

WHEN A FOOD PROCESSOR FILES BANKRUPTCY: WHAT EVERY CALIFORNIA GROWER SHOULD KNOW BEFORE CONTRACTING TO SELL CROPS

I. INTRODUCTION

The traditional American farming lifestyle is deserving of one's utmost respect. As such, it is fundamentally unfair that farmers, while contracting for the sale of their crops, lose a year's revenue because they do not understand the ramifications of the contracts they sign. Farmers, on the average, are conservative, hard-working, honest, loyal people with immense respect for their land, their families, their community, and their profession.¹ While farmers undoubtedly respect the legal system in general, small farmers, in an attempt to save money, may prefer to handle legal problems themselves rather than consult with an attorney.

The first part of this comment briefly explores the history of agriculture in California and examines what happens when the farmers' traditional ways of doing business, with trust and a handshake, in this mega-billion dollar industry meet the intensely detailed world of corporate contracts. The second part of this comment discusses contract law as it relates to the sales of agricultural commodities under the California Commercial Code. Different types of agricultural contracts are explored, including California's special contractual requirements for grapes and edible nuts; the requirements for releases and waivers of agricultural contract provisions under California law. This section examines the various remedies offered to farmers through California and

¹ See generally Matthew M. Harbur, *Anti-Corporate, Agricultural Cooperative Laws and The Family Farm*, 4 DRAKE J. AGRIC. L. 385, 387 (1999) ("The small farm town supported twice as many local businesses, spend more on schools, have more parks and playgrounds, and twice the number of civic organizations and churches as the industrial farm town.").

federal law for breach of contract when a processor refuses to pay. The third part explains the statutory protection farmers have through the California Producer's Lien and the federal Perishable Agricultural Commodities Act, the ways in which these protections are enforced, and how easily unprepared farmers can lose their protection. Lastly, this comment focuses on the types of bankruptcies a processor can file. Current bankruptcy decisions are reviewed, along with Federal and California law as they relate to the status of secured and unsecured agricultural claims against the processor, including a discussion of the automatic stay, the role of the trustee, and the trustee's lien avoiding powers under the Bankruptcy Code.

II. ECONOMIC IMPORTANCE OF CALIFORNIA AGRICULTURE

California is home to the largest agricultural economy in the United States.² The Golden State produces over 350 of the world's most diversified crops, with no one crop dominating the state's farm economy.³ California farmers produce more "than half of the nation's fruits, nuts, and vegetables."⁴ California's agricultural production gross cash income receipts totaled almost \$26 billion in 1998. "Over twelve percent of the national gross cash receipts [from] farming is produced in California on 89,000 farms."⁵

Within California, the San Joaquin Valley leads in agricultural production.⁶ Fresno County has maintained its position as the number one agricultural production county in the state for the past three years with a 1999 production value of \$2.6 billion.⁷ Fresno farmers produce eighteen percent of the grapes, more than one-third of the processing tomatoes, and thirty-seven percent of the peaches grown throughout California.⁸

Despite the image of wealth these statistics present, the production value and number of farms is dwindling throughout California. The definition of a farm in 1950 was a place with "ten or more acres

² See RESOURCE DIRECTORY, CAL. DEP'T OF FOOD & AGRIC., 28 (1999) [hereinafter RESOURCE DIRECTORY].

³ See *id.* at 29.

⁴ See *id.* at 28.

⁵ *Id.* at 29.

⁶ See *id.* at 30.

⁷ *Our Top Crops*. FRESNO BEE, Aug. 19, 2000, at B1; RESOURCE DIRECTORY, *supra* note 2, at 30.

⁸ RESOURCE DIRECTORY, *supra* note 2, at 43.

