# DEPARTMENT OF AGRICULTURE AND FORESTRY
# STATE OF LOUISIANA

COMPLIANCE AUDIT
ISSUED APRIL 25, 2012

**LOUISIANA LEGISLATIVE AUDITOR**
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LOUISIANA LEGISLATIVE AUDITOR
**DARYL G. PURPERA, CPA, CFE**

April 25, 2012

**DR. MIKE STRAIN, COMMISSIONER**
**DEPARTMENT OF AGRICULTURE AND FORESTRY**
**STATE OF LOUISIANA**
Baton Rouge, Louisiana

We have audited certain transactions of the Department of Agriculture and Forestry. Our audit was conducted in accordance with Title 24 of the Louisiana Revised Statutes to provide the general public with mostly historical information that we were able to obtain on the development, financings, operations, and sale of the Lacassine syrup mill project.

Our audit consisted primarily of inquiries and the examination of selected financial records and other documentation. The scope of our audit was significantly less than that required by *Government Auditing Standards*.

Respectfully submitted,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

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# BACKGROUND AND METHODOLOGY

In 1996, in response to falling market prices for rice and soybean crops, a group of farmers in southwest Louisiana formed the Lake Charles Cane Cooperative, Inc. (Co-op) to promote sugarcane as an alternative crop in the region. The Co-op provided agriculture services to its members such as planting, harvesting, and transportation. By 2001, approximately 15,500 acres of sugarcane were in cultivation in the southwest part of the state including the parishes of Calcasieu, Cameron, and Jefferson Davis.

Since there were no existing sugar mills in the area, the yearly sugarcane crop was transported by truck approximately 100 miles eastward to other sugar mills in Louisiana. Transporting the sugarcane this distance both reduced the quality of the harvested crop and increased the cost to the farmers. In addition, the large number of trucks required to transport the sugarcane significantly increased road congestion.

In 1998, under the administration of former Commissioner of Agriculture and Forestry Bob Odom, the Louisiana Agricultural Finance Authority (LAFA) addressed the farmers' concerns with a project to transport the raw sugarcane by rail (train) from Lake Charles to Baldwin, Louisiana. Baldwin was selected as a convenient transshipment point to local sugar mills. The State of Louisiana funded this project with a $6 million legislative appropriation of capital outlay funds. LAFA used these public funds to build a loading facility at the Port of Lake Charles, in Calcasieu Parish, and to purchase flat rail cars and open box containers to transport the sugarcane.

In 2003, the loading facility was moved to Lacassine, Louisiana (Jefferson Davis Parish) to shorten the operating cycle and to reduce costs.[1] LAFA drew $2.5 million from a line of credit account with Hibernia National Bank (in return LAFA gave two notes totaling $2.5 million to Hibernia) to fund construction of a new rail spur in Lacassine to accommodate the "cane train." Subsequently, this $8.5 million ($6 million above plus the $2.5 million) state-funded rail transportation system failed. We understand that it failed because of scheduling difficulties between the farmers and train operators and high transportation costs. We also understand that LAFA is currently using the rail spur for other commercial projects, including oil transportation.

In February 2003, LAFA board minutes indicate that LAFA had plans to build an ethanol/co-generation facility in Lacassine. The purpose of this facility was to provide a market for local sugarcane farmers and at the same time alleviate the transportation problems. However, the LAFA board did not pursue this project because high cost estimates (approximately $160 million) made the project not feasible.

On September 10, 2003, the LAFA board then decided to pursue the development of a syrup mill in Lacassine in another attempt to address the farmers' lingering market needs and

[1] Because of a lack of documentation for the Port of Lake Charles project, we cannot determine if there was a comprehensive plan for this project or if the project met its objectives.

highway problems caused by transporting sugarcane by truck. The LAFA board's plans included financing the development and construction of the syrup mill through the issuance of $45 million in revenue bonds and having the Co-op lease and manage the syrup mill. In 2004, the Co-op created the Lake Charles Cane - Lacassine Mill, LLC (LCCLM) which in 2006, leased and operated the mill. LCCLM purchased the mill from LAFA approximately four months after the initiation of the lease. Aside from two-month long intervals in the 2007 and 2008 harvest seasons, the syrup mill has remained idle.

