

AgFeed Shareholders Blame Hormel For Ch. 11

By **Matt Chiappardi**

Law360, Wilmington (October 30, 2014, 1:58 PM ET) -- The equity committee for bankrupt AgFeed Industries Inc. launched an adversary action Wednesday alleging ex-business partner Hormel Foods Corp. made "false representations" and knew about claims it had asserted against the hog production company that led to an arbitration award that the debtor says ultimately pushed it into Chapter 11.

In an adversary suit filed in the Delaware bankruptcy court, the equity committee alleges Hormel made false statements in communications with AgFeed, then headquartered in China, that induced it to purchase prominent hog grower M2P2 LLC in 2010 and expand its operations into the United States.

Hormel said M2P2 or its subsidiaries had not breached its agreement to raise and supply pigs to the company but later turned around and pressed claims that it had in an arbitration proceeding against AgFeed, the equity committee claims.

In 2013, an arbitrator found partially in favor of both parties, resulting in a nearly \$8 million award to Hormel when fees were taken into account, but the payment was an event of default on AgFeed's \$68.5 million credit facility from Farm Credit Services of America that the debtor has cited as one of the prime reasons for its bankruptcy filing in July of that year, according to court records.

"By proceeding with the acquisition in reasonable reliance on Hormel's false representations, debtor incurred substantial damages and was ultimately forced, along with the AgFeed entities, to seek relief under Chapter 11," the adversary action states. "Debtor was justified in proceeding with the acquisition in reliance upon Hormel's false representations and behaved reasonably in doing so, but was nevertheless deceived by such false representations."

The equity committee is pressing both misrepresentation and breach-of-contract claims and seeking damages to be determined at trial.

It also objected, in a separate filing, to a \$2.8 million claim by Hormel in the case connected to an unsecured note, arguing that the amount owed to the food giant will be more than offset by the damage award that would arise out of the adversary action.

A representative for Hormel called the equity committee's claims "baseless" in a brief emailed statement Thursday.

"Hormel Foods will vigorously defend these baseless claims," the statement read.

The issue stems over the deal that brought AgFeed, founded in 1995 as an agricultural feed producer in China, into the U.S. market to grow into a business that yielded nearly \$250 million in gross revenues in 2012, according to court records.

When AgFeed bought M2P2 and several affiliates, which it rebranded as AgFeed USA, the target was already under a contract to buy young pigs from Hormel and raise and supply them to Hormel's processing facilities, court records state.

Before the sale was completed, Hormel sent a letter that stated "To Hormel's knowledge none of the M2P2 entities have violated, breached, or defaulted any term or provision' of specified agreements," the complaint states. Nonetheless, about two years later, Hormel initiated arbitration against M2P2, now owned by AgFeed, alleging it had improperly overstated costs incurred raising the pigs, according to the complaint.

AgFeed filed a counterclaim alleging Hormel supplied its subsidiaries with unhealthy hogs and failed to timely make certain payments, but the net \$6.2 million arbitration award Hormel won, plus certain costs and fees, set in motion a series of events that forced the debtor into bankruptcy, the equity committee claims. The committee says that information came to light during the arbitration that Hormel already knew about and apparently accepted the alleged activity for several years that it later pressed after the M2P2 deal closed.

If Hormel hadn't sent the letter misrepresenting M2P2's compliance with the agreement, AgFeed either wouldn't have gone ahead with the deal or would have corrected the target's accounting practices to avoid further liability, the complaint states.

Moreover, Hormel made a second arbitration demand immediately after the favorable ruling in the first, and AgFeed was forced to settle in a deal that "dramatically reduced" the debtor's value, something the equity committee argues wouldn't have happened if not for Hormel's original representations.

Meanwhile, AgFeed was originally scheduled for a Oct. 27 confirmation hearing on its Chapter 11 plan, which would mostly divvy up proceeds from the debtors' two bankruptcy sales, but that proceeding was pushed back to next week.

Some of its former top executives had objected to the plan on the grounds it didn't provide them with enough funds to indemnify them against anticipated litigation connected to an \$18 million settlement with the U.S. Securities and Exchange Commission over alleged accounting fraud, according to court records.

In a proposed settlement filed late Wednesday, AgFeed, subject to confirmation of its plan, will pay the certain former brass \$280,000 to be divided among them, the debtor said in a court filing. In exchange, the executives will withdraw their opposition to the plan and cast new ballots supporting it, and the parties will mutually release each other from future liability, according to the debtor's motion.

U.S. Bankruptcy Judge Brendan L. Shannon is set to consider the settlement at a hearing in Delaware on Monday.

The equity committee is represented by Rafael X. Zahralddin-Aravena and Eric M. Suttly of Elliott Greenleaf as well as Aaron L. Hammer and Mark S. Melickian of Sugar Felsenthal Grais & Hammer LLP.

AgFeed is represented by Robert S. Brady, Donald J. Bowman Jr., Ian J. Bambrick, Ashley E. Markow and Elizabeth S. Justison of Young Conaway Stargatt & Taylor LLP.

Counsel information for Hormel was not immediately available Thursday.

The adversary action is The Official Committee of Equity Security Holders v. Hormel Foods Corp., case number 1:14-ap-50942, in the U.S. Bankruptcy Court for the District of Delaware.

The bankruptcy case is In re: AgFeed USA LLC et al., case number 1:13-bk-11761, in the same venue.

--Additional reporting by Stewart Bishop, Jamie Santo and Jeff Sistrunk. Editing by Christine Chun.