850 members will have to wait years to see any dividends from the sale of PGG's assets, if any. Two years later, PGG is still in the process of selling off its assets.

continued on next page...

20 OregonFamilyFarmer.com Fall 2018 · OregonFamilyFarmer.com Fall 2018 21

READ ARTICLE

NORPAC

NORPAC accused of overstating inventory by $7 million

Complaint alleges problematic bulk product mis-classified

By MATEUSZ PERKOWSKI
Capital Press

The bankrupt NORPAC cooperative is accused of overstating the value of its bulk inventory by $7 million in an asset sale to farm entrepreneur Frank Tiegs.

National Frozen Foods, a company owned by Tiegs, has filed a lawsuit seeking to recover the alleged $7 million overpayment from NORPAC as part of the food processor's bankruptcy proceedings.

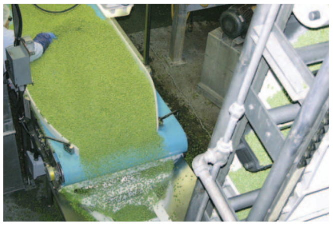
In December, Tiegs prevailed in an auction against the J.R. Simplot Co. to buy NORPAC's facility in Quincy, Wash., as well as associated assets and products, for up to $107 million.

The deal included $21.5 million for the facility, equipment, intellectual property and other assets, as well as $77.6 million to $85.6 million for bulk inventory, depending on the amount remaining when the sale closed.

According to Tiegs' complaint, the price of the bulk inventory was supposed to exclude "hold products" that cannot be sold "as is" due to potential problems with quality or food safety.

For example, "hold products" included foods that were contaminated, that contained excessive stalks, that became too hot during processing or that hadn't gone through metal detection, among other reasons.

The complaint alleges that NORPAC mis-classified about 19.7 million pounds of "hold product" that should have been excluded from the bulk inventory price, which came to light after "a thorough and detailed inspection



Capital Press File
Frozen peas head to the bagging machines at NORPAC Foods in Salem.

and analysis of the inventory" conducted after the sale.

The bankrupt farm cooperative has "refused to reimburse" the shortfall, so Tiegs is asking the bankruptcy court to deduct the alleged $7 million overpayment from a $10 million invoice for NORPAC's finished goods inventory, which he bought in a related transaction.

"Debtor breached its representations and warranties that all inventory would be merchantable and fit for its intended purpose, that it would be of marketable grade, and that it would conform to applicable customer agreements," the complaint said.

Albert Kennedy, NORPAC's attorney, said the company will respond to the complaint in due course but it's "not going to have a material impact on the winding up and administration of the estate."

All of NORPAC's assets have been sold and now the bankruptcy court is deciding the how to disburse the proceeds among the cooperative's creditors, which will likely take several months, Kennedy said.

Multiple farms have filed liens against NORPAC seeking repayment for crops, but as a general proposition, Oregon law doesn't provide lien rights to member-owners supplying their own cooperative, he said.

"That is one of the issues the court will have to work out," Kennedy said.

When NORPAC filed for Chapter 11 bankruptcy protection last year, the cooperative claimed to own $315 million worth of assets. The company reported $165 million worth of debts, with about 75% of that amount owed to Cobank, a major agricultural lender.

Aside from the Quincy facility and assets, NORPAC also sold its three processing facilities in Oregon's Willamette Valley — in Brooks, Salem and Stayton — for $49 million to Lineage Logistics, a cold storage company.

Tiegs has since bought the Brooks facility from Lineage, where he plans to continue processing fruits and vegetables as well as farming on 1,000 surrounding acres.

He also plans to farm about 600 acres purchased along with the Stayton facility, from which he's removed the most valuable processing equipment and is currently using for storage.

"I'm still debating what to do with it," Tiegs said of his long-term plans for the Stayton building.

READ ARTICLE

NORPAC: Former officers, directors may face lawsuits

By MATEUSZ PERKOWSKI
Capital Press

NORPAC
Executives and board members of the formers NORPAC cooperative may face lawsuits for financial mismanagement, according to a recently proposed bankruptcy plan.

The former NORPAC cooperative is raising the possibility of former executives and board members facing lawsuits for financially mismanaging the bankrupt food processor.