As of March 23, 2012, according to our calculations (see Appendix A), the State of Louisiana has spent/incurred nearly $72 million to assist a group of sugarcane farmers in southwest Louisiana that never numbered more than 30. In addition, LAFA guaranteed $11 million of debts of LCCLM of which $6,205,000 is unpaid at March 23, 2012. LCCLM is delinquent in paying those debts and LAFA, as guarantor, may have to spend additional public funds to satisfy the required principal and interest payments.

This report provides the general public with mostly historical information that we were able to obtain/review on the development, financings, operations, and sale of the Lacassine syrup mill project.

We reviewed available records and our procedures performed included:

(1) interviewing current and former employees of LAFA and LCCLM;

(2) interviewing other persons as appropriate;

(3) examining selected documents and records of LAFA and LCCLM; and

(4) gathering documents from external parties.

The following is mostly historical information that we were able to obtain/review regarding the Lacassine syrup mill's inception, financing, feasibility, construction and operations, and sale.

**Inception of Syrup Mill**

At its September 10, 2003, board meeting, the LAFA board adopted a resolution authorizing the financing and development of a syrup mill (mill) in Lacassine, Louisiana, which would refine sugarcane into syrup.

LAFA's intent was to have the syrup production shipped by rail eastward to other sugar mills in Louisiana where it would be processed into sugar. LAFA projections showed that this plan (reducing the raw sugarcane to syrup and shipping by rail) would decrease transportation costs by 75% and reduce road congestion caused by truck delivery.

LAFA would be the general contractor for the syrup mill, use state workers to work on the mill, and would contract with Arkel Sugar, Inc., for design and other engineering services on the project.

The proposed mill was to be a new state-of-the-art facility capable of processing 5,000 tons of sugarcane per day with a design that allowed for an upgraded capacity of 10,000 tons of sugarcane per day. It was to use advanced diffuser extraction technology that allowed more efficient extraction of syrup compared to existing mills in the state. It would include a fully computerized instrumentation package that enhanced processing performance and reduced man-hour requirements. Finally, the mill was to include a co-generation facility that allowed for production and sale of surplus electrical power.

**Initial Financing**

On September 18, 2003, eight days after the LAFA board adopted its resolution, the Louisiana State Bond Commission approved the issuance of $45 million in variable rate revenue bonds to finance the development and construction of the Lacassine syrup mill.

Payments on the revenue bonds are secured by a pledge of revenue from:

(1) net operating revenue of the syrup mill and

(2) State of Louisiana slot machine revenue allocated by law to LAFA. (LAFA receives $12 million annually in slot machine revenue.)

The mill has not generated any net operating revenue to date and bond payments have been made using LAFA's slot machine revenue. Also, on July 1, 2009, a state legislative appropriation of $15 million was used to make bond payments. On November 18, 2009, the remaining $30 million in bonds outstanding was converted to a fixed rate. As of the date of this report, the principal balance owed on the bonds was $16,165,000. The bond payment schedule indicates the bonds are to be fully redeemed by September 14, 2014.

**Project Feasibility**

There was no formal, comprehensive, and independent study performed to support the economic or financial feasibility of the Lacassine syrup mill project.

Neither the Louisiana State Bond Commission nor the Trustee Bank (Hancock Bank) was able to provide us with a written feasibility study on the mill. In fact, the official statement for the $45 million bond issue stated, “No independent feasibility study has been conducted with respect to the Project [Lacassine syrup mill].”

Although LAFA records also did not include a formal, comprehensive, and independent feasibility study, they did include several “draft” cash flow statements prepared by an accounting firm. We noted that there was a cash flow statement faxed to LAFA on September 11, 2003, seven days before the State Bond Commission’s approval. This cash flow statement showed the mill project with a negative net cash flow for the initial three years of operation and a positive cash flow thereafter upon reaching a processing level of 500,000 tons of sugarcane.

Our review of the cash flow statement revealed that it (1) did not consider potential revenue from sales of excess electricity, (2) assumed a $41 million project cost, and (3) assumed steadily increasing levels of sugarcane production. In hindsight, the assumptions in the cash flow statement were overly optimistic considering the actual cost of constructing the mill and the actual sugarcane production. As we present later in this report, the mill cost approximately $63 million rather than $41 million and the mill incurred another $11 million of debt to complete construction and fund operations. Also, sugarcane production actually declined during the period of mill construction and remained well below the levels assumed in the cash flow analysis.

