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FDA E. COLI ADVISORY WARNINGS AND PRODUCT RECALLS:
What They Really Mean and How Suppliers Should Respond

The FDA's recent advisory warning about the E. Coli outbreak in spinach has raised numerous questions throughout the produce industry concerning not only the legal and practical effect of such advisories, but what steps a supplier should take in response.

Distinction Between Product Recalls and FDA Advisory Warnings

Contrary to common belief, the FDA does not order recalls of food products. Any headlines or news reports to the contrary are wrong. This is because the Federal Food, Drug, and Cosmetic Act authorizes the FDA to order a product recall only in limited situations where a medical device, human tissue product or infant formula pose a risk to human health. When the risk to human health involves any other product, such as fresh produce, the FDA may only issue advisory warnings and, if necessary, may request (but not order) manufacturers to recall the suspect food product.

For this reason, all product recalls in the current E. Coli outbreak have been voluntary based on the FDA's advisory warning that no one should eat any fresh spinach or salad blends that contain spinach that are consumed raw. Of course, from a supplier's perspective, the distinction between a "product recall" and an FDA "advisory warning" is often a distinction without a difference. In either case, the end result is that the product is pulled from store shelves and the supplier is faced with numerous dilemmas, ranging from customers who might

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refuse to pay for the product to legal action against the supplier if the product it sold turns out to be from a contaminated source.

FDA Guidelines for Companies To Follow When Recalling Products

The FDA provides a few guidelines for companies to follow when recalling products. Not surprisingly, these guidelines are designed to preserve evidence of contamination and the ability to track the tainted product but offer little guidance for dealing with the issue from a business perspective. The FDA guidelines are summarized as follows: (1) prepare and maintain a current written contingency plan for use in initiating and effecting a recall; (2) use sufficient coding of products to make possible positive lot identification and to facilitate effective recall of all violative lots; and, (3) maintain such product distribution records as are necessary to facilitate location of products that are being recalled. (Further information about FDA recall policies, including a more thorough explanation of guidelines for companies to follow when recalling products, can be found on the FDA's website at http://vm.cfsan.fda.gov/~lrd/recall2.html.)

Does an FDA Advisory Excuse the Buyer From Paying For the Produce?

Generally no, unless the advisory was made prior to the transfer of title and is tantamount to a formal "Stop Sale" order issued by the federal government, which are rare. In a 1990 case involving cyanide tainted grapes, the USDA ruled that a buyer was liable for the full contract price where the shipment of Chilean grapes was received *before* the federal government issued a "Stop Sale" directive on *all* Chilean fruit. *Pandol Bros., Inc. v. Burnett Produce Co.,* 49 Agric. Dec. 1206 (1990). According to the *Pandol* case, a buyer's obligation to pay for recalled produce turns on whether title passed to the buyer before or after the recall.

"...a buyer's obligation to pay for recalled produce turns on whether title passed to the buyer before or after the recall."

Title passes for a recalled load, as for any load, based upon the shipping terms. For example, under FOB terms, both title to the load and the risk of loss pass to the buyer as soon as the produce is placed with the carrier for transportation to the buyer. Thus, if the recall was issued at any point after the product was loaded, the recall notice itself would likely not excuse the buyer from its payment obligations. By comparison, in a delivered sale, title passes when the load is delivered to the agreed destination. In this situation, if the recall notice was issued before delivery, the buyer would most likely be excused from having to pay for the load.

Keep in mind that many produce suppliers will opt to issue credits to their buyers even in cases in which the risk of loss has technically passed to the buyer. It is reassuring to know that not everyone governs their own conduct based strictly on the legal technicalities involved. Such decisions often come at a high personal expense to the supplier. It is no wonder that so many within the produce industry are known for their decency and character, and not necessarily for who their lawyer might be.

Will a "*Force Majeure*" Clause Excuse the Buyer from Paying for the Produce?

Probably not. If you have a written supply contract or terms of sale containing a *Force Majeure* clause, you may still be required to perform on the contract, depending on the specific wording in the contract. Typically, a *Force Majeure* clause is effective only if the parties are aware of where the crops were produced and the unforeseen event occurred at that location. If the farmlands upon which the crops were to be grown were not identified in the agreement, a presumption that the supplier has several production regions will likely be drawn, in which case the supplier will be obligated to procure cover products to fill the order. Also, if the *Force Majeure* event occurred after the buyer accepted shipment, it is less likely that the remaining obligations of the parties (i.e., buyer's payment) will be excused. If you have specific concerns regarding a *Force Majeure* clause, you should contact your attorney.