[with] annual sales of agricultural products of \$50 or more.”⁹ In 1950, there were 144,000 farms in California covering almost 38 million acres, with the average size farm occupying 260 acres.¹⁰ The production value of California crops has steadily declined over the past two years, from \$34 billion in 1997 to \$25.9 billion in 1998.¹¹ The definition of “farm” has changed to “places with annual sales of agricultural products of \$1,000 or more.”¹²

Today, there are just 89,000 farms in California covering 28 million acres with the average size farm occupying 318 acres.¹³ Although farmers continue to work just as hard as they did in 1950, to prevent their extinction it is vitally important that they receive all the monies due to them from the sale of their crops.¹⁴

⁹ *Id.* at 38.

¹⁰ *Id.*

¹¹ *Id.* at 28.

¹² *Id.* at 29.

¹³ *Id.* at 38.

¹⁴ See *Tos v. Mayfair Packing Co.*, 160 Cal. App. 3d 67, 74 (1985); *Id.* at 81 (“Growers [should not be] deprived of income from their year’s hard-earned, annual harvest.”); see generally David Oliver Relin, *The Bodacious Hoedown of Cuming County*, *PARADE*, Oct. 15, 2000, at 22 (quoting Laurie Mason Schmidt as saying, “Farming’s been awful tough lately.”)

Table I¹⁵

United States 1998 Top Five Agricultural States

<u>State</u>	<u>Rank</u>	<u>Value (in billions)</u>
California	1	24.6
Texas	2	13.2
Iowa	3	10.9
Nebraska	4	8.8
Kansas	5	7.7

Table II¹⁶

1999 Top Farm-producing Counties in California

<u>County</u>	<u>Production Value</u>
Fresno	\$2.6 billion
Tulare	\$2.5 billion
Merced	\$1.2 billion
Kings	\$766 million
Madera	\$615 million
Mariposa	\$19.2 million

As the production values and subsequent revenue from their crop sales decrease, California farmers struggle to pay their farm debt and support their families.¹⁷ Orchard and other perennial crop farmers have a long-term investment in their land and seek long-term buyers for their crops.¹⁸ Farmers of annual processing crops, such as tomatoes

¹⁵ RESOURCE DIRECTORY, *supra* note 2, at 31.

¹⁶ *Id.* at 30.

¹⁷ *New West Fruit Corp. v. Coastal Berry Corp.*, 1 Cal. App. 4th 92, 97 (1991) (stating general custom and practice in California strawberry production to help farmers afford to grow and harvest their crops is for brokers to advance money and secure the advances by requiring growers to sign a sales and marketing agreement granting the brokers a security interest in the farmers' crops).

¹⁸ ROBERTA COOK, U.C. DAVIS, DEP'T OF AGRIC. ECONOMICS, THE INSTITUTIONAL ASPECTS OF FRESH FRUIT AND VEGETABLE MARKETING SYSTEMS: IMPACTS ON PRODUCERS, BUYERS, CONSUMERS AND MARKETS —THE CASE OF THE UNITED STATES 8 (1996) [hereinafter COOK]; ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRIC., LEAFLET NO.

and peaches, are concerned about the continued availability of a reliable processing facility for their production.¹⁹ Farmers are loyal to and rely upon processors with whom they have had previous success.²⁰ This loyalty and reliance, coupled with the trust and a handshake ways in which farmers traditionally do business, sets the stage for financial disaster if the processor does not pay for the farmer's crops.²¹

A. Modern Business Trends

Farmers' livelihoods are generated from the sale of their crops. During the growing season, the traditional farmer works from dawn until dusk seven days a week.²² Raising perishable crops may present financial problems for farmers who do not have cash buyers at harvest. To remedy this, some farmers contract with processing companies and agree to defer payments "over periods [that are] longer than the harvest season."²³ This arrangement benefits the processor by allowing cash strapped businesses to spread their costs out over a longer period of time, while the farmers undoubtedly benefit from the steady in-

AER-747, 3 FARMER'S USE OF MARKETING AND PRODUCTION CONTRACTS (1999) [hereinafter FARMER'S USE] (farmers enter into marketing contracts to guarantee that someone will buy their produce).

¹⁹ COOK, *supra* note 18, at 8; see FARMER'S USE, *supra* note 18, at 19 ("By securing markets for products, farmers are managing the risk that either prices may change and hurt a farm's profitability or that cash or spot markets may not be available for a farm's products.").

