AN EXAMINATION OF
THE PUBLIC'S INVESTMENT IN AN
ECONOMIC DEVELOPMENT PROJECT IN HARRLAN COUNTY

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October 3, 2000

Marvin E. Strong, Jr., Secretary
Cabinet for Economic Development
500 Mero Street
Capital Plaza Tower
Frankfort, Kentucky 40601

Honorable A. B. Chandler, III
Attorney General, Commonwealth of Kentucky
State Capitol, Suite 118
Frankfort, Kentucky 40601

Honorable Joseph A. Grieshop, Judge/Executive
Harlan County Fiscal Court
Harlan County Courthouse
P.O. Box 956
Harlan, Kentucky 40831

Honorable Glenn R. Freeman
Bluegrass Hosiery, Inc.
P.O. Box 430
Cumberland, Kentucky 40823

RE: Examination of Selected Financial Transactions Involving the Kentucky Cabinet for Economic Development, Harlan County Fiscal Court, Harlan County Industrial Development Authority, Bluegrass Hosiery, Inc., et al.

Gentlemen:

At the request of the Kentucky Cabinet for Economic Development (Cabinet), a meeting was held on July 16, 1999, attended by representatives of the Cabinet, the Office of the Attorney General (AG), and this office (APA).

The purpose of the meeting was to discuss the default on a $100,000 economic development loan of public funds involving the following parties:
As a result of discussions at the July 16, 1999 meeting, we agreed to conduct an examination of certain financial transactions involving the County and BGH. We have identified four separate loans of public funds to BGH from two government sources. These sources (with breakdown of loans) are:

1. federal Community Development Block Grant (Block Grant) proceeds totaling $944,468, granted by
   (a) the Kentucky Department for Local Government (DLG), to the County and the County Development Authority, for loan to BGH, totaling $844,468, as follows:
      (i) a $144,468 loan of Block Grant Revolving Loan Funds (RLF) which consists of the County’s recaptured Block Grant Economic Development Loans, and
      (ii) a $700,000 loan of “new” Block Grant funds from DLG, in two installments of $650,284.67 and $49,715.33; and by
   (b) DLG to the Cumberland Valley Area Development District (CVADD) for loan directly to BGH, totaling $100,000; and

2. state Local Government Economic Development Fund (LGEDF) proceeds totaling $100,000, transferred by the Cabinet, through KEDFA, through the County Development Authority, to BGH.

These loans to BGH total more than $1,044,000 of public funds. BGH received all loan proceeds during 1996, although the application process for the loans began in 1994 and continued throughout 1995 and into 1996.

We also identified an additional grant of public funds from KEDFA to the County Development Authority for the benefit of BGH totaling more than $548,500.
When we began our examination, less than $13,000 of principal and interest on the four public fund loans had been repaid by BGH, with the most recent loan repayment having been made in March, 1998. During the course of our examination, two additional loan repayments totaling $16,000 have been made for a total repayment, through September 26, 2000, of principal and interest on all public fund loans of approximately $29,000.

BGH ceased hosiery-manufacturing operations sometime during 1998, and closed the business. In June 1999, the County Development Authority wrote off $942,707.33 worth of BGH’s debts of these public funds without making any apparent attempt to collect the amounts owed from BGH.

In addition, BGH’s hosiery manufacturing equipment, purchased with borrowed public funds, (a) is currently being used as collateral to secure private sector bank loans from the First National Bank of Corbin, Kentucky (First National) made to Glenn R. Freeman as an individual, and (b) is being leased by the current tenant of the hosiery manufacturing facility, Parkway of Kentucky, Inc. (Parkway) from Glenn Freeman individually. These lease proceeds are being used to pay off Glenn Freeman’s debt to First National. Parkway moved into the facility as a tenant after BGH ceased hosiery manufacturing operations there in 1998.

Finally, the County invested public funds in a Certificate of Deposit (CD) in the amount of $100,000, and pledged this CD as collateral to secure, initially, a $916,000 private sector loan from First National to “Glennco, Inc., D/B/A Bluegrass Hosiery, Inc., Glenn Freeman.” This $916,000 loan was later consolidated with other First National loans to Glenn R. Freeman and his businesses, resulting in a loan of more than $2,200,000 to Glenn Freeman as an individual. Thus, $100,000 of the county’s money is currently securing a multi-million dollar loan to a private individual, which loan proceeds are apparently being used by Mr. Freeman for purposes other than BGH.

