

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA

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In re: * Bankr. Case No. 15-40057
Chapter 11
HEPAR BIOSCIENCE LLC, *
TAX ID#: 74-3230210, * **DISCLOSURE STATEMENT**
Debtor. * **DATED MAY 29, 2015**
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I. CAVEAT

THE ATTACHED PLAN IS COMPLEX IN AS MUCH AS IT REPRESENTS A PROPOSED LEGALLY BINDING AGREEMENT BY THE DEBTOR. CREDITORS ARE URGED TO CONSULT WITH COUNSEL IN ORDER TO FULLY COMPLY WITH THE PLAN.

NO REPRESENTATIONS CONCERNING THE DEBTOR ARE AUTHORIZED BY THE DEBTOR OTHER THAN AS SET FORTH IN THIS DISCLOSURE STATEMENT.

THE INFORMATION CONTAINED IN THIS DISCLOSURE STATEMENT HAS NOT BEEN SUBJECTED TO A CERTIFIED AUDIT. THE ACCURACY OF INFORMATION IN THIS DISCLOSURE STATEMENT IS DEPENDENT UPON THE RELIABILITY OF DEBTOR'S RECORDS. THE DEBTOR IS UNABLE TO WARRANT OR REPRESENT THAT THE INFORMATION CONTAINED HEREIN IS ABSOLUTELY WITHOUT ANY INACCURACY. ALTHOUGH GREAT EFFORT HAS BEEN MADE TO BE ACCURATE, THE LAW FIRM OF GERRY & KULM ASK, PROF. LLC, COUNSEL FOR THE DEBTOR, HAS NOT VERIFIED THE INFORMATION SET FORTH HEREIN, BUT SUCH FIRM HAS NO ACTUAL KNOWLEDGE OF ANY INACCURACIES.

II. LEGAL REQUIREMENTS FOR ACCEPTANCE OF THE PLAN

The Bankruptcy Code provides that in order for the United States Bankruptcy Court to confirm a Plan, the Court must count the acceptances or rejections filed by creditors of classes whose rights are impaired. In order for a Plan to be deemed accepted by a class, of the ballots cast by the creditors in such class, more than one-half in number and at least two-thirds in amount of the allowed claims in such class must vote to accept the Plan.

III. NATURE & HISTORY

Hepar BioScience LLC was formed in 2007 to market, process and produce animal fats/grease and pharmaceutical by-products. The bulk of the supply chain at that time originated from a "Supply Agreement" with SPL/Mobren providing for the Debtor to be supplied with porcine related materials on a long-term basis.

In 2011 Debtor acquired land to construct a plant to utilize products which were being disposed of. Construction commenced in 2012. In 2012 Debtor extended the "Supply Agreement" with SPL/Mobren and simultaneously entered into a "Processing Agreement" with SPL/Mobren.

Debtor has been significantly impacted by factors out of its control which led to this reorganization.

In 2013, Porcine Epidemic Diarrhea Virus (PEDv) was identified in the United States. During the winter of 2013-2014, PEDv became a significant challenge for the domestic pork industry due to high mortality rates in piglets due to PEDv. Debtor's product originates from porcine by-products, specifically the intestinal tract, which harbors large volumes of the PEDv virus. As a result, domestic (same species) pork based feed ingredient usage nearly vanished upon the recommendation of leading porcine veterinarians and nutritionists in guiding their customers to not feed Hepar's functional protein product out of concern of transmission of PEDv through the feed ingredient. Functional vegetable proteins have been and are currently being used to replace Debtor's porcine protein in animal diets or other non-porcine species at almost no biological viral risk. The international market place has been impacted but not to the extent that the US domestic market has. Outbreaks of PEDv in the United States increased throughout 2014 but have subsided during the 2014-2015 winter season. It has been and continues to be a challenge to regain any market share back as a result of changed buying patterns due to PEDv. Values of Hepar's functional proteins have been negatively impacted and continue to be.

Debtor's other product line values are tied to commodity pricing of crude oil and grain prices. In the last 12 months, commodity prices have seen a significant decrease which directly impacts revenues for Debtor. In the last 12 months crude oil has decreased 39.7%, corn decreased 23.7%, soybean decreased 38% and soybean meal decreased 39%.

Debtor's functional protein product sales are additionally indirectly tied to the poultry and egg laying industries domestically, some of Hepar's customers' plants are currently quarantined. The 2015 outbreak of Avian Flu (H5N2) has had a negative impact on volume of products sold in this product line as significant flocks have been ordered by the U.S.D.A. to be destroyed to prevent the spread of the virus. Once seasonal outdoor temperatures increase, experts believe that this impact will diminish but there is a potential risk to revenue upon the return of winter weather.

