

[ELECTRONICALLY FILED]

**COMMONWEALTH OF KENTUCKY
FAYETTE CIRCUIT COURT
FOURTH DIVISION
CIVIL ACTION NO. 20-CI-00332**

**HAYNES PROPERTIES, LLC,
MITCH AND SCOTT HAYNES DBA
ALVIN HAYNES & SONS,
S&GF MANAGEMENT, LLC, ON BEHALF
OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED**

PLAINTIFFS

V. ASSOCIATION’S PRE-HEARING BRIEF ON CERTAIN QUESTIONS

**BURLEY TOBACCO GROWERS COOPERATIVE
ASSOCIATION**

DEFENDANTS

AND

**GREG CRADDOCK,
ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED**

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The Court has raised certain questions to determine the proper course and direction of this action, including whether is any relationship between the current case and the prior Curtis Congleton, et al. v. Burley Tobacco Growers Cooperative Association, et al. case that was litigated in this division, Case No. 06-CI-0069 from 2006 through early 2015, and other subjects. On behalf of the Burley Tobacco Growers Cooperative Association (the “Association”), this briefing will address (1) Congleton and its holdings, including but not limited to whether “old members” who ceased production of burley tobacco and took the federal tobacco buyout payments in addition to their distributions of the FETRA net proceeds have any claim to a share

of the present net assets of the Association if dissolved, whether Congleton kept open any matters for future resolution, and whether this action involves only “new claims;” (2) the justification for judicial dissolution of the Association, recommended by its Board of Directors as part of the mediated partial settlement; and (3) the basis or rationale for the proposed definition of the “Settlement Class.” There can be no debate that members of the Association have equal property rights. That principle was declared in the Articles of Incorporation for the Association in 1922, Item Six, and is stated in several sections of KRS Chapter 272 as well.

Discussion of other class action questions will be left to the Named Plaintiffs and Defendant Gregory Craddock and their counsel. The Association does favor class action treatment for this partial settlement, as opposed to a less structured “common-fund” approach under KRS 412.070, because of the need for complete and binding finality upon over 3,000 present and past members, and as the most effective means to fulfill the Association’s indemnification responsibilities (with advancement of defense cost) to its present and past directors, officers and employees, and to expedite dissolution and make distributions to its members. The class action vehicle provides robust notice, opportunity for objections, and a hearing process that would make the partial settlement and any remaining settlement or adjudication binding upon all Association members, and would avoid the risk and expense of multiple lawsuits against the Association and/or its directors and officers, unlike a common fund proceeding. (Of course, the Association disputes there is any merit to existing or threatened claims of breach of fiduciary duties to its members, but we will reserve that battle for another day.) If desired, the Association can explain its existing statutory and contractual indemnification responsibilities and the benefit of the “Forbearance Covenant” in the proposed partial settlement, at the July 29 hearing or by separate short briefing.

I. The Instant Action is Not a Continuation of the Congleton Case, and Former members of the Association Who Have Ceased Being Engaged in the Production or Marketing of Burley Tobacco Before 2015 No Longer Have Automatic Membership Rights in the Association.

The Association did not write any of the Complaints filed herein that refer to the prior litigation in Congleton. However, the Association's short answer to the Court's first inquiry is No, this action is not and should not be a continuation of Congleton. The Corrected Third Amended Complaint in this 2020 action makes new claims, all arising within the last five years, Congleton was originally filed in 2004 in Fayette District Court, and after transfer to Circuit Court and Amended Complaints was filed, cross-motions for summary judgment were briefed thoroughly by the parties. Judge Goodwine only ruled in favor of the Congleton plaintiffs on one count (but the biggest), compelling distribution of all net FETRA Tobacco Sale Proceeds to all present and former members of the Association as of 2002-2004 (in excess of 190,000 persons and entities). See March 15, 2007 Opinion & Judgment on FETRA Tobacco and Sale Proceeds.