Our objective was to analyze the financial transactions and relationships between the various parties in sufficient detail so that a determination could be made by the AG as to whether any transactions or relationships examined involve any unlawful use or expenditure of public funds that would warrant further investigation.
We analyzed financial records of public entities such as the County, the County Development Authority, DLG, the Cabinet, KEDFA, and the CVADD, including grant applications, grant agreements, loan agreements, guaranty agreements, security agreements, and other financial and accounting records. We analyzed some of the financial records of private entities such as BGH, First National, and Middlesboro Federal Bank (Middlesboro Federal), including checking account statements, cancelled checks, promissory notes, security agreements, and other loan documents. We examined real estate and equipment leases, and invoices for manufacturing equipment and renovation expenses. We examined records filed in the case of Freeman v. Cape Publications, Inc., et. al., Harlan Circuit Court, Case No. 99-CI-00316. We also reviewed correspondence between the parties involved in these transactions. Finally, we interviewed various state and County officials, bank personnel, and two principals of BGH, Silas H. Russell and Glenn R. Freeman.

The results of our examination are set forth below. In accordance with our objective, our findings are referred to the AG for further investigation or determination.

We thank those who cooperated with this examination.

Very truly yours,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

EBHJr:kct
Summary of Findings

The Commonwealth of Kentucky has provided the proceeds for over $1,000,000 in loans of federal and state public funds, as well as a grant in the amount of approximately $550,000, to or for the benefit of BGH for the purpose of purchasing equipment and renovating facilities intended for use in a hosiery manufacturing operation that was to provide 75 jobs in Harlan County.

The principal and interest owed by BGH on these borrowed public funds have not been repaid in accordance with the terms of the Loan and Grant Agreements.

Since the fall of 1998, BGH has been an inactive corporation no longer operating a hosiery manufacturing operation in Harlan County.

A substantial portion of the borrowed public funds was initially earmarked to be used by the County, through the County Development Authority, to purchase hosiery-manufacturing equipment which would then be leased to BGH. The County Development Authority instead loaned the proceeds directly to BGH, and the proceeds were used to purchase the equipment.

The County Development Authority voluntarily took a subordinate security interest to that of First National in the equipment.

In June 1999, the County Development Authority wrote off over $900,000 of the loaned public funds, with no apparent attempt to collect them.

Glenn R. Freeman is now personally leasing the equipment purchased with public loans to Parkway of Kentucky, Inc., a private company, for $4,643.28 per month. Parkway has no ownership connection to BGH, its equipment rental payments are being made directly to Mr. Freeman, and it has no obligation to repay the public fund loan proceeds to the public entities that loaned the funds to BGH for equipment purchase.
The facility was subleased for $4,145 per month by BGH from Glenn R. Freeman under a capitalized lease, and was used by BGH for its hosiery manufacturing operations. Once BGH ceased production, the lease agreement between BGH and Glenn R. Freeman apparently was never declared to be in default. It appears from the documents we have been able to examine that the facility is currently being subleased by Parkway from Glenn R. Freeman for $9,616 per month—$5,471 more than Mr. Freeman’s obligation to the facility’s owner. The equipment rental payments and the excess facility rental payments currently being made by Parkway to Glenn R. Freeman are being used by Mr. Freeman to repay his personal debt to First National, and not to repay BGH’s public fund debts to the public entity lenders; and a Harlan County certificate of deposit for $100,000 continues to secure private bank loans made to Glenn R. Freeman, individually.

### Transactions Timeline

The four public fund loans to BGH, with the dates the loan proceeds were conveyed to BGH, and the one public fund grant for the benefit of BGH, are summarized as follows:

- **January 9, 1996** – loan: from the County and the County Development Authority of DLG’s Block Grant RLF proceeds in the amount of $144,468 for BGH to purchase equipment to manufacture hosiery;

- **March 7, 1996** – loan: first installment of a $700,000 loan from the County Development Authority of Block Grant proceeds in the amount of $650,284.67 for BGH to purchase hosiery manufacturing equipment;

- **April 1, 1996** – grant: Grant Agreement executed for a grant from KEDFA of LGEDF proceeds to the County Development Authority in the amount of $548,547 to construct extensions of County water and sewer lines to BGH’s manufacturing facility for the benefit of BGH; these funds were transferred by DLG through the County to the County Development Authority in several installments from April 11 through August 6, 1996;

- **August 27, 1996** – loan: from KEDFA of state coal severance tax fund proceeds through the County Development Authority in the amount of $100,000 to renovate BGH’s manufacturing facility; this loan is a part of the April 1, 1996 Grant Agreement between KEDFA, the County, and BGH;
October 15, 1996 – loan: from the CVADD, of Block Grant RLF proceeds in the amount of $100,000 to purchase equipment for BGH;

November 11, 1996 – loan: second installment of the $700,000 loan from the County Development Authority of Block Grant proceeds in the amount of $49,715.33, for BGH to purchase hosiery manufacturing equipment.