²⁰ See *In re GVF Cannery, Inc.* 188 B.R. 651, 662 (Bankr. N.D. Cal. 1995) (where farmer continued renewing his sales contract with processor because throughout junior high and high school, the processor's sales representative and he had been "the best of buddies.").

²¹ See *Mosekian v. Davis Canning Co.*, 229 Cal. App. 2d 118, 123 (1964) (where cannery induced 80-year-old farmer who was hard of hearing into relying on their continued promises to buy his peach crop, so that he sought no other buyers, ultimately resulting in his crop rotting off the trees); see also *In re GVF Cannery, Inc.*, 188 B.R. at 666 (stating agricultural business was historically done on a handshake basis).

²² Interview with Nathan Woodsmith, in Fresno, Cal. (July 4, 2000) (4th generation family citrus farmer discussing his experiences growing up on a family farm and in a small farming community); see David Oliver Relin, *The Bodacious Hoedown of Cumming County*, PARADE, Oct. 15, 2000, at 22 ("Soon it will be time to head back home. [B]y first light tomorrow morning, [the farmers] will once again be hard at work on their farms.").

²³ Dale Bratton, *The California Agricultural Producer's Lien, Processing Company Insolvencies, and Federal Bankruptcy Law: An Evaluation and Alternative Methods of Protecting Farmers*, 36 HASTINGS L. J. 609, 611 (1985).

come.²⁴ As discussed later in this comment, farmers who agree to deferred payments may be barred from exerting their beneficiary status under the Perishable Agricultural Commodities Act (PACA) trust provisions, making them unsecured creditors.

When processors ask farmers to sign preprinted form sales contracts, “with little or no opportunity to negotiate different terms,” it allows the processors “to take unfair advantage of farmers with one-sided, poorly written, or oppressive contracts.”²⁵ These contracts give the farmers creditor status and expose them to risks — nonpayment or debtor insolvency. As creditors, farmers must weigh the benefit of having a ready buyer for their perishable crop versus the risk of nonpayment and possible legal fees to enforce collection.

III. THE IMPORTANCE OF AGRICULTURAL CONTRACTS

Farmers make contractual agreements with processors or other farmers that “specify conditions of producing and/or marketing an agricultural product.”²⁶ In California, no single statute governs agricultural contracts. The statutes are interwoven between the California Uniform Commercial Code (UCC), the Civil Code, the Food & Agricultural Code, and the Business & Professions Code. The federal Perishable Agricultural Commodities Act (PACA) and Bankruptcy Code also apply. These statutes are supplemented by California case law.

California’s version of the UCC, particularly Division 2 relating to the sale of goods, is of particular importance to farmers. When a farmer contracts to sell his crops to a processor, whether they are already harvested or still growing, it is a contract for the sale of goods and is governed primarily by the UCC.²⁷

In California, a valid written contract must include the name of the parties, be signed by the party agreeing to pay, and state a quantity to be sold.²⁸ Another significant factor for consideration is the contract price. If the price is for \$500 or more, then the contract, to be enforceable, must be in writing.²⁹ This includes contracts for both a pres-

²⁴ *Id.*

²⁵ Neil D. Hamilton, *State Regulation of Agricultural Production Contracts*, 25 U. MEM. L. REV. 1051, 1054 (1995).

²⁶ FARMER’S USE, *supra* note 18, at 2.

²⁷ CAL. COM. CODE § 2105(1) (Deering 2000); *see* *Tos v. Mayfair Packing Co.*, 160 Cal. App. 3d 67, 78 (1984); *see generally* *New West Fruit Corp. v. Coastal Berry Corp.*, 1 Cal. App. 4th 92, 95 (1991).

²⁸ CAL. COM. CODE § 2201(1) (Deering 2000).

