

## DFA's Woes Mount:

# Losses, Payoff, Pending Indictment(s), Financial Downgrade:

by Pete Hardin

Anybody want Rick Smith's job?

When Smith replaced Gary Hanman as CEO/President of Dairy Farmers of America (DFA), *The Milkweed* offered the wisdom that Smith's legal expertise would come in handy. And how!

A long list of bad news has been piling up on DFA's doorstep in recent months:

\* In March 2008, DFA announced losses of \$109 million for its 2007 fiscal year. That loss was the biggest loss ever reported by a U.S. dairy cooperative.

\* On May 9, 2008, DFA announced a secret, \$1 million payment by Hanman to former board chair-

### DFA-related News Articles Posted on *The Milkweed's* Web site

The flurry of news about DFA is so hot that *The Milkweed* has created a special section of its Web site where interested persons can access those articles. Just go to our Web site at:

[www.themilkweed.com](http://www.themilkweed.com)

Click on the "DFA Antitrust Update" headline near the top of the home page.

## IRS Found \$1 Million Payment to Brubaker!

Statements by Dairy Farmers of America's leadership regarding the illegal, secret, \$1 million payment to former board chairman Herman Brubaker implied, inaccurately, that DFA came across that payment while doing audits involving other matters.

That's not quite accurate. According to *The Milkweed's* sources, a disgruntled employee at DFA tipped off the Internal Revenue Service of the illegal payment by DFA's National Dairy Holdings subsidiary. IRS investigators unearthed the illegal payment, with no special assistance from DFA, sources say.

The IRS is into the fourth year of an audit of DFA's 2001-2004 financial records. If the \$1 million payment to Brubaker is any reflection of "business as usual" at DFA (and subsidiaries), then look out.

## Brubaker Also Paid Off by Dairy Promotion Group

Recent word of the secret, \$1 million payment by Dairy Farmers of America to its former board chairman, Herman Brubaker, brought a flurry of phone calls to *The Milkweed*, reminding of a liberal "personal consulting agreement" received by Mr. Brubaker from Dairy Management, Inc. (DMI) when he retired as chairman of that board about four years ago.

Seems that Brubaker wangled a \$100,000 payment as a three-year, personal consulting contract from DMI when he retired as DMI's board chairman. No dairy producer prior, nor since, has cut such a deal. Details were scarce.

After one year, enough DMI directors raised a stink about Brubaker's special consulting deal that DMI cancelled it. Word was that Brubaker actually received only about one-third of the total amount of the contract.

Brubaker served simultaneously as DFA's board chairman and DMI's board chairman for several years. At DMI, a large number of programs seemed to benefit DFA and its "friends." During that time, the USDA Secretary of Agriculture's political appointments of producers to the National Dairy Board seemed unduly weighted towards those with DFA connections.

Soon after Brubaker's \$1 million secret payment from DFA became public, DMI CEO Thomas Gallagher sent out an e-mail to the dairy promotion community, assuring everything regarding Brubaker's consulting fee was on the up-and-up and had been approved by USDA as a normal course of business. "Business as usual" ... in dairy co-op and national dairy promotion circles!

man Herman Brubaker. Hanman ran DFA like a corner candy store ... and questions about whose hands were in the candy jar are now coming forward.

\* On May 19, 2008, *The Wall Street Journal* reported that DFA will soon be indicted for alleged cash Cheddar price manipulations at the Chicago Mercantile Exchange. (Privately, *The Milkweed* is hearing that investigators at the Commodities Futures Trading Commission "want blood" to flow from the pending DFA indictments.)

\* On May 21, *The Kansas City Star* reported that Standard & Poor's - one of the main companies that rates borrowers' ability to repay debts - announced that DFA's financial ratings were under review with likely negative consequences. In other words: look for a downgrade of DFA's financial ratings.

Never before has a firm in the dairy industry taken such an array of hard hits. And the hits just

keep on coming ...

These recent events come atop continuing problems at DFA, including:

\* Being named in two major class action lawsuits (with Dean Foods, among others) involving coercion of milk markets in the Southeast.

\* Trying to get on top of massive losses at the National Dairy Holdings fluid milk subsidiary. NDH lost \$134 million in 2007, including \$63.5 million in last year's fourth quarter. DFA was forced to buy out some co-investors in NDH in late 2007. Because DFA took majority control of NDH, NDH's horrid financial results were unveiled in DFA's 2007 financial audit.

The confluence of these events ... and others ... may cause DFA to fall apart financially. To cover its massive debts, DFA's lenders have as collateral the money that remains outstanding for milk checks paid awaited by DFA's members.