BGH also obtained private sector bank loans, as follows:

November 16, 1995 – loan: #15014 from First National to “Glennco, Inc. D/B/A Bluegrass Hosiery, Inc., Glenn Freeman,” in the amount of $916,000, for the purpose of purchasing “equipment for business.”

January 23, 1998 – loan: #23393 from First National to “Glenn R. Freeman,” in the amount of $1,200,000, for the purpose of consolidating five (5) previous bank loans, including the November 16, 1995 loan #15014 listed above, but also including other previously-made bank loans to Glenn Freeman that did not fund BGH. This $1,200,000 was, in December 1998, itself consolidated with other loans to Glenn R. Freeman, resulting in a loan from First National of more than $2,200,000.

Activity Background and Details

BGH was incorporated by Glenn R. Freeman and Silas H. Russell as a Kentucky for-profit corporation in January 1994. After incorporation, Mr. Freeman approached representatives of the County and the County Development Authority for assistance in securing publicly funded economic development financing for a new hosiery manufacturing operation to be located in the County and operated by BGH. By letter to County Judge/Executive Delzinna Belcher, dated December 14, 1994, written on the letterhead of “Kingdom Come Industrial Development Authority, Inc.,” which is a separate non-profit Kentucky corporation for which Mr. Freeman serves as a director, Mr. Freeman wrote: “[p]lease consider this letter as Bluegrass Hosiery, Inc.’s commitment to create 125 new jobs at the proposed new facility in Cumberland, Kentucky.”
In January 1995, the County made a commitment to use $144,468 of Block Grant RLF moneys on hand to expand water and sewer lines to BGH’s facility. However, in a June 9, 1995, letter from County Judge/Executive Belcher to DLG, Judge Belcher stated that the $144,468 would be loaned directly to BGH to assist with equipment purchases instead of being a part of the financing to extend the water and sewer lines to the BGH facility.

The $144,468 Block Grant/RLF loan proceeds were transferred to BGH on January 9, 1996. The interest rate on the loan was 3 percent. The loan agreement stipulated that in the event a loan repayment was not made by the 10th of each month, a late fee of 3 percent would be assessed and added to the monthly payment. BGH was to make monthly interest payments only for the first two years, and then monthly payments of principal and interest of $1,122.43 per month through 2010. BGH made payments on the RLF loan on January 15, 1997, and March 12, 1998, totaling $1,456.73 of interest only.

Also in January 1995, the County, through the CVADD, submitted an application to DLG for a grant of $730,000 in federal Block Grant funds to assist in the start-up of BGH’s hosiery manufacturing operation. Of this amount, $30,000 was a grant earmarked for legal and grant administration costs, with the remaining $700,000 a loan to BGH for the purpose of purchasing manufacturing equipment. After lengthy negotiations, a Grant Agreement for $730,000 of Block Grant funds was executed between DLG and the County on August 8, 1995. This $700,000 loan will be discussed in further detail below.

Thus, from DLG Block Grant transfers to the County, the County, through the County Development Authority, loaned BGH a total of $844,468 of Block Grant funds for equipment purchases.

BGH’s manufacturing facility was to be located in an existing structure known as the Lily C. Plaza Shopping Center in Cumberland, Kentucky, owned by Jimmy R. Cox and wife, Lisa Cox, and the Lark Group, Inc., a Kentucky corporation (Lark). In October 1994 this facility was leased by Lark, through a lease/purchase agreement (capitalized lease), for a term of 16 years, to Glenn R. Freeman, as an individual, with monthly rent payments due from Freeman to Lark of $4,145.84.
In May 1995, Mr. Freeman, in turn, sub-leased the premises for a term of 16 years to BGH, with monthly rent payments from BGH to Freeman of $4,145.84. Both the lease and the sub-lease agreements granted to the lessee and sub-lessee, respectively, the option to purchase the premises for the sum of $100 after expiration of the 16 year lease. (A second Lease Agreement, identical to the October 1994 lease between Lark and Freeman except for the dates of execution, was executed by Lark and Freeman on October 23, 1995, which 1995 lease presumably replaced the original lease executed by the parties in October 1994.)