The Court expressly dismissed another count seeking to certify a class of "1982 Participation Certificate Holders" who asserted pro rata claims to a separate \$25 million, the net profits from the redemption and sale of the 1982 loan pool stocks to RJ Reynolds Tobacco, a sale outside the ordinary course of business approved by the U.S. Department of Agriculture in the early 1990's. The Court ruled that the \$25 million could be retained by the Association and used for its continuing operations. See March 13, 2007 Opinion & Order on Contract claim. This money is still part of the present assets of the Association, and was designated by Board resolution after Congleton was settled as a "reserve for credit and commercial purposes." The money is invested at Wells Fargo Bank, and secures the Association's line of credit that has funded its purchases of burley tobacco from members since 2014. This \$25 million is clearly outside of Congleton's reach.

Claims for breach of fiduciary duties asserted against certain named officers and directors of the Association were also dismissed after discovery in Congleton. Following the two major opinions by Judge Goodwine in March 2007, the parties began to mediate. A September 28, 2007 Order created a voluntary Qualified Settlement Fund Trust (“QSFT”) that was initially funded with \$68.6 million.

As the Court has already noted, her predecessor also entered an Order in Congleton on November 30, 2007 that sustained in part Defendant’s Motion Regarding Plan of Distribution.¹

Mediation continued into December 2007. On December 19, 2007, the court entered an Agreed Order that gave the Association additional credit for \$10 million in satisfaction for its claim of a 1% reserve for the handling, storage and insurance of pool tobacco from 1983 to 2004 while operating under the No-Net Cost Act, to be returned from the QSFT to the Association. This \$10 million is the Association’s property and is beyond the reach of any Congleton claims.

All prior orders were made final and appealable by the December 19, 2007 Final Judgment that reflected the net \$60.3 million in the QSFT plus future FETRA Tobacco Sale Proceeds and tax refunds that were to be paid into the QSFT for distribution to the Association’s present and past members. Counts for dissolution and injunctive/equitable relief were dismissed. One last Amended Nunc Pro Tunc Order was issued on October 10, 2008, allowing the

¹ The Association’s October 2007 motion sought in pertinent part:

- “1. Any uncashed checks should revert to the Association after 120 days under Bylaw Article XIV, section 4(b).***
4. The Association should be able to purge from its membership list all past members, “unless that individual voids and returns his/her distribution check to the Association, confirms a current mailing address and certifies he/she is currently engaged in the active production of burley tobacco and desires to remain a voting member of the Association.”

The Court’s November 30, 2007 Order at page 3, paragraph C(ii), ruled that: “The Association may purge its 2002-2004 membership list of all former members for whom distribution checks were returned by the Postal Service or not timely cashed, and all others who fail to provide such certification of eligibility and address within 30 days after the expiration of the 120 day period for members to cash their distributions checks, without prejudice to anyone’s right to join or re-join at a later date, if otherwise then eligible to be a member, according to the terms of the Association Articles and Bylaws then in effect.”

Association a credit or the right to retain \$3.5 million to pay income tax on the \$10 million reserve settlement.

Thereafter, the Association began to amend its prior tax returns and applied for federal tax refunds arising from its payments into the QSFT. Those refunds brought over \$30 million more into the QSFT, and a series of distributions to the 190,000 plus current and former Association members commenced. Plaintiffs' counsel fees and expenses were paid under the common fund statute out of the QSFT.

Congleton was closed by Order dated May 15, 2015. From that point forward, the Association was no longer under court supervision. During the litigation, Judge Goodwine for several years had routinely reviewed and approved operating budgets of the Association, to assure that the QSFT was properly funded. The Association that emerged from the Congleton litigation was the same Burley Tobacco Growers Cooperative, a Kentucky corporation, but with a much smaller, "rolling" membership that changed from year to year, as many farmers ceased their involvement in the production of burley tobacco and lost eligibility, and some commenced being burley growers or landlords and became members. The statutory requirements for membership have never changed.