Will a Supplier's Voluntary Recall Excuse the Buyer From Paying For The Produce?

Where a supplier voluntarily recalls product based upon an FDA advisory warning, that voluntary recall could well be construed as an admission that the product is neither in a merchantable condition nor fit for a particular purpose.

UCC §2-314 (adopted by most states) establishes an implied

warranty of merchantability on goods. To be "merchantable," goods must "pass without objection in the trade under the contract description." Similarly, UCC §2-315 establishes an implied warranty of fitness for a particular purpose. This means that, if seller knows the particular purpose for which the buyer intends to use the goods, and the buyer is relying on the seller's skill or judgment to select or furnish goods suitable for the buyer's needs, the goods must be fit for that purpose.

Under each of these commercial codes, a voluntary (as opposed to ordered) recall of product could be construed as the supplier's admission that the product is unmerchantable and unfit for human consumption its intended purpose. However, in many instances, such as with the current spinach voluntary recalls, the source of the contamination is still undetermined and so much of the recalled product may be perfectly safe.

"Even if your insurance policy does not specifically provide for coverage under these circumstances, it may be a good idea to file a claim anyway."

There is a real "Catch-22" here - if the supplier does not voluntarily recall the produce, the supplier would certainly suffer grave consequences in the event that the produce was contaminated and caused illness, or even death, to any consumer. On the other hand, a supplier "voluntarily" recalling its produce, when the source of the contamination is still undetermined, might be perceived as impliedly acknowledging to its buyers that its product is worthless, even if it turns out to have been perfectly safe. Thus, voluntarily recall decisions, as well as the guidelines to be followed (including press releases) when making such recalls, are both critically important. Every produce supplier should take some time to create, with input from appropriate experts, a thorough and carefully drafted recall plan and procedure so that it is in place well in advance of a crisis.

Suggested Actions Suppliers May Take When Facing a Recall

Insurance Coverage and Claims. Review, or ask your attorney or an insurance expert to help you review, your insurance policies to determine what coverage exists, if any. Types of coverage to look for include general liability, product liability, product contamination, and product recall. Even if your insurance policy does not specifically provide for coverage under these circumstances, it may be a good idea to file a claim anyway. Pay particular attention to the deadlines for notifying your insurance carrier of a potential claim, which in many cases are as short as 30 days from the date on which you knew, or should have known, about the possible claim. If you have questions about filing an insurance claim, you should consult your attorney as soon as possible.

Explore Other Sources of Recovery. If the source of the contamination is ever confirmed, a claim may also be made against that source's insurer. In addition, most suppliers rely upon results of food safety audits and laboratory soil analysis issued by certifying agencies (such as independent labs) which inspected the farmlands upon which the spinach was grown, took crop and soil samples, verified that Good Agricultural Practices and Good Manufacturing Practices were utilized in the production, harvest, and processing of the spinach. These results, as well as any samples should be preserved. If the food safety certification received verified the absence of the E. Coli contaminant responsible for spinach advisories, the certification may prove to be valuable evidence in the future. The possibility that the certifying laboratory, or its insurance carrier, may also have liability exposure may also need to be explored before a claim deadline expires.

Calculate Potential Damages. Spinach growers and suppliers should begin computing their actual and anticipated losses as soon as possible. All receipts and other documentation establishing expenditures and losses should be preserved and photos should be taken of growing crops, noting precise identification of field location and field dimension before the crops are disked. Sometimes pre-harvest plant pathologists or other experts are retained to assist in both contamination analysis and damage assessment before the crop is destroyed. A supplier's damages might include the selling price plus all related sales charges, such as palletization, packing, cooling, freight, etc. Other costs associated with a recall, such as dumping or disposal fees, restocking charges, cover purchase requirements, substitution-related costs, and similar expenses, should be included. From the production end, keep track of all growing costs and keep receipts associated with such costs. Growers should try to compute their per acre growing costs, per acre yields, and the number of acres of spinach left unharvested, the harvesting costs for the number of acres of unusable spinach actually

harvested, as well as damages associated with responding to the recall, e.g., disking fields.

