



SHARPENING PACA'S TEETH:

CHANGES TO THE LAW COULD GIVE SMALL SUPPLIERS MORE BITE

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Today's economy makes it more important than ever for produce buyers to pay for the produce they purchase. The strongest weapon in the produce seller's credit arsenal is the protection under the Perishable Agricultural Commodities Act ("PACA") 47 U.S.C. 499a-t.

Under PACA, a statutory trust is created upon the sale of produce. The buyer acts as the trustee, holding the produce, and the monetary proceeds from reselling the produce, in trust, for the benefit of the seller, until the seller is fully paid. Since a failure to pay is a breach of the trust, not merely a breach of contract, and a breach of the fiduciary duties as trustee, a produce seller who properly preserved his rights is entitled to a "super-priority" even over secured creditors. This super-priority also results in personal liability for those in a position to control the corporate buyer and the PACA trustee's breach of its fiduciary duties are typically not dischargeable in a Chapter 7 bankruptcy. By changing the nature of the transaction, from contract to the fiduciary duty of a statutory trust, Congress gave unpaid produce sellers a serious set of teeth to take a bite out of delinquent buyers' assets. "Congress intended PACA to protect small farmers and growers who were vulnerable to the practices of financially irresponsible buyers." *Pacific International Marketing, Inc. v. A&B Produce, Inc.*, 462 F.3d 279, 282 (3rd Cir. 2006) quoting *Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 202 (3rd Cir. 1998).

Other articles have touched on what kinds of produce and buyers PACA covers and what a seller needs to do to preserve its PACA rights. This article will discuss how PACA could be improved to benefit the small produce seller by focusing on two areas: 1) recovery of attorneys' fees and 2) inconsistent statutes of limitation.

I. AMEND PACA TO PERMIT RECOVERY OF LEGAL COSTS AND FEES

One of the biggest hurdles to pursuing a valid PACA claim in court is the legal costs. While larger companies have an easier time absorbing the legal costs of a law suit, smaller companies face a far more difficult time. Frequently the smaller produce seller will have a

number of small unpaid receivables from different customers. Although the dollar amount of each claim may be relatively low, the percentage of gross revenue each claim represents will be greater, thereby making each unpaid claim more significant. A PACA claim for \$10,000.00 means a lot more for a seller whose total business is \$100,000.00 than a seller who grosses over \$1,000,000.00. The low dollar amount of each individual account may make it financially impractical to seek the needed legal help.

Presently, PACA only specifically provides for recovery of attorneys' fees when going to court to enforce a reparations order already issued by the United States Department of Agriculture ("USDA") through its formal grievance procedure. 7 U.S.C. §499g(b). There is no statutory provision that permits recovery of attorneys' fees when seeking enforcement of the PACA trust directly from the courts.

Fortunately, some courts have picked up the slack. A growing waive of Appellate Court decisions across the country follow the terms of the parties' contract to permit an unpaid produce seller to recover some or all of its attorneys' fees. This is separate from attempting to recover fees for actions that benefit the all beneficiaries of a particular PACA trust.

Attorneys' Fees by Contract.

Frequently the produce seller's invoices serve as the contract. Once, a contractual right to attorneys' fees is established, they become "sums owing in connection with" perishable agricultural commodities transactions under PACA and are entitled to the same trust protection as the produce itself. 7 U.S.C. §499e(c)(2). *See Coosemans Specialties, Inc. v. Jack Gargiulo*, 485 F.3d 701 (2nd Cir. 2007) *citing Country Best v. Christopher Ranch LLC*, 361 F.3d 629, 632 (11th Cir. 2004); *Middle Mountain Land & Produce v. Sound Commodities*, 307 F.3d 1220, 1222-25 (9th Cir. 2002); *See also Pacific International Marketing*, 462 F.3d at 286. Thus, if the seller pays its attorneys \$10,000 to recover \$30,000.00 in produce, the ultimate PACA claim and judgment against the buyer would be \$40,000.00.

Unfortunately, these decisions are only binding in the Second, Third, Ninth, and Eleventh Circuits¹. Even so, these decisions still leave open for argument whether or not payment of attorneys' fees was in fact an agreed part of the parties' contract and creates an additional round

¹ The Second, Third, Ninth, and Eleventh Appellate Court Circuits cover the following states: (Second) New York, Vermont and Connecticut; (Third) Pennsylvania, New Jersey, and Delaware; (Ninth) Arizona, California, Nevada, Oregon, Idaho, Montana, and Washington; (Eleventh) Alabama, Georgia, and Florida.

of litigation, and additional legal fees, which would not have taken place if PACA itself provided a statutory right to recover attorneys' fees. Just last year in 2007, the U.S. Court of Appeals for the Second Circuit decided such an issue in *Coosemans*, 485 F.3d at 708-709.

In *Coosemans*, the defendant alleged that the attorneys' fees provision on the plaintiff's invoices were never discussed or agreed to and therefore were unenforceable additional terms. *Coosemans*, 485 F.3d at 708. The Second Circuit applied New York Law which states that "additional terms are to be construed as proposals for addition to the contract" N.Y. UCC §2-207(2). However, when the parties are merchants, the additional terms become part of the parties contract unless: 1) the offer to purchase produce expressly limits acceptance to the terms of the offer; 2) the additional terms materially alter the offer; or 3) notice of an objection to additional terms was given within a reasonable time. *Id.* The *Coosemans* defendant alleged the attorneys' fee provision "materially altered" the terms of their contract with the plaintiff, which under New York Law, means the provision would result in surprise or hardship if made part of the contract without the express awareness of the defendant². *Coosemans*, at 708 citing *Bayway Ref. Co v. Oxygenated Mktg & Trading A.G*, 215 F3d. 219, 223-224 (2nd Cir. 2000); N.Y. UCC §2-207 cmt. 4. "Surprise" includes both subjective and objective elements – namely, what a party actually knew or should have known. *Id.* Fortunately for the produce seller, the Second Circuit found that the defendant buyer failed to provide evidence that would demonstrate any surprise over the attorneys' fee provision in the plaintiff seller's invoices. *Coosemans*, at 708. Since there was a contractual right to fees, the attorneys' fees became part of the PACA trust. *Id.* at 709.