After the massive federal tobacco buyout, the only reliable (though not perfect) list of remaining burley tobacco producers in 2015 was one compiled by the Farm Services Agency in its Kansas City office. Farmers filed annual FSA Form 578 crop reports, showing their production of burley tobacco and other crops each year. The Association obtained the 2015 FSA list and began to use for its membership list. The first list showed 3,126 farmers had reported growing burley in crop year 2014. Another 417 farmers signed contracts to sell their tobacco to the Association and became members. When the Association obtained the 2016 FSA list, it showed 2,455 burley tobacco growers had reported during the 2015 crop year. That year, there

were another 359 “contract members” not on the FSA list (due to its one-year time lag). From and after 2017, however, the Farm Services Agency no longer would provide its list to the Association. The Board of Directors had to amend its Bylaws, after prior notice to all existing members, and began to require members to “certify” to the Association each year that the member was actively engaged in the production of, or shared in the risk of production of burley tobacco. Only active “Grower Members” were allowed to vote in annual elections of directors and at any special meetings. In 2017 and 2018, the number of tobacco farmers who took the initiative to comply with the amended bylaw dropped dramatically: only 289 and then 274 farmers affirmatively certified they were active producers, in addition to contract growers who sold burley to the Association.

Accordingly, the Association records of its members has changed year by year. This spring, its staff has worked hard to compile a consolidated “Five Year Membership” list for “Property Rights” purposes, eliminating duplications, verifying the years for which members have FSA or other records on file to confirm their active engagement in the production of burley tobacco.² This list is available for use in this action to notify potential Settlement Class Members of the pendency of this action and proposed partial settlement, and for use in making distributions after dissolution of the Association. The Association believes it has followed applicable statutes and Judge Goodwine’s November 30, 2007 Order respecting former members who ceased producing burley tobacco, and there are no matters from Congleton that are open or can or should be revisited.

II. Basis for Dissolution of the Association.

For an agricultural cooperative corporation, there are several statutory means for

² See below discussion in argument III about why we believe the only past members who retain Property Rights are from the last five years.

dissolution. One is voluntary dissolution by the requisite vote of its current voting members under KRS 272.325 at a duly called regular or special meeting of the members. The other route is judicial dissolution under KRS 273.330 (1)(a) as made applicable by KRS 272.042.³

The Board of Directors of the Association overwhelmingly passed a resolution on June 9, 2020 approving the proposed partial settlement and the dissolution of the Association. Respectfully, the Court should not consider substituting its judgment for the reasonable business judgment of the corporate directors. By February, the Board determined it was no longer beneficial to the Association to buy burley tobacco from members yearly because of low demand, and voted 14-2 to distribute its “surplus assets,” amounting to 85% or more of its net assets, to its members in difficult economic times. Even before Covid-19 befell everyone, the Association had been contacted by representatives of state government asking if the Association could free up money to distribute to tobacco farmers; demand for burley and the poundage of burley tobacco being sold in the Kentucky market each year has continually declined; and it has been increasingly difficult to compete with the substantially lower prices of tobacco being grown in South America. In the last ten or so years, the major tobacco companies and other buyers no longer seem to care about “quality Kentucky burley.” The quantity of burley tobacco sold each year is now about a third of its former peak volume.

The Board has been heavily criticized for several years for not been paying “high enough prices” in its purchases of burley tobacco from members, and for not achieving profits from the purchase and sale of tobacco from members and not paying any patronage dividends since 2014.

³ Under KRS 273.330(1)(a), it is sufficient to confer jurisdiction on the Court for judicial dissolution of a non-profit corporation “when it is made to appear . . . 4. That the corporate assets are being misapplied or wasted; or 5. That the corporation is unable to carry out its purposes.” Both grounds are alleged by Named Plaintiffs. While the Association denies any wrongful acts or omissions, for purposes of the mediated settlement and joint motion that requests judicial dissolution, its Board recognizes that a strong case can be made under factor 5, and the usefulness of its primary purposes as a marketing cooperative has ceased.

In recent years, the Association offered to buy 3 million pounds of burley, and then in 2019, 1.5 million pounds, but growers did not fill up the offered volume. The Association had less than 300 contracts with burley growers in 2019, and has been chastised for that. When formed in 1922, the Association was intended to be an active and exclusive marketing cooperative for burley farmers to achieve price stability and protect the farmers from the excessive power of tobacco warehouses and tobacco companies. It has not been the exclusive marketing agent for its members since the Great Depression, and those lofty goals cannot be achieved now against the international conglomerates in a shrinking, oligopolistic market. After the tobacco buyout, there are no true tobacco auction warehouses, they are like receiving stations. Tobacco companies have consolidated. Fewer consumers smoke. The Board had justification to halt its purchase and sale of burley tobacco from a fraction of its members.