Also in May 1995, while the County’s $730,000 Block Grant funds application was pending with DLG, BGH obtained a commitment for a $416,000 line of credit from First National, contingent upon First National receiving as collateral a $100,000 CD from Harlan County consisting of public funds, plus a priority first lien security interest in all hosiery manufacturing equipment to be purchased for the project.

This $416,000 bank line of credit was formalized by First National, on November 16, 1995, into a loan to “Glennco, Inc. D/B/A Bluegrass Hosiery, Inc., Glenn R. Freeman” for $916,000 to “purchase equipment for business.” This $916,000 bank loan was secured by (1) a first priority security interest in “all inventory, raw materials, goods in process, finished goods, machines, machinery, furniture, furnishings, fixtures, equipment, accounts receivable, whether now owned or hereafter acquired, and all attachments, accessions, and additions thereto, substitutions, accessories, and equipment therefore, and replacements and proceeds;” and (2) a “CD #61807 $100,000.00 5.5% maturity 5-16-96 in the name of Harlan County Fiscal Court.”

With the $416,000 bank line of credit in place by May 1995, the $700,000 Block Grant funds were ready to be loaned by the County Development Authority to BGH. Initially, the application for this Block Grant loan had called for the County Development Authority to use the $700,000 to purchase hosiery-manufacturing equipment and lease the equipment to BGH. However, due to First National’s not being comfortable with its collateral position, the $700,000 of Block Grant money was loaned by the County Development Authority directly to BGH. The equipment was purchased, and BGH promised to repay the loan over a period of
10 years, at 4 percent interest on the loan, with a two-year deferral of payment of the principal. The equipment served as collateral to secure First National’s loans to BGH, while the County Development Authority took a secondary lien position in the equipment as collateral.

In the June 9, 1995 letter from County Judge/Executive Belcher to DLG’s William Wolejsza, referenced on page 8 of this report, Judge Belcher wrote:

“Please accept this letter as a request to restructure the financing arrangement as it relates to the [BGH] project. As you know, the project-financing portion of this project requires approximately $650,000 of private funds to assist in the purchase of equipment, and building improvements. The $700,000 Community Development Block Grant was to be used by the Harlan County Industrial Authority to purchase specific items of equipment and leased to the company. [sic] When the application was submitted the local banks were receptive to assisting in the financing of the $650,000. But, when the banks were approached for loan negotiations the conditions placed by the banks were unacceptable and failed to materialize into commitments. Therefore, in an effort to resurrect the project, and secure the financing required to proceed in a timely manner, we offer the following structure:

1. The $700,000 CDBG will be used as a direct loan to the company for equipment, and the County/Industrial Authority will take a 2nd position to the financing of the balance of the equipment needs. The rate and term will remain the same as stated in the grant agreement.

2. The $144,468 of CDBG pay back funds [i.e., revolving loan funds] originally scheduled to assist in the extension of sewer and water lines will be moved to assist in the equipment financing with the same provision as the $700,000 CDBG loan.

3. Harlan County has secured (verbally) additional funding from the Local Government Economic Development Fund to finance the entire cost $455,300 for extending the sewer and water lines.
4. Middlesboro Federal has approved a $150,000 loan for building renovation, and working capital.

5. One of the owners (local) has committed to borrowing from the 1st National Bank of Corbin, $460,000 through his leasing company [Glennco, Inc.] to purchase equipment and leased to the Bluegrass Hosiery [sic]. However, 1st National Bank of Corbin has agreed to the loan on the condition that Harlan County deposits a $100,000 CD in their bank, and be given a first position on the $1,260,000 of equipment. Mr. Glenn Freeman, the local owner has agreed to this $460,000 bank loan the proceeds of which will be used to purchase the equipment in the name of Glennco Leasing. The purpose of the structuring the transaction in this manner to secure the $460,000 loan with the personal assets of Glenn Freeman [sic]. A direct loan to the company in the traditional manner will not work.”

On August 18, 1995, a series of agreements was executed with respect to the $700,000 Block Grant loan:

1. a Loan Agreement was executed by Glenn Freeman as Secretary of BGH, the borrower, and Kenneth M. Thompson as Chairman of the County Industrial Authority, the lender, in which the $700,000 was loaned to BGH for the purpose of purchasing equipment to be used in the hosiery manufacturing facility near Cumberland, in Harlan County, Kentucky.