**Mill Construction, Additional Financing, and Sale**

In May 2004, construction began with the intent of having the syrup mill complete in time for the 2005 harvest season. However, the mill was not commissioned until March 2006. According to the project manager, the delays were related to the disruptions caused by hurricanes Katrina and Rita, delays in the shipment of key components, a lower level of prefabrication than expected on key components, and a lack of contract workers during the initial stage of the project.

The mill’s first general manager was Jack Theriot. Mr. Theriot was the general manager from at least October 2005 through the commissioning in March 2006. Although the mill commissioning began in March 2006, it did not operate at full capacity because of various technical problems.

During the commissioning process, mill management worked with employees of M.A. Patout and Son, LTD (a Louisiana sugar mill company) and Arkel Sugar, Inc., to make the mill operational despite a number of technical difficulties that had to be overcome. Although the mill was operational and was supposed to process up to 5,000 tons of sugarcane per day, its actual processing capacity was only 2,000 to 2,500 tons of cane per day.

The $45 million of bond revenue was not sufficient to complete the mill. According to the project manager, the additional costs were caused by material costs that were higher than estimated, design changes that required more materials such as concrete, and modifications and upgrades that were necessary to have the mill operate reliably. In addition, he did not feel that the initial cost estimates were accurate even without the design changes that were made.

The additional construction and related costs totaled $7,416,709 and was funded by LAFA and the Louisiana Department of Agriculture and Forestry (LDAF) as follows:

- $383,299 of construction costs paid by LAFA
- $650,000 of construction/bond costs paid by LDAF (from Fertilizer and Pesticide Fund)
- $6,383,410 in payroll was paid by LDAF to its employees for working on the mill project

Furthermore, LAFA provided use of its John Deere 7420 Hi-Crop tractors and five John Deere 3510 and 3510T sugarcane harvesters to assist in increasing sugarcane production. This equipment cost approximately $2,200,358 and was later purchased by the mill operator.

On June 29, 2006, agreements were entered and notes were guaranteed by the State Market Commission:

- LAFA signed a lease/purchase agreement whereby the Lake Charles Cane – Lacassine Mill, LLC (LCCLM) would lease the mill with an option to purchase the mill at any time during the term of the agreement. The term of the lease agreement was from June 29, 2006, to December 31, 2051. LCCLM was created by the Co-op on February 16, 2004, with the intent that it would operate the mill upon its completion.
- LCCLM entered into a management services contract with M.A. Patout and Son, LTD. Under the agreement, M.A. Patout agreed to provide management services including the location and placement of a general manager. The agreement also called for M.A. Patout to provide engineering services to "evaluate, plan and implement modifications, upgrades, repairs, and work projects at the Plant with the goal of making the facility operational…"
- The Louisiana State Market Commission, at the time organizationally a part of LDAF, guaranteed $7 million of fixed rate (7%) promissory notes issued by LCCLM and did so without the approval of the State Bond Commission. The notes were issued to obtain funds for necessary improvements and modifications to the mill; working capital, equipment, and inventory for the mill; and the cost of issuance of the notes. The State Market Commission guaranteed the outstanding principal balance up to $7 million. The guaranty was secured by a first mortgage on the syrup mill in favor of the State Market Commission. Agriculture

Commissioner Bob Odom signed the guaranty. The notes are to be fully redeemed by September 15, 2016.

Note: LCCLM failed to pay the March 15, 2012, interest payment of $127,500. LAFA, as guarantor, made this interest payment on March 23, 2012. The unpaid principal balance at March 23, 2012, is $3.5 million.

Subsequently, on August 11, 2006, LAFA entered into an agreement with LCCLM and Cementos Andinos S.A., (a Colombian company owned by the Santacoloma family) whereby Cementos acquired an 80% interest (controlling interest) in LCCLM with no exchange of cash. This agreement also required Cementos to construct an ethanol plant at the mill site. Cementos Andinos S.A. terminated the agreement with M.A. Patout and installed its own management team.

Reimbursements to LAFA for Additional Syrup Mill Expenses

LAFA incurred approximately $6,119,543 of additional mill expenses after the $45 million in bond funds and the previously noted LAFA funds were spent. LAFA billed LCCLM for these additional expenses and LCCLM reimbursed LAFA with funds from its $7 million of promissory notes issued (that was guaranteed by the Louisiana State Market Commission) and a subsequent $4 million loan that was guaranteed by LAFA.

We noted that four of the six LCCLM checks used to reimburse LAFA were co-signed by then Agriculture Commissioner Odom who was a signatory on the operating account of LCCLM. Based on interviews with LDAF management, Commissioner Odom was a signatory on this account so he could review LCCLM expenditures and ensure the funds guaranteed by the State Market Commission and LAFA were spent for legitimate mill expenses.