Responding to Buyers. When discussing the spinach recall situation with customers, suppliers should be cautious about making statements that might be interpreted as admissions of some sort. Moreover, while the facts are still being investigated, it may be best for suppliers to take a "wait and see" approach with their buyers in response to buyers' demands for refunds, credits and freight reimbursement. Suppliers who rush to placate their customers might come to regret their impulsiveness later on. Remember, if the source of the contamination has not been identified, there is no evidence that a particular supplier's spinach is tainted, nor that its conduct resulted in a breach of contract or the unmerchantability of the spinach. *See Pandol Bros. Inc.*, cited above. In FOB transactions, the risk of loss is supposed to pass to the buyer at shipping point, and risk of loss should therefore remain with the buyer absent proof of the supplier's breach of contract. It may be prudent for a supplier to spend more time conferring with its attorney than with its customers, at least until the facts become clearer and an informed decision can be made.

Federal Courts of Appeal Decision Denies Transportation Company's Attempt to Trump PACA Trust Claims

In what would have been a devastating decision for produce suppliers in future cases if the Court ruled for the transportation company, the federal Third Circuit Court of Appeals instead decided against the transportation carrier. In *Pacific International Marketing, Inc., et al. v. A&B Produce, Inc., et al.*, the appellate court was asked to decide whether a claim for unpaid transportation charges could be paid from PACA trust funds prior to payment of the unpaid produce sales.

The case involved A&B Produce, Inc.'s failure to pay numerous creditors, including several produce suppliers as well as Exel Transportation Services, Inc., a logistics company that arranged and paid for the transportation of produce from the produce suppliers to A&B prior to A&B ceasing operations. Exel paid certain carriers to transport the produce to A&B and invoiced A&B for these services.

After A&B closed its doors and began the process of liquidating its assets for creditors, parties were permitted to submit claims in order to share in a pro rata distribution of A&B's assets. Exel sought payment for its transportation services as an administrative expense, which if validated, would be paid *prior to* any distribution to PACA trust creditors. The U.S. District Court denied Exel's claim reasoning that allowing transportation claims to be considered "administrative expenses" would defeat the purpose of the PACA trust provisions. Exel appealed this decision to the Third Circuit Court of Appeals.

After a detailed discussion of the PACA and its legislative history, the appellate court discussed bankruptcy decisions that allowed a trustee who preserved trust assets for PACA trust creditors to recover attorney fees for these services. Exel argued that without its transportation services, there would be substantially less trust assets for distribution to the PACA trust creditors. Thus, Exel argued that similar to courts that allowed trustees to recover fees for preserving trust assets, it should be permitted to recover the amounts paid for transporting the produce (and maintaining its value).

The Court rejected Exel's arguments reasoning that if Exel's transportation claim were allowed to be paid prior to PACA trust claims, then numerous other claims would also

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have to be allowed to be paid first, such as utility companies that cool the produce, paper companies that allow invoices to be printed, etc. The result would be that the Congressional intent underlying the PACA trust (to put the produce suppliers first in line) would be defeated.

The Court also rejected the argument that transportation charges should be paid first since the PACA allows for payment of "sums owing in connection with" the produce sales. The Court reasoned that Exel's transportation services were not "in connection with" produce transactions because Exel *only* arranged for transportation and did not also sell produce.

In the end, Exel raised several novel and creative arguments, but the Third Circuit Court of Appeals saw through to the fact that Exel's arguments, if accepted, would dilute the effectiveness of the PACA trust. Such dilution would act to hurt the produce suppliers, which are the exact class of creditors that Congress intended to protect by enacting the PACA trust.

So, for now, PACA trust creditors need not worry about transportation claims receiving a priority classification that could trump their claims (at least until another creditor challenges the PACA trust).

Invoice Provisions That Provide for Recovery of Attorney's Fees & Interest in PACA Trust Collection Action Might Not be Sufficient to Recover Legal Fees & Interest

Some Courts Have Determined Invoices Provide a Contractual Basis for Fees

PACA does not provide for the recovery of interest on overdue invoices nor does it provide for the recovery of attorneys' fees and costs incurred by a PACA creditor in an action to collect outstanding invoices or to enforce PACA trust rights. However, several courts have determined that if there was a contractual basis between the buyer and seller for the recovery of fees and interest, then the seller was entitled to include fees and interest as sums owing in connection with the sales transaction as part of its PACA trust claim. If there was no contractual basis for the recovery of fees, then under the vast weight of judicial decisions, there was absolutely no chance of the PACA creditor recovering its fees. Obtaining an award for interest on outstanding invoices was not quite as problematic as courts have the discretion to award interest. However, the rate of interest is based on the state percentage rate and is usually considerably less than a typical contractual rate of interest negotiated between the parties.