After it was publicized that the Board of Directors voted to distribute its surplus assets, even that attempted pro-member action was met with opposition, formally in this action and informally by others, as an “unauthorized” sale of “substantially all of the assets” of the Association that requires member approval under KRS 272.241. Member approval is not required for the payment of patronage dividends from a particular crop, and since many members have wanted to receive a distribution from the Association for several years, the Board thought members could not possibly object, but here we are.

The adverse effects of the Coronavirus have interfered with normal Association processes too. In mid-March, after the Association sent out notices scheduling a special meeting of members on April 8, 2020 as requested by about 260 members on the Plan of Dissolution represented by the Billings law firm, that meeting was halted by the Governor’s March 25, 2020 Executive Order, which banned large public gatherings and is still in effect. As the number of new Covid-19 cases remains high, it will continue to be unwise, if not unlawful, to convene a

members meeting in the next few months. A members meeting would likely be attended by perhaps 90 to 300 members. This inability to hold a members meeting was a significant factor in the Board's decision in mediation to agree to a judicial dissolution of the Association. The Board, the Named Plaintiffs and Craddock's group all want a distribution of the Association's net assets to its members, and agree that there is no lasting benefit in continuing the Association's present activities. Instead, the parties agree that a new, much smaller tobacco farmers advocacy nonprofit should be formed with funding of only \$1.5 million, to advocate for all tobacco farmers (not just burley producers) with tobacco companies and government agencies, and to provide or promote education and research of benefit to all tobacco farmers. Since Congleton, the Board of Directors has already tried a variety of programs and services for burley tobacco farmers, including renting equipment, providing insurance and tobacco grading services, funding educational meetings and issuing grants for research and agricultural scholarships, which have not satisfied a discernable majority of Association members. The inescapable fact is, many tobacco farmers need financial assistance in a tough farm economy. The proposed dissolution and distribution of net assets of the Association to its members will be welcome.

The pending motion by members to dissolve has put the Board into a "lame duck" status. A vote of two-thirds of a quorum of one-third of the current Grower Members can dissolve the Association; they do not need any reason to justify their vote to dissolve. Purportedly, clients of the Billings law firm hold over 300 proxies, posing a credible threat of voluntary dissolution by the members. The 2019 active Grower Members list of eligible voters numbers 998 persons. While the Board might survive a vote on dissolution, it is likely there would be a court challenge to the vote, either way. While the Association has loyal supporters, the Directors do not believe it would benefit the Association or its members to engage in a multi-year proxy fight over

dissolution. The Board's initial plan to distribute surplus assets has been incorporated into the mediated partial settlement to serve the best interests of the members by allowing an orderly liquidation of its assets under court supervision and a prompt distribution to its members. The Board voted to take this action knowing that claims still may be brought against some or all of the Directors and officers which will have to be defended. Entering into this partial settlement was an act of integrity.

Many of the present Directors have been members and directors of the Association for years. They know best when the time has come to dissolve the Association and to move on to new and different activities.

III. Basis for the Definition of "Settlement Class Members."

KRS 272.121 (1) provides that "five or more persons engaged in the production of agricultural products" may form an association, with or without capital stock. (Emphasis supplied.) This is the first of several statutes that clearly require a member must be actively "engaged in the production of" the commodity.

KRS 271.191 is quite specific on who may become members:

- (1) Under terms and conditions prescribed in its bylaws, an association may admit as members (or issue of voting stock to) only persons engaged in the production of agricultural products, including tenants and landlords who receive any part of the crop raised on the leased premises... (Emphasis supplied.)