The *Coosemans* case illustrates the need for uniformity when holding a delinquent buyer liable for the attorneys' fees the seller incurred trying to enforce the PACA trust. If the PACA statute mandated that the delinquent buyer must pay legal fees in a trust enforcement action, the *Coosemans* plaintiff could have avoided the various motions in District Court on this issue, not to mention the appeal. The litigation contesting the terms of the parties' contract could have been avoided. Moreover, a statutory attorneys' fees provision could be applied uniformly across the country.

² Many states have adopted versions of the Uniform Commercial Code that are similar.

II. THE LACK OF A STATUTE OF LIMITATION CAUSES INCONSISTENT RESULTS.

Under PACA, perishable agricultural commodities are held in trust by the buyer until the seller is fully paid. 7 USC 499e(c)(2). Logically, the trust remains until the seller is paid no matter how long that takes and the failure to pay, and continued use of PACA trust funds for non-PACA purposes, should be considered continuing violations of the trust that toll, or postpone, any statute of limitations. However, the PACA statute itself is silent on this matter and has left it to the unfortunate interpretation of the courts.

In 2005, the U.S. Court of Appeals for the Third Circuit limited the time to pursue PACA claims against an individual. *Weis-Buy Services, Inc. v. Paglia*, 411 F.3d 415 (3rd Cir. 2005). In *Weis-Buy*, the appellate court determined that because PACA failed to supply a statute of limitations, it should apply the statute of limitations for a breach of fiduciary duty from state law, which would be Pennsylvania in this particular case. *Id.* at 422. Pennsylvania law requires a breach of fiduciary duty claim to be brought within two years of when the claim accrues. *Id.* The claim accrues and limitation period begins to run when the “trustee openly and unequivocally violates his duties”. *Id.* In plain English, this means when a buyer fails to pay on time, its supplier has two years to pursue a PACA claim, *in Pennsylvania*, against the individuals who control the buyer company.

While the *Weis-Buy* case is not controlling outside of the Third Circuit, it highlights the lack of a national standard. Some courts in other jurisdictions may choose to accept the argument that the continued use of PACA assets for non-PACA purposes constitutes a continuing violation that does not have any time limitation. However, application of the *Weis-Buy* court’s ruling can lead to wildly different results in different parts of the country. For example, in Tennessee the statute of limitations for a breach of fiduciary duty claim is one year, in Virginia it is two years, while in New York it can range from three to six years depending on the basis of the claim and in Illinois the statute of limitations can be five years³.

Typically, an unpaid seller would sue the principals and corporation at the same time, but these lawsuits can occur at different times if the principals are unknown or if corporation is in bankruptcy, as was the situation in the *Weis-Buy* case. In the bankruptcy, more often than not, suit would have to be brought against the principals separately in District Court since bankruptcy

³ TCA 48-18-601; Va Code Ann. 8.01-248; See *Malmsteen v. Berdon LLP*, 477 F. Supp 655, 666-667 (SDNY 2007); and 753 ILCS 5/13-205 and See *Walker v. The Northern Trust*, 2007 U.S. Dist. LEXIS 4261 (NDIL. 2007).

courts generally may not have jurisdiction to adjudicate PACA claims against non-bankruptcy debtors. Unpaid suppliers may be reluctant to immediately pursue their claims simultaneously in two separate courts when it is uncertain whether enough assets may be recovered from the bankrupt corporation to satisfy all or part of the PACA claim. It is understandable that produce sellers, especially the small or low volume seller, would seek to avoid the increased legal bills that go along with fighting on two fronts. However, if an unpaid seller is not careful and is unaware of the applicable statute of limitations in the buyer's home state, the individual liability claims against a buyer's principals could be barred. Unless Congress amends PACA to either have a consistent standard or keep the claim alive until paid, unpaid suppliers of all sizes are going to have to keep track of the limitations periods in each and every state they do business in.

III. CONCLUSION

PACA still remains a strong weapon in the unpaid supplier's arsenal but needs to be improved in order to better meet its objective to protect small farmers and growers. Just as PACA permits recovery of attorneys' fees when enforcing a USDA reparations order in court, PACA should be amended to also provide recovery of attorneys' fees when pursuing a trust enforcement action in court. Such an amendment will provide a unified standard for the entire country and relieve the industry from the additional litigation burden currently required solely to prove a suppliers' right to recover its legal fees. This burden is felt more keenly by the small or mid-sized produce supplier without a large legal budget. A mandatory imposition of legal fees on a delinquent buyer will make equal the consequences of not paying, no matter the size of the seller. Small suppliers will be more apt to seek legal help and buyers will be more apt to settle, allowing the suppliers to pay their own bills and thereby improving the financial stability of the industry.

Additionally, Congress needs to amend PACA to specifically state there is no time limitation to a PACA claim against either the buyer or its principals, or at least set a specific and reasonable time period. The current silence on the issue only causes wildly different results across the country and can easily result in confusion which will ultimately cost a multi-state supplier large amounts of money when its claim against a bankrupt buyer's principals is barred. Hopefully Congress will heed these warnings and provide PACA with the needed "dental work" by filling the gaps in the law's teeth.

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