For these reasons, **Rynn & Janowsky** has advised its clients to include provisions for the recovery of interest on unpaid balances due, attorneys' fees and costs on their invoices. While these provisions did not guarantee a recovery of fees and interest, it provides a strong legal argument for the recovery of these amounts. Indeed, PACA creditors have recovered tens of thousands of dollars in fees and interest because attorneys' fees and interest language appeared on their invoices to the buyer.

No Recovery of Attorney's Fees for PACA Claimants in Louisiana

Whether or not a contract exists between the parties is an issue based upon state law. Any reliance on invoice provisions as the contractual basis to recover fees and interest recently came to a screeching halt in cases pending in Louisiana. (*In re Dixie Produce & Packaging, LLC.*, Case No. 05-13410; *In re A&A Potato of Del Norte Colorado, LLC,* Case No. 05-16392; *In re Old Dixie Produce & Packaging, Inc.*, Case No. 05-16397; *Keith Connell, Inc. et al. v. Old Dixie Produce & Packaging, Inc. Adversary Proceeding No. 05-01098*, U.S. Bankruptcy Court for the Eastern District of Louisiana, collectively referred to as "Dixie").

Louisiana is the only state that has not adopted the Uniform Commercial Code ("UCC"), which governs commercial transactions (sales of goods, commercial paper, bank deposits and collections, letters of credit, bulk transfers, warehouse receipts, bills of lading, investment

securities and secured transactions). Louisiana's state courts have repeatedly ruled that provisions on invoices or delivery tickets for fees and interest even if signed do not establish a contract between the parties.

In 1995, Louisiana's legislature drafted and adopted Article 2601 of the Louisiana Civil Code, which provides that between merchants, additional terms become part of the contract unless the additional terms materially alter the parties' contract or there is an objection within a reasonable time to the additional term. Article 2601 closely follows UCC 2-207. In modeling Article 2601 after UCC 2-207, Louisiana elected to make its civil law system more compatible with the law of other states, which have also adopted the UCC as the basis for their laws. Unfortunately, the Louisiana state courts have declined to apply this statute and continue to rule that invoice provisions are insufficient to establish a contract between the parties. In Louisiana, only those parties that entered into a separate agreement that specifically provides for recovery of fees and interest have a contractual basis to demand fees and interest as part of any claim.

A Customer's Credit Application With Attorney's Fee Language May Prove Extremely Valuable In PACA Trust Enforcement Proceedings

Taking steps to minimize (or, hopefully, eliminate) the risk associated with the above-described District Court decisions has become critically important. All too often, one of the simplest and most effective tools available to both minimize these risks and maximize collection of accounts receivable is either overlooked or underused. That tool is the Credit Application.

An accurate and complete Credit Application can be one of the PACA Trust creditor's most valuable tools to minimize these risks and to place your company in its strongest position to collect all sums due to it from a delinquent produce buyer. Indeed, if Credit Applications are signed by the customer, the terms contained in that application become contractual terms that will govern the sales transactions. Thus, a company's Credit Application should be carefully reviewed and modified to make certain that it includes all terms and conditions that you wish to control sales transactions between your company and its buyers.

With respect to the finance charge and attorney's fee issues that became so problematic in the *Dixie* case, those issues would have been avoided had the seller required the buyer sign a credit application containing language such as the following:

- *"The entire outstanding balance due to Seller on all invoices shall become due and payable in full within the payment terms set forth on Seller's invoice. Applicant agrees to pay finance charges in the amount of 1.5% per month or the highest rate permitted by law, whichever is less, on any past due amount until collected."*

- *"Should any action be commenced between the parties to this contract concerning the sums due hereunder or the rights and duties of any party hereto or the interpretation of this contract, the prevailing party in such action shall be entitled to, in addition to such other relief as may be granted, an award as and for the actual attorney's fees and costs in bringing such action and/or enforcing any judgment granted therein."*

In addition to finance charge language and attorney fee language, there are other often overlooked terms of sale that should be included on the credit application. For example, if a seller utilizes payment terms other than PACA prompt terms of 10 days after receipt and acceptance of the produce, the credit application is the perfect opportunity to reduce those extended terms to writing, thus helping satisfy the PACA regulations requirement that the parties have *written* evidence of those terms prior to the sale. Therefore, if the seller has 21-day payment terms, the credit application should include language stating those terms. Bear in mind, however, that any written payment term beyond PACA prompt terms *must* be disclosed on not only on invoices but also on all other documents seeking payment for the produce, such as account statements.