Sale of Syrup Mill

On November 2, 2006, LCCLM exercised its option to purchase the Lacassine syrup mill for $60 million. The sale of the mill included the improvements and equipment but not the land. Although the mill was operational at the time of the sale, there were still some issues regarding the reliability of mill operations. LAFA's project manager for the mill estimated it would have cost an additional $2.75 million to address the reliability issues.

LAFA sold the syrup mill to LCCLM for zero cash up front and a $60 million promissory note. The only cash involved in the purchase was a $300,000 security deposit that was paid by and returned to LCCLM after the sale. The terms of the LAFA note included a 3% interest rate and 44 annual installment payments payable on December 31 each year beginning December 31, 2007. The first four installment payments were $100,000 each. After the fourth installment payment, the balance of principal and interest due was to be amortized over the remaining 40 years. [Note: LCCLM made the initial four payments of $100,000 each. The fifth payment of $2,948,147 was due on December 31, 2011, and has not been paid as of March 23, 2012. Therefore, no other payments have been made by LCCLM other than the initial $400,000.]

LAFA memorandums indicate the $60 million sale price was determined/calculated using a cost approach. The available financial records reflect the mill's total cost to be $59,201,714. This total included the cost of the buildings, equipment, interest expense, and labor for the mill. However, in our review, we noted the following items that may impact LAFA's cost calculation:

1. The full borrowing cost of LAFA's $45 million bond issue was not included in the calculation. Although $10,941,087 of interest expense accrues over the term of the bond issue, only $3,784,305 of interest was included (this amount represented the interest that was incurred during construction of the mill). We maintain that the interest difference of $7,156,782 should have been considered in LAFA's cost approach.

2. Costs of $2,135,921 included in the calculation were previously reimbursed to LAFA by LCCLM.

If the above two items had been considered in LAFA's calculation at the time of sale, the actual cost of the mill may have reflected $64,222,575 ($59,201,714 + $7,156,782 - $2,135,921). If so, it is clear that the $60 million sale price did not recoup all mill costs.

On the day following the sale, November 3, 2006, LAFA guaranteed a $4 million bank loan made to LCCLM without approval from the State Bond Commission. The loan guaranty was signed by Commissioner Odom. The Jeff Davis Bank and Trust loan had a 7% interest rate and a five-year repayment schedule. The loan funds were to be used for "obtaining operating capital and making modifications to complete a Syrup Plant located by Lacassine, Louisiana…" LAFA, as the guarantor, is responsible for repayment of the outstanding principal balance plus accrued interest. This guarantee is not secured by any collateral. [Note: LCCLM, although having been granted several payment extension requests, failed to make its December 31, 2011, principal and interest payment of $994,478. As of March 23, 2012, LAFA has not made any payments on this loan. The unpaid principal balance at March 23, 2012, is $2,705,000.]

Under the new ownership and management, the mill operated for approximately one month during the 2007 and 2008 harvest seasons. Since the 2008 sugarcane harvest season, the mill has been idle.

**Land Leases and User Fees**

The sale of the mill did not include the (1) 59-acre syrup mill site; (2) 50-acre site for the proposed ethanol plant; or (3) approximately five acres of land with a prefabricated metal building. All three sites were located on the approximately 200-acre industrial park owned by LAFA in Lacassine.

In November 2006, at the time of the mill sale, LAFA also entered into leases with LCCLM for the syrup mill site and the five-acre site (with the prefabricated metal building), and with Louisiana Green Fuels, LLC for the ethanol plant site.

LAFA charged a yearly user fee of $500 per acre for all three sites over a 44-year lease term. In addition to the user fees, LAFA charged LCCLM a rental fee of $2,571 per month for the metal building. LCCLM made all payments on the lease of the five acres and metal building until it exited this lease in June 2010. LAFA is currently leasing the property to a private company not related to the mill.

In 2007 and 2008, LCCLM and Louisiana Green Fuels, LLC made all payments on the leases of the mill site and ethanol site, respectively. However, LAFA granted a waiver to both companies for the 2009 and 2010 user fees. In return, the companies provided maintenance on the grounds of the industrial park including grass cutting and road work. Our understanding is that LAFA revoked the waiver in 2011 and both companies currently owe a combined total of $33,651 of user fees on both the mill site and ethanol site.