During 2014, the financial stresses of PEDv and falling commodity prices led to the renegotiation of Debtor's obligations with Northwest Bank, which includes a personal guarantee of Mark Nylen and corporate guarantee of Sovereign Holdings, Inc. The guarantee of Sovereign had been required since commencement of the construction project where Debtor had paid nearly half of the new purchase price through debt payments for Sovereign's largest asset, a low-time

business jet then used by Hepar BioScience LLC. In consideration for renegotiation of the Northwest Bank debt, the Sovereign guarantee was required to remain in place and renewed.

On two occasions in 2014 Sovereign sold large percentages of its assets with consent and understanding that the proceeds from the sales would remain in Sovereign's possession. Northwest Bank has asserted in the 2nd half of 2014 proceeds from Sovereign asset sales were wrongfully deposited in accounts out of Sovereign's reach without Northwest Bank's consent. In January 2015 Northwest Bank determined that all of the proceeds from the Sovereign's major asset sales were deposited into an account outside of Sovereign's reach. The deposits into an account not in Sovereign's name were declared a default by Northwest Bank under multiple guarantees provided by Sovereign Holdings to the Bank. In January 2015, Northwest Bank informed Debtor and Guarantors that Debtor's loan was in default due to Sovereign's actions.

Debtor sought bankruptcy protection prior to an anticipated acceleration of the Hepar debt resulting primarily from Hepar's guarantor's (Sovereign) actions and Hepar's inability to convince Sovereign's major shareholder to cure such default.

Due to the falling revenues/cash flow of Debtor starting in 2014 and the subsequent bankruptcy filing, Debtor over the last 6 months has eliminated employees from payroll, completion of the plant has come to a near standstill, there are no distributions being made to shareholders other than for Debtor's obligations for Debtor's income taxes and all expenditures are being closely reviewed and subject to Bank approval.

The goal of Debtor's plan is to continue to keep the business operational and profitable as it navigates the new normal business environment, maintain current minimum staffing levels, pay its creditors in full and be in a position to create jobs in the future and emerge from bankruptcy at some mid-term future point. When the business environment improves, full construction on the plant can resume and new plant jobs will be created.

With the completion of the plant, it is anticipated that 15-20 jobs will be created with average wages of \$27.50 per hour, and full family health insurance and company paid 401k. Without a reorganization creditors are at risk to not be able to collect 100% of the pre-petition amounts owing them and possibly have to reduce their staff and curtail their business operations.

IV. ORGANIZATION OF THE PLAN

The Plan divides claims as follows:

- A) **LEASES AND EXECUTORY CONTRACTS:** The Plan provides for the assumption of all true leases and executor contracts entered into pre-petition, to include employment agreements, vehicle and equipment leases, warehouse in North Sioux City, SD, residential lease and the Supply Agreement, Supply Extension Agreement and Processing Agreement with SPL/Mobren.
- B) **ADMINISTRATIVE EXPENSES:** The Plan provides that expenses of administration shall be paid on the effective date of the Plan. Debtor's counsel fees and expense will be paid upon approval by the Court and any Trustee fees and Clerk fees will be paid upon the effective date of the Plan.

C) PRIORITY CLAIMS: Debtor owes a priority claim under 507(a)(5) to R.W. Baird & Co. in the amount of \$73,457.69. This is for employee 401k contributions. This will be paid within 30 days after the effective date of the Plan.

D) DESIGNATION AND TREATMENT OF CLASSES OF CLAIMS:

1. Class 1 – NORTHWEST BANK: This creditor has a claim in the amount of \$18,561,612.25, which is secured by a mortgage filed against land located at 3148 North Highway 105, North Sioux City, SD. This creditor also holds a perfected security interest in Accounts, Equipment, Inventory and Intangibles. This creditor does not have a perfected interest in titled vehicles, titled equipment, livestock or farm assets. This creditor is fully secured. This creditor is allowed pendency interest accruing at the rate of 3.40% per annum from date of petition to date of confirmation. The loan is current as principal and interest payments of \$194,083.75 continue to be made monthly as agreed. Upon confirmation of the Plan, the remaining claim will be paid over the originally scheduled amortization through September 15, 2024 at the rate of 3.40% with a monthly payment to remain at \$194,083.75. Any covenants in the loan documents requiring minimum debt service coverage and cash scoops are eliminated in order to perform the remainder of the Plan and allow for payment of the unsecured creditors. Monthly payments of \$194,083.75 will continue past September 15, 2024 to cover any allowed attorney's fees and expenses until they are paid in full. Any "Adverse Change" and deemed "insecurity" clauses in the loan documents which would allow the creditor to notice a default are terminated upon confirmation of the Plan.
2. Class 2 – GLOBAL ENGINEERING AND CONSTRUCTION: This creditor has a claim in the amount of \$94,846.03 which is secured by a mechanic's lien filed against land located at 3148 North Highway 105, North Sioux City, SD. This creditor is fully secured. Upon confirmation of the Plan, the remaining claim will be paid over 24 months and bear interest at the Federal Judgment rate of .25% per annum. Debtor will pay this claim in 24 monthly payments of \$3,962.22 including interest. First payment will be made within 30 days from the effective date of the Plan. If there are any allowed attorney's fees, payments would begin in month 25 and be paid a monthly amount of \$3,962.22 until paid in full.
3. Class 3 – UNSECURED CREDITORS: The class of creditors shall consist of all unsecured creditors who have timely filed a Proof of Claim, which is not properly objected to or are listed on Debtor's Schedules or Amendments, that are not listed by Debtor as disputed, contingent or unliquidated, or those creditors who obtained a court order allowing their claim. The amount owed to this class of creditors is approximately \$2,600,000.00. This class of creditors will receive 4% of their approved original amount of each respective claim paid each month for 25 months. The first payment will be made within 30 days from the effective date of the Plan. All judgments held by unsecured creditors shall be deemed released upon completion of the Plan.

V. OTHER PROVISIONS

- A) Quarterly Federal Tax estimates will be paid on income generated by the Debtor at an effective tax rate of 39.6%.
- B) Construction of the plant will resume at a much reduced level. The Plan reserves \$100,000.00 per month for plant construction. Actual construction costs may exceed the reserved amount provided that payments to the creditors are current in accordance with the Plan.
- C) Mark Nylen will remain as controlling member and Manager of the Debtor. Mark Nylen has been involved in businesses involved with the business of processing, purchasing and sales of animal by-products and biological pharmaceuticals for over 40 years. Over that time, he has established a substantial amount of personal goodwill with suppliers and customers of processed by-products. His willingness to remain as the Manager of the Debtor is a critical factor, essential to the success of this Plan. If Mark Nylen were no longer associated with the Debtor, it would negatively affect Debtor's ability to execute the Plan, (paying all creditors, maintaining supplies that Debtor does not have supply agreements with, maintaining all sales customer relationships, creating jobs, and business for the community).
- D) Attorney's fees related to Mark and Mary Ellen Nylen's dissolution have been rejected and are not a debt or obligation of the Debtor.

VI. STATEMENT FOR ALL CREDITOR CLAIMS

The Plan provides that all secured creditors shall retain their Lien position until paid in accordance with the Plan. Upon final payment under the Plan, secured creditors shall release all liens, mortgages and encumbrances of record. The Plan provides that Debtor shall insure, maintain and replace secured assets, so as to retain the value of such assets, absent ordinary wear and tear.

The Plan provides Debtor's reservation of right to prepay creditors at any interval, without penalty.

The Plan provides that in the event Debtor defaults in any monthly payment due to any creditor, then that creditor shall have the right to give Debtor thirty-days' written notice to cure such default. In the event Debtor fails to timely cure a noticed default, then such creditor may accelerate the remaining balance owed in accordance with the Plan, and pursue its State Court remedies.

VII. OBJECTIONS TO CLAIMS

Debtor has not had the opportunity to determine if credit has been given appropriately for offsets and all payments made to creditors, nor to review Proofs of Claim. The Plan reserves the right for Debtor to object to Proofs of Claim, post-confirmation, for any reason.

VIII. BASIS FOR THE PLAN

Debtor is of the opinion that confirmation of the Plan will result in not only a full value payment to all secured creditors, but an opportunity for full payment to unsecured creditors which would receive less than full payment if assets were liquidated.

IX. LIQUIDATION ANALYSIS

See Exhibit "A".

Debtor estimates that the unsecured creditors may not receive full payment if Debtor liquidated.

X. DEBTORS' FINANCIAL PROJECTIONS

Attached as Exhibit "B" are Debtor's monthly projections for July 2015 through December 2017 and annually thereafter through 2024.

XI. FUTURE MANAGEMENT

Debtor will continue to be managed and operated by Mark Nylén who draws approximately \$5,000.00 per week to increase normally for necessary living expenses. Income tax liability is a pass through from entity to Mark Nylén and Debtor also makes such quarterly related tax payments.

Respectfully submitted this 29th day of May, 2015.

HEPAR BIOSCIENCE, LLC:

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Its: Managing Member

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