Credit applications can also be the perfect place to include various terms that will assist a company in the event litigation is required to collect the balance due. Such terms include jurisdiction clauses (requiring that lawsuits be filed in a particular court), arbitration clauses, or personal guarantees. Remember, any term that will benefit a PACA Trust creditor and maximize "clout" if legal steps must be taken to collect payment should be included on the credit application.

Recent Appellate Court Decision on Producer's Lien is Clear Victory for California Growers Who Sell Product To Processors

The Court of Appeal in Fresno recently added some muscle to the growers' side of the rugby-like scrum, which growers face when battling banks and other creditors for the assets of a financially sinking processor. Specifically, in *Frazier Nuts, Inc. v. American Ag Credit*, the court concluded that a California producer's lien not only attaches to the farm product delivered to and still in a processor's hands, but it also extends to *sales proceeds* generated by the processor's sale of the product.

Of course, banks are screaming foul and are expected to push for the appeal of this decision, since such a lien would trump a bank's security interest in the processor's accounts receivable.

On the other hand, given the wide variety of agricultural commodities covered by the California producer's lien law, this decision is cause for jubilation by growers of almost any "agricultural, horticultural, viticultural, or vegetable product of the soil, honey, beeswax, oilseeds, poultry, poultry product, and livestock for immediate slaughter" who sell to California processors, particularly those who cannot take advantage of the federal Perishable Agricultural Commodities trust provisions (which are limited to sellers of fresh and frozen fruit and vegetables who sell on no greater than 30 day terms)

"... the court concluded that a California producer's lien not only attaches to the farm product delivered to and still in a processor's hands, but it also extends to sales proceeds generated by the processor's sale of the product."

In this new decision, the appellate court was faced with two competing creditor groups, both of whom claimed superior rights to the proceeds from the sale of a bankrupt processor's almonds, nearly $400,000 of which the processor had paid to the secured lender. The growers filed a lengthy complaint in the Superior Court against the lender, which in essence demanded that the lender turnover to them "the wrongfully diverted proceeds of the sale of their almonds."

The court looked to the California Producer's Lien law, which states that every producer of any farm product that sells his product to a processor "has a lien upon the product" and upon all processed or manufactured forms of the farm product for his labor, care, and expense in growing and harvesting it. The statute further states that the lien is on every farm product and on any processed form of the farm product "which is in the possession of the processor." A processor is defined as "any person" "engaged in the business of processing or manufacturing any farm product" "for the purpose of processing or manufacturing it and selling, reselling, or redelivering it in any dried, canned, extracted, fermented, distilled, frozen, eviscerated, or other preserved or processed form."

In other words, a grape grower who sells his grapes to a winery has a first priority lien for the full extent of the agreed price upon the grapes and the wine that is produced from the grapes while they are in the winery's possession. The lien attaches to the grapes the day that they are delivered to the processor and no further steps, such as a UCC filing, need to be taken by the grower to perfect the lien on the grapes or their processed form.

The lender in the *Frazier Nuts* case argued that the Producer's Lien does not extend to the *proceeds* from the sale of the product, since the lien according to the lender only attaches to the farm product while it is in the *possession* of the processor. The court, however, disagreed. It noted that the Producer's Lien law expressly states that "it is *unlawful* for any processor" to

remove from his control any farm product which is delivered to him, or any processed form of the farm product, to which the lien has attached, except the processor is not prohibited from selling the product *if* "the total proceeds from the sale are used to satisfy obligations to producers which are secured by a lien." This sentence, the court concluded, imposes a legal duty upon processors to use proceeds from the sale of farm products to pay the producers, which "constitutes a lien on the proceeds" that is a "producer's lien" superior to all other liens except certain wage and salary claims and warehousemen liens.