**Conclusion**

In conclusion, it appears that the payments made by the state to address the sugarcane farmers' needs were not commensurate with the value received.

# APPENDIX A

# Summary of State Financing

The following table presents a summary of the state's financing of the cane train and Lacassine syrup mill[2]:

| Description | Amount | Funding Sources |
|---|---|---|
| **Cane Train:** | | |
| Infrastructure Expenses | $3,000,000 | State of LA - Capital Outlay funds |
| Infrastructure Expenses | $3,000,000 | State of LA - Capital Outlay funds |
| Rail Spur | $2,500,000 | LAFA |
| **Total Cost of Cane Train** | **$8,500,000** | |
| | | |
| **Syrup Mill:** | | |
| Construction and Operating Expenses | $45,000,000[3] | Syrup Mill Bond Issue: Secured by LAFA slot machine revenue and the net operating revenue of mill |
| Interest Expense (on $45 Million Bond Issue) | $10,941,097[4] | LAFA |
| Construction Expenses | $383,299 | LAFA |
| Construction/Bond Expenses[5] | $650,000 | LDAF |
| Payroll Expenses - LDAF employees | $6,383,410 | LDAF |
| Interest Expense (on LCCLM Promissory Notes) | $127,500 | LAFA |
| **Total Cost of Syrup Mill** | **$63,485,306**[6] | |
| **Total Combined Cost** | **$71,985,306** | |

[2] We determined the funding based on available LAFA records and interviews of LAFA current and former employees.
[3] The principal balance owed as of this report date is $16,165,000. LAFA and the State of Louisiana have made all principal payments ($28,835,000) under the bond issue.
[4] The $10,941,087 represents the total amount of interest due over the term of the $45 million bond issue. To date, LAFA has paid all interest due on the bonds totaling $10,285,111. The interest expense remaining to be paid totals $655,976.
[5] Given the lack of documentation, we cannot determine if the funds were used to pay construction costs or bond debt.
[6] The $63,485,306 represents public funds used for the mill as of March 23, 2012. It does not include the unpaid balance of the $7 million of fixed rate promissory notes issued by LCCLM and guaranteed by the State Market Commission, nor does it include the unpaid balance of LCCLM's $4 million bank loan guaranteed by LAFA. The principal unpaid balances owed by LCCLM on the notes and loan as of March 23, 2012, totaled $6,205,000.

# APPENDIX B

# Management’s Response

LOUISIANA DEPARTMENT OF AGRICULTURE & FORESTRY
MIKE STRAIN DVM
COMMISSIONER

April 17, 2012

Mr. Daryl G. Purpera, CPA, CFE
Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804

Dear Mr. Purpera:

Re: Compliance Audit
Lacassine Facility

The Louisiana Department of Agriculture and Forestry (LDAF) is in receipt of the compliance audit report pursuant to your letter dated April 10, 2012.

The LDAF concurs with the audit report. I would like to clarify that the decision to construct the Lacassine facility and incur initial financing obligations were made prior to my term as Commissioner, which began in January 2008.

As Commissioner of LDAF and Chairman of the Louisiana Agricultural Finance Authority (LAFA), and with approval of LAFA's Board of Directors, I have initiated a series of prudent business decisions to minimize the legal and financial exposure of the state regarding the Lacassine facility. Accordingly, I have been successful in reducing bond debt from $45 million to $16.1 million. In November 2009, the bonds were converted from variable rate with a swap provision rate of 11 percent to fixed rate at 3.8 percent. As noted in the compliance audit, LAFA is the guarantor of two notes of which Lake Charles Cane-Lacassine Mill, LLC (LCC) is the borrower. Through much persistence, I have been able to reduce the amount owed to Jeff Davis Bank and Hancock Bank/Merrill Lynch from $11 million to $6.2 million. Additionally, LDAF has aggressively marketed the unused sections of the Lacassine facility, resulting in leases that generate annual income of approximately $70,000.

At its meeting on March 23, 2012, LAFA placed LCC in default for failure to make its December 31, 2011 payment to LAFA for the purchase of the mill. In addition, LCC did not make the required payment to Hancock Bank that was due on March 15, 2012 or the required payment to Jeff Davis Bank that was due March 31, 2012. LAFA is working with these banks to keep the notes current.

I will continue to serve the citizens of Louisiana through careful oversight of this matter.

Sincerely,

Mike Strain DVM
Commissioner



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