In addition, KRS 272.151 authorizes bylaws of an agricultural cooperative to govern:

- (2)(i) ...the conditions upon which, and the time when membership of any member shall cease; the automatic suspension of the rights of a member when he ceases to be eligible to membership in the association, and mode, manner, and effect of the expulsion of a member, manner of determining the value of member's interest and provision for its purchase by the association upon the death or withdraw of a member, or upon the expulsion of a member or forfeiture of his membership, or at the option of the association, by conclusive appraisal by the board.

Despite the statutes in KRS Chapter 272 and the Bylaws of the Association, misconceptions and arguments abound about who is a “member” of the Association, both in the context of who is entitled to vote, and who has a property interest in the net assets of the Association. Undoubtedly, some farmers who ceased the production of burley tobacco after the federal USDA buyout believe they are still members of the Association just because they sold tobacco into the tobacco loan pool stocks back in the 1980s or 1990s, or paid assessments under the No-Net Cost Act. That is incorrect. Judge Goodwine’s November 30, 2007 Order in Congleton upheld the right of the Association’s board of directors to purge pre-2004 members who did not continue to be actively produce or market burley tobacco. Therefore, the Association has a “rolling” or fluid membership from year to year, both for voting and Property Rights purposes. KRS 272.151 and 272.191 clearly declare that it is the Board of Directors of the Association who determines who becomes or is a member of the Association, according to the “engaged in production or marketing” of burley tobacco criteria. Even Board members have to provide written proof of current Grower status every single year.

Several statutes provide that a period of five years is relevant when addressing the property rights of members of an agricultural cooperative. KRS 272.291 permits an association to “recover, after a period of five years, any unclaimed stocks, dividends, patronage refunds, or book equities for which the owner cannot be found in which are the result of distributable savings of the cooperative ...when the notice to the individual of these amounts has been returned by the U.S. mail and the amounts have not been called for, after five years, the amounts involved may be placed in the income of the cooperative for the year in which such determination is made and redistributed to the patrons of that year.” This is the statute relied on in the November 30, 2007 Order in Congleton.

Now, however, another statute is dispositive: KRS 272.325(3) governs voluntary dissolution of an agricultural cooperative. It limits distribution of the net assets remaining after payment of all debts to “members and other patrons...as shown by the association books over the preceding five fiscal years or if the estimated cost of making such distribution, in the opinion of the committee approximate more than fifty percent of the amount available for distribution, the association may dispose of its net assets by converting them to cash and paying the money over to the College of Agriculture of the University of Kentucky, or to any nonprofit farm organization operating within the areas served by the cooperative.” (Emphasis supplied.) Since only the 2012 crop bought by the Association has been profitable (for which patronage dividends were paid in 2014), there are no patrons entitled to a pro rata share of any monies upon dissolution. Thus, we are only dealing with equal distributions to members from the last five years in the proposed dissolution.

Coupled with the fundamental statutory requirement in KRS 272.191(1) that membership is limited to “only persons engaged in the production of agricultural product, including tenants and landlords...”, the only eligible persons who should qualify as Settlement Class Members should be those who have been involved in the production or sharing of the risk of production of burley in at least one of the last five fiscal years, 2015 -2019. The Association’s fiscal year is October 1 to September 30, which as a practical matter encompasses each growing season or “crop year” for burley tobacco. The Court as a lifelong resident of central Kentucky can take judicial notice that by September 30, nearly all burley tobacco has been cut and hung in the barns to dry. In its ordinary business, the Association always refers to “crop years.”

The consolidated Five Year Membership list has been ascertained by the Association and the proposed partial settlement includes a thorough and fair mechanism for broad notice to all burley farmers, with ample chance for those farmers who did not previously send in their FSA

Form 578 crop report or other proof of active burley production or a tobacco lease to the Association to supply their information. There will be appeal opportunities by arbitration, or to this Court if the Court prefers. Given that KRS 272.151 and KRS 272.191 ordinarily empower the Board of Directors to determine who qualifies for membership, the extra protections in the proposed settlement are quite fair.

Respectfully submitted,

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CERTIFICATE OF SERVICE

It is hereby certified that on July 28, 2020, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system, which will send notification of such filing on the following attorney(s) of record:

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