2. a Security Agreement was executed by the parties which contains this provision:

“It is understood by the parties and represented by the Debtor [BGH] that the security interest herein granted in and to the Equipment constitutes a second position lien in the amount of seven hundred thousand dollars ($700,000). This lien shall be second only to that $460,000 secured interest previously filed by First National Bank & Trust Company and shall share the second position only with the $144,468 secured interest filed by Harlan County.”
3. an undated Promissory Note for $700,000 was executed by Glenn Freeman, Secretary of BGH.

4. a Guaranty Agreement was executed by Glenn Freeman in which Glenn Freeman promised to pay to the lender any and all principal and interest, up to $700,000, owed by the debtor, BGH. One provision of this Guaranty Agreement states that “[t]he liability assumed by the undersigned [Glenn Freeman] is a primary and direct obligation without regard to any other obligor or security or collateral held by Lender [County Development Authority].”

For some reason, a second series of agreements was executed by and between the borrower, BGH, and the lender, County Development Authority, on March 6, 1996, including (1) a Loan Agreement, (2) a Security Agreement, (3) a Promissory Note, and (4) a Guaranty Agreement, all substantially the same as the August 18, 1995 series of agreements, except that the amount borrowed by BGH in the March 6, 1996 Loan Agreement is $650,284.67, which is, apparently, a first installment of the total commitment of $700,000 of Block Grant funds. This $650,284.67 was released and transferred to the account of BGH on March 7, 1996. This $650,284.67 loan bears an interest rate of 4 percent, with principal payments deferred for the first two years, during which two-year period BGH was to make monthly interest payments of $2,167.62. After the initial two-year deferral period, BGH was to make monthly principal and interest payments of $7,926.50 per month for 10 years.

As part of this second set of agreements, a second installment of the $700,000 loan, in the amount of $49,715.33, was released and transferred to BGH on November 8, 1996. The second installment of the $700,000 loan was made at an interest rate of 4 percent, requiring payments of $532.48 for 112 months. Payments were to begin on December 6, 1996.

Why there are two separate series of executed agreements between the County Development Authority and BGH covering the same $700,000 Block Grant funds loan is unclear.

Our review of the available records shows that BGH made payments on the total $700,000 loan only on January 15, 1997, April 1, 1997, and March 12, 1998. These three payments totaled $8,690.48 of interest only. BGH did not, and has not to this day,
made any payments on the $700,000 principal. This $700,000 has apparently been written off by the County Development Authority with no prior attempt being made to collect the debt owed. Likewise, there is no evidence that DLG pursued the remedies an event of default triggers in the grant agreement. Accordingly, this information is referred to the AG for further investigation or determination.

By April 1996, total costs of improvements and equipment for BGH’s manufacturing facility were projected at $2,987,915, with public fund loans and grants comprising $1,593,015. Thus, to date, the taxpayers of Kentucky have paid for slightly more than 53 percent of the total costs of the BGH project. The federal Block Grant proposal called for two principals of BGH to contribute $100,000 each for a total of $200,000 of equity in the BGH project, approximately 7 percent of the total costs of the project; and private sector loans have financed the remaining 40 percent of the costs of the project.

In addition to the $700,000 federal Block Grant loan, BGH received an additional $100,000 loan of LGEDF state coal severance tax fund moneys, through the Cabinet by way of KEDFA to the County Development Authority, then to BGH. These loan proceeds were disbursed to BGH on August 27, 1996, and were a part of a Grant Agreement executed by KEDFA, the County, and BGH, on April 1, 1996. This Grant Agreement called for $548,477 of Cabinet/KEDFA economic development funds to be granted to Harlan County to extend water and sewer lines to BGH’s facility, for a total grant/loan of the KEDFA/LGEDF funds of $648,477 for the benefit of the BGH project.

According to a letter dated November 3, 1995, to Harlan County Judge/Executive Belcher, however, Cabinet Secretary Marvin Strong originally denied this additional $100,000 loan request. As reasons for the rejection, Secretary Strong wrote:

“Additional LGEDF participation for the Bluegrass Hosiery project was rejected for three reasons. First, the project had 45% public money (Block Grant and LGEDF) in it before the proposed [$100,000] amendment. We do not feel that additional public funds are justified for this project. At the time of the original application, Mr. Freeman had a commitment from a bank for the additional financing and
rejected the offer because of bank management’s requirements. While we will not form an opinion on the bank’s loan conditions, if Mr. Freeman believes the management requirements to be unreasonable, he should pursue other private lenders to fund building improvements. We do not believe the state or county should finance building improvements for facilities owned by private individuals.”