Consequently, under the rationale of the *Frazier Nuts* decision, if a grower delivers his tomatoes, olives, nuts, chickens, honey, spinach, or rice to a processor, who thereafter files for bankruptcy protection or otherwise fails to pay the grower, the grower not only has a first priority lien on the product in the processor's possession, but his producer's lien also trumps the processor's secured lender's interest in the processor's accounts receivable from the sale of the farm product.

Given the sums involved in the *Frazier Nuts* case and the enhanced credit risk that lenders must now bear, the decision may be appealed. Of course, even if this decision survives an appeal, growers must carefully read any contract that they enter into with their processor to make sure that they are not waiving the producer's lien rights. As the court emphasized in *Frazier Nuts*, the California producer's lien statute was enacted "to strengthen the position of farms as against lenders to the processor." It is a position that should be carefully guarded.

Oral Agreements To Extend Payment Terms May Result in Disqualification of PACA Claim

Do the following statements sound familiar? "That's OK, send me the check next week." "Don't worry about it. I know you're good for it. Send me a check when you can." "Send me what you can, when you can." "Hey, I know you're waiting for payment from so-and-so. You can pay me when you get paid." "Is it OK if I send you a check next week?" "Hey, can I pay you a portion now and the rest over the next few weeks?"

Each of the above statements sounds innocent enough, but in attempting to be reasonable with a customer in granting "just a little bit of extra time" to pay their outstanding invoices, a seller may have jeopardized its PACA trust rights by inadvertently extending payment terms beyond thirty (30) days. Certain court decisions have determined that statements not unlike those recited above, may create oral agreements extending payment terms beyond thirty (30) days, which would void a buyer's PACA trust rights especially if there is a writing (letter or e-mail message) memorializing the "extended" payment terms.

In *Dixie*, the bankruptcy court was inclined to disallow claims based upon alleged oral agreements extending terms beyond thirty (30) days even if there were no written documents confirming these alleged oral agreements and the creditors disputed the existence of the oral agreements!

The long established law that oral agreements cannot extend payment terms is being chiseled away by some courts. Often, judges, especially bankruptcy court judges, do not like the drastic impact PACA has on non-PACA creditors, especially secured creditors. For this reason, more courts are demanding strict compliance with the PACA statute so as to eliminate as many PACA Trust creditors as possible. Recently, the Second Circuit Court of Appeals in *American Banana Co., Inc. et al. vs. Republic National Bank of New York*, reasoned that the "[PACA Trust Creditor's] failure to reduce to writing an agreement that violates PACA should not result in the preservation of the trust, where the same agreement, if memorialized [in writing], would have resulted in forfeiture of such protection." Accordingly, the Court ruled that "where a seller agrees orally or in writing to a payment period exceeding thirty days, it forfeits trust protection."

The *Dixie* court was sympathetic to the Second Circuit's

reasoning in *American Banana*, and for this reason, **Rynn & Janowsky** strongly urges suppliers to educate their sales staff. Salespersons, accounting personnel, and management should be cautioned not to agree to payment terms beyond the invoice terms for any reason. Immediate payment in full of all outstanding invoices must be demanded. On the other hand, a payment plant that is negotiated and agreed to by both the buyer and seller *after* the seller has filed a complaint to enforce the PACA trust in federal district court, and which is approved by the court, should not result in an extension of payment terms so as to be subject to attack by the other PACA creditors who may subsequently sue the debtor.

