

Creamery's unsecured creditors to begin own fraud investigation

Possible \$30 million owed by creamery on top of \$55 million in secured bank debt

An agreement was reached in federal bankruptcy court Wednesday morning that will allow attorneys for Humboldt Creamery unsecured creditors to begin their own investigation into potential fraud at the 80-year-old cooperative.

The investigation is necessary, according to documents filed by the creditors committee lawyer, because of future possible fraud claims and legal actions that may produce revenue to pay back the unsecured creditors.

Judge Alan Jaroslovsky held a status conference of Humboldt Creamery's bankruptcy proceedings at the Eureka federal building on Wednesday morning. Creamery executives, some dairymen and lawyers for the secured creditor, CoBank, the creamery association and the creamery LLC were present, along with the attorney representing the unsecured creditors.

Attorney John Fiero filed an objection with the court, stating that the emergency

debtor in possession financing didn't fairly "carve-out" funds for the unsecured creditors committee to do its own investigation. Fiero stated that only \$10,000 was allowed for an investigation compared to the debtor's "professionals" carve-out of more than \$800,000.

"The level of prior fraud appears to be astronomical," states the objection. "Perhaps most glaring, the debtor's inventory required an adjustment from approximately \$38 million to \$7.5 million. The debtor's

accounts receivable required a 50 percent write down, and the debtor's accounts payable required an upward adjustment from approximately \$7 million to \$23 million. These are dramatic changes that could not (or should not) have been missed by the debtor or the association. Instead, it appears that responsible parties, at best, turned a blind eye to such rampant fraud, and, at worst, were culpable in the wrongful conduct."

The objection states that the unsecured creditors are

concerned that the creamery will be sold, the banks will take the proceeds and the company will move into Chapter 7. It called the reorganization strategy a "glorified foreclosure."

Agreement was reached, however, between attorneys Wednesday morning that the funds available for "professionals" will be equally shared when or if the creamery is sold.

Meanwhile, the creamery submitted a revised operating budget Wednesday for the summer months and the final court

approval of a \$3 million debtor in possession loan was expected late Wednesday afternoon.

Creamery officials have said that the results of its forensic accounting investigation have been completed at the cost of \$100,000, but that only an oral report was given to directors. Board Member Dennis Leonardi explained that attorney-client privilege was the reason for an oral report.

Another status conference will be held in Santa Rosa on September 4.