In a disclosure statement explaining the newest version of its bankruptcy plan, the cooperative said "former officers and directors" may be liable for "breach of fiduciary duty and similar causes of action."

Specifically, the cooperative said officers and directors could face claims of making payments to member farms that were "inconsistent" with NORPAC's "organizational documents" and "historical payment practices."

Former officers and directors may also be subject to allegations they failed to "properly monitor and maintain adequate inventory tracking, reporting and control systems" for the cooperative's business operations, the proposed plan said.

The amount of money that could be recovered from former executives and board members "is unknown at this time," the plan said.

While NORPAC's officers and directors may not seek to recover such funds themselves, U.S. bankruptcy law allows creditors to obtain "derivative standing" to file complaints on the behalf of a bankrupt company.

For example, a committee representing unsecured creditors has asked a bankruptcy judge for permission to file a complaint on NORPAC's behalf to "claw back" at least $5.3 million in past crop payments to member farms.

That claim may be dropped under a proposed settlement agreement that would resolve disputes between NORPAC,

See NORPAC, Page 11

READ ARTICLE

NORPAC sues farmers who demand crop payments

By MATEUSZ PERKOWSKI
Capital Press

Capital Press File
Workers at NORPAC Foods prepare onions for processing. The cooperative, now known as North Pacific Canners & Packers, has filed a lawsuit against farmers who demand crop payments.

The former NORPAC cooperative is suing several of its own growers because they're demanding to be paid for crops, thus delaying the processor's liquidation plan.

The company has filed a complaint asking a bankruptcy judge to declare that 10 member farms aren't entitled to any payment for crops delivered in 2019 from the $40 million that it plans to disburse to other creditors.

Since last year, the 10 defendants have filed bankruptcy claims against NORPAC — which is now called North Pacific Canners & Packers — alleging the processor owes them collectively nearly $13 million.

That amount includes earnings that were retained by NORPAC instead of being paid out to farmers, who instead increased their ownership in the cooperative.

In bankruptcy proceedings, owners are the last in line for repayment and often don't receive any money for their equity when a liquidated company's debts exceed its assets.

However, the defendants in this case claim to be owed $2.3 million for last year's corn, bean, cauliflower and broccoli crops, which are secured with agricultural liens that typically have top priority for repayment in bankruptcy.

In its lawsuit, the cooperative argues these claims should be "set to $0" because member farms are subordinate to all other debt holders under NORPAC's articles of incorporation.

The defendants are effectively seeking repayment of "unpaid crop proceeds," but due to the company's net losses, their earnings are "less than zero" and thus their claims are worth nothing, according to the cooperative.

Member farms cannot file agricultural liens against their own cooperative under Oregon law and under the terms of their contracts with NORPAC, the complaint said.

Agricultural liens are only valid when crops are sold to a "purchaser" under Oregon law, which doesn't include the cooperative to which a farmer belongs, the complaint said.

The liens filed by the farms have violated their contracts with NORPAC, causing "uncertainty and confusion" regarding the cooperative's liquidation plan and forcing it to spend additional money to resolve the dispute, the complaint said.

If the cooperative prevails in the lawsuit, the defendants will also be liable for the company's litigation costs under the terms of their contracts, the complaint said.

The complaint against these first 10 defendants should be considered a "test case" that will provide legal guidance for claims filed by other member farms against NORPAC, according to the cooperative.

Mark Comstock, an attorney for several of the defendants, said the farms do not believe the legal issues to be as "cut and dry" as alleged by the processor's attorneys.

"We're looking to see how we can maximize any recovery for growers who supplied NORPAC," he said.

A key legal point that must be decided is whether the Oregon law that prohibits its growers from filing agricultural liens against their own cooperative still applied to NORPAC after it filed for bankruptcy in August 2019, Comstock said.

At that point, the processor became a debtor-in-possession and was no longer covered by that statute, he said. "It's no longer a cooperative, technically, and that's what we want a bankruptcy judge to decide."

Payments owed for crops delivered to the processor within 20 days immediately before its bankruptcy filing are also entitled to be treated as administrative claims, which receive a higher priority for repayment than general unsecured claims, Comstock said.

Aside from the lawsuit against these growers, the cooperative has also recently submitted its liquidation plan to the bankruptcy court under which the farmer-owners will receive no distribution of remaining funds.