Save The Dates

Upcoming Specialized PACA Workshops

Rio Rico / Nogales, Arizona Week of **December 11, 2006**

Visalia / Fresno, California **January 9, 2007**

Bakersfield, California **January 10, 2007**

Coachella Valley, California **March 15, 2007**

Santa Maria, California **March 20, 2007**

Salinas, California **March 21, 2007**

Honolulu, Hawaii Week of **April 23, 2007**

Rynn & Janowsky, LLP is pleased to announce that three attorneys from the firm, Patricia Rynn, Jason Read and Marion Quesenbery, will soon be hitting the road to conduct a series of seminars and workshops on PACA. These seminars are supported by a USDA-Risk Management Agency partnership grant, which was awarded to Western Growers Association through the Hercules efforts of its Trade Practice Director, Tom Oliveri. Apart from Western Growers Association, which is the anchor association sponsoring the seminars, other produce organizations, including the Fresh Produce Association of the Americas, the California Grape and Tree Fruit League, the Salinas and Santa Maria Grower Shipper Associations and the Maui County Farm Bureau are also sponsoring the PACA seminars. The seminars will address the latest developments in enforcing PACA Trust rights, and will offer valuable guidance for avoiding pitfalls that can result in a loss of eligibility under the PACA Trust. After a catered lunch, there will also be breakout workshop sessions to provide in-depth study in three distinct areas: (i) Credit Management and Reducing Credit Risk; (ii) Produce Sales for Dummies; and (iii) Growers Are from Mars; Produce Salesmen Are from Venus – Build Better Grower Relationships, Understand Grower Agent Duties, and Review Marketing Agreement Basics. Take advantage of the opportunity to benefit from all three workshops by sending employees to each of the sessions.

Long-time Director of Trade Practices for Western Growers Association, Mr. Tom Oliveri, will be participating in the Produce Sales workshops. In addition, the California Department of Food and Agriculture Chief of the Market Enforcement Branch, Ms. Agatha d'Esterhazy, will attend all of the California seminars and discuss requirements under the California Commission Merchant Law, and describe the most common licensee violations encountered by her agency. For the Arizona presentation, attorney Kip Martin, a fixture in Nogales legal circles, will address special "cross border" issues between growers and marketers.

Given the number of upcoming seminars, it's a good bet that one will be held in or near your town. Or, if you're looking for a perfect excuse for your next trip to Hawaii, this is it. Come join us! The seminar locations and exact dates will be announced shortly. Please check our website for updated information and additional details. Start jotting down your PACA questions now. We look forward to seeing you at one of the seminars!

Accepting Produce on Consignment from California Shippers Can Expose Commission Merchants to Lawsuits Brought by Shipper's Undisclosed Growers

New Worries For Receivers Taking Produce on Consignment

Wholesale market receivers and commission merchants should be prepared to defend a new type of potential liability in connection with California grown produce: lawsuits brought by growers dissatisfied with the sales returns negotiated or approved by their marketing agents.

In a state appellate court decision entitled *Mendoza v. Continental Sales Co.*, 140 Cal. App. 4th 1395 (2006), which some might say could have only been authored in California, land of fruits and nuts, the court held that a receiver accepting produce on a consignment basis from a California marketer may be sued by the marketer's grower, not just the marketer. This is so even in the absence of an agreement or contract between the wholesaler and the grower. Indeed, the mere fact that a receiver is unaware of the existence, much less the identity, of a marketer's outside grower, is no bar to the grower's lawsuit against such receiver.

Factual Allegations Surrounding The *Mendoza* Case

Mendoza, a pomegranate grower in California, entered into marketing agreements for his 2001 and 2002 pomegranate crops with Rast Produce Company, who in turn sold the pomegranates to various produce wholesalers across the country. After claiming that there were "irregularities" in its returns for the 2002 crop, Mendoza sued the 13 wholesalers (both inside and outside California) to whom Rast sold the pomegranates, alleging that the wholesalers were re-consignees, as opposed to purchasers, and therefore were subagents of Rast. Mendoza alleged that as subagents of Rast, the wholesalers owed him the same duties that any agent owes a principal, and therefore these wholesaler receivers should be liable to Mendoza for conversion, breach of fiduciary duties, accounting, negligence, breach of contract and fraud. The wholesalers moved for a judgment on the pleadings, arguing that because the wholesalers and Mendoza had no contractual relationship with one another, known as "privity" of contract, the wholesalers owed no duties to Mendoza. The trial court agreed with the wholesalers and granted their motion. Mendoza appealed this decision to the California Court of Appeal.

Court of Appeal Decision Allows Grower to Amend Complaint

The sole issue on appeal was whether or not Mendoza's complaint sufficiently alleged legal theories upon which the wholesalers could be properly sued. Therefore, the Court of Appeal did not decide whether the transactions between Rast and the wholesalers were sales or re-consignments. Instead, the Court simply considered whether or not the wholesalers *could* be liable to Mendoza under agency theory *if* the transactions were found to be re-consignments.