## DFA: Physically Fit HQ Employees, If Not Fiscally Fit

Which comes first - physically-fit, happy employees at corporate headquarters ... or the fiscally-fit dairy cooperative? Evidently Dairy Farmers of America's CEO/President Rick Smith would rather view healthy bottoms than a healthy bottom line.

Never mind DFA's \$109 million loss in 2007. Word from Kansas City is that on April 29, 2008, DFA opened a new "fitness center" at the co-op's headquarters. Opening day for the facility was May 1. Costs are unknown.

A brochure, circulated to employees about these events invited them all to attend the "ribbon cutting" (4:00-6:00 p.m. on April 29), proclaimed:

"The Fitness Center is free and open to all DFA employees who have signed a waiver. Waivers will be available at the open house."

Word from inside DFA's headquarters is that Rick Smith is big on "good times" with employees, a carry-over from his days heading up Dairylea Co-op in Syracuse, New York. Smith is fond of "recess" days at DFA's headquarters, where employees shirk work at their desks in favor of playing games, enjoying free food, wine and beer in the parking lot.

Apparently, Smith is paying attention to the wrong "bottom lines," if his recent claims about DFA's financial soundness may be believed.

## DFA Legal Updates:

### ANTITRUST CASES: Plaintiffs' Lawyers Score Wins

Events have been moving slowly, but they're perking up in the pair of private antitrust cases filed by groups of dairy producers in the Southeast against DFA and Dean Foods.

The initial complaints were filed by Howrey, LLP in July 2007. Howrey is the nation's largest antitrust law firm, but seldom plays "offense" in such matters. A handful of "copycat" lawsuits were also filed in the Southeast ... with some other firms' filings mimicking the Howrey complaint right down to the typographical errors.

During the fall and early winter months, consolidation of these related cases was shifted to the federal court for the Eastern District of Tennessee. During that time, agreements were worked out among lawyers for various plaintiffs that saw the Howrey firm cede a number of case management functions to other firms.

Plaintiffs' attorneys won major victories in late May in decisions issued by federal judge J. Ronnie Greer:

**1) Plaintiff's request for discovery may proceed.** Judge Greer concurred with plaintiffs' attorneys' request for discovery (requesting documents and records). The various defendants' lawyers had denied the validity of the complaints against their clients and fought against discovery. Judge Greer ordered: "... discovery should proceed as provided for in the Court's case management and scheduling order."

This order is a strategic blow to defendants DFA and Dean Foods, because plaintiffs' lawyers

are requesting all documents turned over by that pair to the Antitrust Division of the U.S. Department of Justice during that agency's multi-year probe of dairy!!!

**2) National Dairy Holdings (NDH) must face plaintiffs in federal court in Tennessee.** DFA subsidiary NDH must answer to plaintiffs' charges in federal court in Tennessee, Judge Greer also ruled in May. NDH attorneys had argued that Tennessee was not the proper venue. Obviously, a firm that lost \$134 million last year (as did NDH) may not be able to afford the best legal cannons. Judge Greer chewed up NDH's attorneys' logic, noting:

"That NDH uses subsidiaries to fulfill *its* contractual obligations is irrelevant and the Position of NDH in this regard is almost nonsensical. It defies logic to conclude that NDH can itself contract for the purchase of milk and the sale of dairy products in the State of Tennessee and then avoid an exercise of jurisdiction by the Tennessee courts by using wholly owned subsidiaries to fulfill its contractual obligations."

Judge Greer chewed up NDH's Executive Vice President and Chief Financial Officer even worse, writing in footnote 1: "... the affidavit of Kathy Turner, presented incomplete and misleading information. This Court finds Turner's lack of personal knowledge regarding the full extent of NDH's contacts with Tennessee, as established by the transcript of her Rule 30(b)(6) deposition, disturbing."

## DFA Hires Outside Counsel to Investigate DFA\*

As part of Dairy Farmers of America's internal review of the secret, \$1 million payment to former board chairman Herman Brubaker, the cooperative has hired an outside counsel to assist board and management.

The outside counsel is provided by the law firm of Bryan Cave, LLP - a nationally recognized heavy-hitter in such matters.

Ironically, Bryan Cave gained experience in the Enron financial failure. That experience should

be valuable as the firm digs into DFA!

No word on which three DFA corporate directors have been appointed to the special committee to investigate Brubaker's payment and other possible wrongdoings at DFA. Relative silence from DFA on the wide range of damaging revelations in recent months indicates that CEO/President Rick Smith is enforcing a code of silence (or else!)

**\*Firm has Enron experience.**