After selling substantially all of NORPAC's assets, including four processing facilities in Oregon and Washington, the cooperative has paid off CoBank — its biggest lender — with about $115 million of the proceeds.

The company has also substantially paid off all other creditors who had claims secured with collateral, including non-member farmers who were protected by the Perishable Agricultural Commodities Act, the plan said.

That's left the cooperative with roughly $40 million, consisting mostly of cash and accounts receivable for sold goods, which will be distributed among unsecured creditors, according to the plan.

NORPAC's largest unsecured creditors include companies that provide packaging and cold storage services, as well as other food processors.

Under the liquidation plan, these and other "convenience class" unsecured creditors with claims over $10,000 will receive 50 percent of the money they're owed, while the remaining funds will be split up proportionally among general unsecured creditors.

These general unsecured creditors can expect to recover 30 percent to 45 percent of their claims under the current version of the liquidation plan.

However, member farms are seeking $16 million to $18 million in payment for crops, while NORPAC is also accused of inflating the price of bulk goods it sold to the National Frozen Foods Corp. by $7 million.

If the cooperative loses these lawsuits, general unsecured creditors may only recover 10 percent to 20 percent of the money they're owed, according to the plan.

READ ARTICLE

NORPAC creditors seek $5M claw back from farmers

By MATEUSZ PERKOWSKI
Capital Press

Creditors of the former NORPAC cooperative want to "claw back" nearly $5.3 million from farmers for crop payments and seed they've already received from the bankrupt processor.

A committee representing unsecured creditors — who don't have collateral for loans to NORPAC — argues the crop payments were "fraudulent transfers" the farmers must return under bankruptcy law.

Recovering the $5.3 million on behalf of the cooperative would benefit the unsecured creditors, who currently stand to be repaid only 10% to 45% of the money they're owed by NORPAC. Under bankruptcy law, money from debtors can be "clawed back" if it's paid out improperly.

Earlier this year, the former NORPAC cooperative, now called North Pacific Canners & Packers, filed a lawsuit against 10 farm members seeking a declaration that they were owed no additional payments for 2019 crops beyond advances for harvesting and hauling expenses.

Now, the unsecured creditors want to file another complaint seeking to recover additional funds that were already received by those same 10 growers, with the lawsuit serving as a test case.

However, the litigation may have additional repercussions for all of NORPAC's 140 grower-owners.

The unsecured creditors allege that NORPAC

NORPAC Foods
Creditors of the former NORPAC cooperative seek to "claw back" more than $5.3 million from farmers.

growers were paid cash for crops in 2018 and 2019 even though the cooperative was insolvent and had sustained a net economic loss from processing and selling those vegetables.

NORPAC's bylaws required the cooperative to reduce cash payments to farmers during money-losing years and instead compensate them more with patronage retains, or ownership in the cooperative, according to a court document filed by unsecured creditors.

Despite sustaining heavy losses in 2018 and 2019, NORPAC made cash payments to the defendant growers that exceeded what they

See NORPAC, Page 12

READ ARTICLE

PENDLETON GRAIN GROWERS

PENDLETON GRAIN GROWERS REPORTS LOSS OF $7.9 MILLION IN 2014

READ ARTICLE

PENDLETON GRAIN GROWERS CUTS ITS LOSSES, NARROWS ITS FOCUS

READ ARTICLE

PENDLETON DISSOLUTION BRINGS END OF PGG

READ ARTICLE

AGRIPAC

New Plants Fit Agripac Expansion Plan like Peas in a Pod

READ ARTICLE

Pro-Fac Faces Farmers' Lawsuit Over Alleged Accounting Fraud

READ ARTICLE

TRI-VALLEY

Tri Valley Growers Files for Bankruptcy

READ ARTICLE

Tri Valley CEO: Feud with Can Supplier Led to Chapter 11

READ ARTICLE

Tri Valley Growers Sold Off in Pieces / Del Monte to Buy S&W, Big Creditor's New Company Acquires Bulk of Co-

READ ARTICLE

DIAMOND

Could You Have Predicted Diamond Foods Accounting Fraud?

READ ARTICLE

Diamond Foods: When Accounting Goes Wrong

READ ARTICLE

Diamond Foods ex-CEO Resigns and Will Pay $2.7M Clawback

READ ARTICLE