In the November 3, 1995 letter, Secretary Strong suggested that if BGH wanted to obtain the additional $100,000 LGEDF loan, he would reconsider his decision to reject the loan if an irrevocable letter of credit were issued on behalf of BGH from a bank to collateralize the loan.

Glenn R. Freeman subsequently met with Secretary Strong on November 8, 1995, and provided an irrevocable letter of credit from First National in favor of the County and the County Development Authority for $100,000. Secretary Strong then recommended that KEDFA approve an amendment granting the $100,000 of LGEDF money as a loan to BGH for renovation of the building to be used by BGH for manufacturing hosiery.

This $100,000 LGEDF loan was secured by the County’s holding, as security interests, both a second lien position on the equipment purchased by BGH (behind a first lien position held by First National), and an irrevocable letter of credit for $100,000 in favor of the County and the County Development Authority. According to a letter to Judge Belcher from Secretary Strong, dated November 9, 1995, the $100,000 irrevocable letter of credit was to remain in effect for “the entire life of the loan term.”

In fact, however, the first $100,000 irrevocable letter of credit, L/C No. 446, dated November 7, 1995 (as amended by First National’s letter dated April 10, 1996) extended by First National in favor of the County and the County Development Authority, stated that, on demand, the credit would be “payable on or before November 7, 1996.” Thus, though this irrevocable letter of credit was renewed by First National on November 7, 1996, for an additional year (L/C No. 467) and yet again on November 7, 1997, for the year expiring on November 7, 1998 (L/C No. 491) it was not renewed after November 7, 1998, thereby violating a term originally required by Secretary Strong.
We found no evidence indicating that the County, the County Development Authority, or the Cabinet (1) demanded that a draft be drawn from any of these letters of credit, nor did we find evidence that any official from these three agencies (2) attempted to extend this letter of credit as security for the loan beyond its last one-year term, which expired on November 6, 1998, or (3) protested when the November 7, 1997, letter of credit was not renewed by First National. As a result, the initial diligence of Cabinet Secretary Strong, in insisting on the letter of credit as security in the first instance, was compromised by the failure of the Cabinet, KEDFA, and the County Development Authority to ensure the extension of this security interest in the loan. Since this may be a violation of law or a breach of contract, this information is referred to the AG for further investigation or determination.

Terms and Purpose of $100,000 LGEDF Loan to BGH

The purpose of the $100,000 LGEDF loan was to make improvements to BGH’s manufacturing facility, which facility was, and remains, privately owned. BGH had to first complete the improvements to the facility and provide proof that the improvements were completed before KEDFA released the loan funds. BGH submitted invoices totaling $131,134.75 on July 15, 1996, as evidence of at least $100,000 of expenditures on the BGH building. Cabinet officials confirmed that the building improvements were made.

According to the terms of (1) the KEDFA/LGEDF Grant Agreement (2) the supporting Loan Agreement between the County Development Authority and BGH, and (3) BGH’s Promissory Note for $100,000, BGH was to repay the $100,000 loan in monthly installments of $691.00 over a fifteen-year period at a fixed interest rate of 3 percent beginning September 27, 1996. (Harlan County Fiscal Court amended all promissory notes from BGH, including the LGEDF loan, on September 17, 1996, due to the failure of the County Development Authority to provide water to BGH in a timely manner, so that the first payments would be due on November 17, 1996.)

According to Section 10.12 of the KEDFA/LGEDF Grant Agreement,

“... [t]he Company agrees to create seventy-five (75) Full Time Equivalent Jobs at the Facility within two (2) years of the Facility Completion Date, and to maintain said level of
employment through the third year following the Facility Completion Date (the “Jobs Requirement”). Should the Company fail to create and maintain the requisite number of jobs as set forth above, KEDFA has the option, but not the obligation, to declare an Event of Default under the Agreement and the Company may be required to pay KEDFA an amount equal to SIX THOUSAND SEVENTY ONE AND NO/100 DOLLARS ($6071.00) for each job not so created or maintained.”

**Loan Repayments by BGH**

BGH made payments on the LGEDF loan on January 15, 1997, April 1, 1997, and March 12, 1998, paying a total of $2,770.68. BGH made no other payments on the loan until after this examination was under way, after which time two additional payments on this loan totaling $16,000 were made. BGH did not create the seventy-five jobs called for by the Grant Agreement, and ceased all operations as a hosiery manufacturing company and closed the business sometime in 1998.