Relying on California Civil Code Sections 2349 and 2351, which state the applicable law of subagents, and the marketing agreement entered into between Mendoza and Rast, the Court concluded that if the transactions between the wholesalers and Rast were re-consignments, then the wholesalers became subagents of Rast. As subagents of Rast, the wholesalers would owe Mendoza the same duties an agent owes a principal, *despite the fact that no contract or agreement existed between Mendoza and the wholesalers.* Accordingly, the Court held that Mendoza's complaint sufficiently alleged causes of action for conversion, breach of fiduciary duties, accounting, and negligence.

What about Price After Sale ("PAS") Transactions?

An important distinction to be drawn from this case is the difference between re-consignments and Price After Sale ("PAS") transactions. PAS transactions *should not* trigger fiduciary duties to the grower because PAS transactions are considered sales under both Perishable Agricultural Commodities Act ("PACA") precedent decisions and cases interpreting the Uniform Commercial Code. The Court's ruling only encompasses re-consignments, in which the receiver acts as an agent for the shipper and in which title never passes to the receiver. The *Mendoza* ruling should not extend to straight sales of any type, including PAS basis transactions.

Practical Ramifications of the *Mendoza* Decision

It is common in the trade for a wholesaler to be contacted by a marketer to handle product on consignment which has been rejected by a retailer or large chain store. Many wholesalers and commission merchants, upon receipt of substandard or distressed produce which otherwise might be rejected, instead agree to handle the produce on a re-consignment basis for the account of the shipper. These scenarios would trigger the additional duties discussed above and could potentially render the wholesaler or commission merchant liable to the grower. To deal with this new risk, **Rynn & Janowsky** is recommending to both its shipper clients and wholesale and commission merchant clients to be sure that PAS arrangements are clearly denoted as such in all sales documentation exchanged between buyer and seller, and in all grower accounting documentation furnished by shippers to their growers.

Additionally, those wholesale and commission merchant clients who might be called upon to handle produce for California produce shippers on a consignment or re-consignment basis, as a general proposition, **before** agreeing to handle produce for the shipper's account, should consider having the shippers sign an indemnification agreement holding them harmless in the event of a lawsuit by any of the shipper's growers over returns remitted for the sale of the produce. Such an indemnification agreement would require the shipper to reimburse its commission merchant for any and all damages, claims, attorneys' fees and expenses incurred for legal actions initiated by any of the shipper's growers against the commission merchant, which could arise from the handling such produce on consignment.

The indemnification agreement might be worded as follows:

> *Veggies 4 Sale, Inc. agrees to indemnify, protect, and hold Veggie Wholesalers, Inc. harmless from any and all damages, claims or actions, including attorney's fees and legal costs incurred, which may arise from claims of any nature initiated by grower relating in any way to Veggie Wholesalers, Inc.'s handling of produce received from Veggies 4 Sale, Inc. on consignment sales basis.*
>
> Date: ____________________
>
> Signature of Shipper

Wholesalers, commission merchants and produce marketers should contact their attorneys regarding whether and to what extent indemnification agreements should be entered into, because each situation may be different. Additionally, marketers should consider adding provisions in the marketing agreements with their growers limiting the scope and nature of proceedings which can be brought in the event a dispute arises between grower and marketing agent.

Conclusion

In summary, wholesalers and commission merchants agreeing to handle produce for the account of a California shipper must now remember that they not only owe fiduciary duties to the shipper who selected them, but to the California growers that shipper may represent as well.

Featured Employee

Tim Dorsey
Legal Assistant

In 2000, Tim joined R&J at the tender age of 19 and instantly made an impression of professionalism beyond his years. While completing his undergraduate studies at U.C. Irvine, Tim worked part-time as the firm's file clerk. Upon graduation, he was quickly promoted to a legal secretary and legal assistant. Tim is an invaluable employee - he's attentive and accommodating to all our clients. Tim is reliable, sharp, and prompt. Tim always lends a helping hand to other co-workers, friends and family. Ethics aside, the staff plans to recommend Tim as a candidate for the first human cloning project.

Within The Firm

In Spring 2006, R&J completed a four-city Washington State PACA seminar tour. The events were supported by a USDA-Risk Management Agency partnership grant and sponsored by Washington Growers Clearing House Association, Washington Potato Commission, Oregon Potato Commission, Potato Growers of Washington, Idaho Grower Shipper Association, and the Idaho Potato Commission. (Top photo from left to right: R&J's partners, Marion I. Quesenbery, Jason Read, and Patricia J. Rynn, and Dan Kelly, Assistant Manager, Washington Growers Clearing House Association.)

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