**KEDFA Declares Default on the $100,000 LGEDF Loan**

On May 19, 1999, Robin Fields Kinney, Cabinet General Counsel, sent a registered letter to Glenn R. Freeman and Harlan County Judge-Executive Joseph Grieshop, informing them that KEDFA had declared the BGH project to be in default. According to the letter, “[t]he default was declared for failure by the Company to create and maintain seventy-five (75) jobs as required pursuant to Section 10.12 of the Agreement.” KEDFA declared $100,000 of the $648,547 grant, plus interest, to be due and payable by the County and the Company.

The County Development Authority Board of Directors voted, on June 1, 1999, to write off $942,707.33 worth of BGH notes receivable, including writing off the $100,000 LGEDF note receivable.

On July 22, 1999, the Harlan County Fiscal Court voted to repay the $100,000 LGEDF note over a thirty-six month period, and on August 30, 1999, KEDFA and the County signed an agreement for the County to repay the $100,000 LGEDF loan. The loan is to be repaid in 35 consecutive monthly installments of $2,098.12 each, with the remaining unpaid balance to be paid in the 36th installment. There is no indication that either the County or the Cabinet is pursuing collection of this debt from BGH.
**Additional Loan Repayments by Glenn R. Freeman for BGH**

After our examination into these transactions began, the County Development Authority received a check, dated December 30, 1999, from Glenn R. Freeman for $8,000. In a letter accompanying the check, Mr. Freeman stated that “this payment will make the account current and up to date.” Mr. Freeman stated in an interview with us on May 24, 2000, that this $8,000 payment was a repayment on the $100,000 LGEDF loan. Mr. Freeman submitted a second $8,000 check to the County Development Authority on June 8, 2000. According to Harlan County Treasurer Patsy Fields, this second $8,000 check was from an account entitled “Freeman Construction Company.” There was also a memo written on the check stating that it was “repayment of a one-third interest of a loan.”

Harlan County Treasurer Patsy Fields stated that both $8,000 checks were deposited in the County Development Authority account.

**CVADD $100,000 Loan**

On October 11, 1996, the CVADD executed a Loan Agreement with BGH for $100,000 of Block Grant RLF funds, at 6 percent interest, with monthly payments of $1,460.86 per month for 84 months. This Loan Agreement was accompanied by a Promissory Note signed by Dean Shelton as BGH’s Secretary/Treasurer. A Security Agreement also was executed by Mr. Shelton for BGH, and by CVADD Executive Director John L. Bruner, II, for CVADD. The Security Agreement creates a security interest in CVADD, as the secured party, of “(1) A lien position on all equipment purchased with loan proceeds; (2) A personal guarantee of the owners of Bluegrass Hosiery (Glenn Freeman, Harry Russell, and Dean Shelton).” Our review of this loan found no evidence that BGH has made any monthly loan repayments, nor that CVADD has sought to enforce the default terms of the Loan Agreement. This information is referred to the AG for further investigation or determination.

**Public Funds Secure Private Loans**

On September 21, 1995, the County approved a motion to grant, as collateral for the $916,000 private sector bank loan to BGH from First National (referenced above on page 9) a $100,000 CD of the County’s public funds. On November 16, 1995, the County assigned CD #61807 for $100,000 to secure First National’s private loan of $916,000 to “Glennco Inc, D.B.A. Bluegrass Hosiery, Inc., Glenn Freeman,” jointly and severally.
On January 23, 1998, this original $916,000 Loan agreement/Promissory Note/Security agreement was combined and consolidated with other private loans from First National to Glenn R. Freeman for a total loan balance of $1,200,000. At that time, then-County Judge-Executive Belcher assigned the $100,000 CD as collateral to secure this new $1,200,000 loan.

On December 30, 1998, First National note #23393 for $1,200,000 and Note #23351 for $300,000 were consolidated with three additional private loans from First National into one loan totaling $2,272,883.30.

Even though the County’s $100,000 CD was assigned to secure the consolidated loan, we found no evidence that the County objected to its $100,000 CD being used to secure a consolidated private loan to Glenn R. Freeman of more than $2 million. Neither did we find any evidence that the County approved of securing this consolidated private loan in the amount of $2,272,883.30 with the $100,000 CD, other than that the previous loan document stated that “this agreement is made to secure the payment of the following described debt(s), plus all extensions, renewals, modifications, and substitutions: Note #23393 dated 1/23/98 to Glenn R. Freeman in the amount of $1,200,000.” Likewise, Note #23351 for $300,000 on the same date carried the same language and stipulations.

It appears from these findings that not only did the public entities loaning the public funds to BGH take a lien position subordinate to that of the private sector lending bank in the collateral equipment, but the County also put up an additional $100,000 of public funds to help secure the private bank loans. This is not a prudent use of taxpayer dollars, and may be either unlawful or a breach of contractual or fiduciary obligations. This information is referred to the AG for further investigation or determination.

BGH is no longer in business manufacturing hosiery in Harlan County, and its corporate status, according to the Kentucky Secretary of State’s corporation database, is listed as “inactive,” and its standing as “bad,” as of September 25, 2000.

According to a lease agreement obtained from Ted Westmoreland of Parkway (the current tenant of the manufacturing facility previously occupied by BGH), Glenn R. Freeman, as an individual, leased one of two of the former BGH buildings to
Parkway on August 1, 1999. The lease term is for fifteen years with a monthly rental of $5,075. Parkway has the option to purchase the building for $304,500 after the expiration of the lease. On May 1, 2000, the second former BGH building was leased to Parkway for a monthly rent of $4,541.

According to Mr. Westmoreland and language contained in the lease agreement, Glenn R. Freeman also has leased certain hosiery manufacturing equipment to Parkway for $4,643.28 per month. The transaction constitutes a capital lease, which amounts to the sum of $374,437 over a 10-year period at 8.5 percent interest.

It appears from these lease agreements that Mr. Freeman is receiving in excess of $14,000 per month in rents from Parkway, and yet the public loans to BGH are not being repaid in accordance with their repayment schedules.

Furthermore, from the deposition of Glenn Freeman filed in the case of Glenn Freeman v. Cape Publications, Inc. et al., (1) Mr. Freeman confirmed that he, personally, is leasing BGH’s equipment to Parkway, equipment bought with loans from public funds that Mr. Freeman as an individual appears not to own, and (2) that he is using the lease proceeds to pay off his personal debt to First National.

Finally, it further appears from Mr. Freeman’s deposition that in 1999, well after BGH had ceased operations, BGH paid $40,000 to Glenn Freeman and Freeman Construction Company, with two checks signed by Glenn R. Freeman as drawer, drawn on a BGH account at the Middlesboro Federal Bank, which funds BGH had received as proceeds from its sale of equipment bought with public funds. Freeman Construction Company is not registered as a Kentucky corporation, and is, apparently, used by Mr. Freeman as a “d.b.a.” entity. The rationale for BGH to pay Glenn Freeman this $40,000 instead of paying off some of its public loans debt is a matter we refer to the AG. Accordingly, these matters are referred to the AG for further investigation and determination.
The following findings are referred to the AG for further investigation and determination:

1. DLG gave $844,468 in federal Block Grant proceeds to the County to loan to BGH. There is no evidence that DLG has pursued the remedies an event of default triggers in the grant agreement.

2. The County Economic Development Authority loaned these funds to BGH, voluntarily taking a subordinate security interest in manufacturing equipment. After BGH failed, the county development authority wrote off the loans, and has made no attempt to collect them.

3. The Cabinet, through KEDFA, granted $100,000 in state coal severance tax proceeds to the County to loan to BGH, securing the loan with an irrevocable letter of credit from BGH in favor of the county. The letter of credit was allowed to expire. Upon the failure of BGH, the county became solely responsible for repayment of the loan to the Cabinet.

4. CVADD loaned $100,000 in federal Block Grant proceeds to BGH. There is no evidence that CVADD has pursued the remedies an event of default triggers in the loan agreement.

5. The County continues to allow a $100,000 CD consisting of public funds to secure private bank loans first to BGH and later to Glenn R. Freeman.

6. The manufacturing facility improved for BGH with public funds, and manufacturing equipment purchased for BGH with public funds, are producing monthly lease rents in excess of $14,000 for Glenn R. Freeman, while loans of public funds to BGH of more than $1 million have not been repaid according to their terms.

7. The Cabinet, through KEDFA, granted $548,477 in state funds to the County Development Authority to extend water and sewer lines to the property. Glenn R. Freeman further benefits from that public improvement.
8. Glenn Freeman has testified by deposition that he, personally, is leasing BGH’s equipment to Parkway. Although this equipment was bought with public funds, he has testified that he is dealing with this equipment as his own, and is using the lease proceeds to pay off his personal debt to First National.

9. Glenn Freeman has testified by deposition that in 1999, he wrote two checks on a BGH account totaling $40,000, one payable to Glenn Freeman, the other payable to Freeman Construction Co. The source of these funds appears to be from the sale of BGH’s equipment purchased with public funds.