²⁹ *Id.*

ent sale of crops and a contract to sell crops at a future time.³⁰ If the price is to be an agreed market price at delivery, then it is not necessary to state a price.³¹ “Unless otherwise agreed, payment is at the contract rate and is due to the seller “within thirty days of the delivery.”³² If the processor fails to pay the farmer, the farmer is entitled to collect “a late charge of five percent per month of the unpaid balance calculated on a daily basis for the period for the delinquency for the first month and an additional one percent per month of the unpaid balance calculated on a daily basis for the remaining period of the delinquency.”³³ If the farmer decides to waive his right to the late charges, it must be made in writing, after the delinquency has occurred.³⁴

California has a variety of special contract requirements for the sale of specific crops. The California legislature explained its public policy behind the special contract requirements for edible nut farmers:

It is the public policy of this State and in the furtherance of the public interest to encourage production of agricultural products. A free and unmanipulated price level for edible nuts and a fair return to the grower for his productive effort are necessary to encourage and increase production. The Legislature declared that this act will encourage and increase such production and that this act is enacted in furtherance of the policy expressed in this section.³⁵

“Every contract for the sale of edible nuts, must ‘be in writing and . . . state the full purchase price’ ”³⁶ If the price depends upon the nuts’ units of weight or measure, “the contract [must] specify . . . the unit and state the full unit price.”³⁷ Written contracts for nuts must state how the price for the nuts will be determined.³⁸ Buyers of edible nuts are liable for the contract price plus a penalty of twice the reasonable value of the nuts if the contracts are not in writing and the farmers do not receive the contract price upon delivery.³⁹

Unfortunately, the statute expressly excludes farmers of edible nuts who are members of non-profit cooperative associations. The statute

³⁰ CAL. COM. CODE § 2106(1) (Deering 2000).

³¹ CAL. COM. CODE § 2305(1)(c) (Deering 2000).

³² CAL. COM. CODE § 2310(a) (Deering 2000); *see* CAL. FOOD & AGRIC. CODE § 55601 (Deering 2000).

³³ CAL. FOOD & AGRIC. CODE § 55881 (Deering 2000).

³⁴ *Id.*

³⁵ *Tos v. Mayfair Packing Co.*, 160 Cal. App. 3d at 75 (1984).

³⁶ CAL. FOOD & AGRIC. CODE § 62801 (Deering 2000).

³⁷ *Id.*

³⁸ *Id.*

³⁹ CAL. FOOD & AGRIC. CODE § 62802 (Deering 2000); *see generally* *Mayfair Packing Co.*, 160 Cal. App. 3d at 75 (discussing the punitive aspects of section 62802).

states: "This article is not applicable to any contract between any member of any [non-profit] cooperative agricultural marketing association, which is operating under, and by virtue of, the laws of this state" ⁴⁰ The Fifth District Court of Appeal explained the legislative reasoning behind the exclusion:

The statute expressly excludes members of non[-]profit cooperative associations from its provisions because those members are assured a competitive price for their crop by the favorable marketing position of the association. The essential foundation of the co-operative association is equality of burden and equality of profits, irrespective of whether one particular grower's crop may or may not be sold upon the most favorable market. ⁴¹

For the sale of grapes, California also has special contract requirements that are fairly straightforward. A contract for the sale of grapes must include "a final price, including any bonuses or allowances, to be set on or before the January 10 following delivery of the grapes" or the contract is "illegal and unenforceable." ⁴² The Ninth Circuit Court of Appeals has strictly enforced these provisions, holding that a grape purchase contract was illegal and unenforceable because it failed to provide a final price. ⁴³

IV. LIENS

Lien law is another area of contract law that is important to farmers. California defines a lien as "a charge imposed upon specific property, by which it is made security for the performance of an act." ⁴⁴ Agricultural liens can be created and released in contracts. A lien provides protection for the farmers by providing a security interest in any crops sold to a processor. Consensual liens arise by contractual agreement between the parties, while "statutory liens arise by operation of law." ⁴⁵

The California Legislature enacted the Food and Agricultural Code to "exercise . . . the power of [the] state for the purposes of promoting and protecting the agricultural industry" ⁴⁶ A part of this code

⁴⁰ CAL. FOOD & AGRIC. CODE § 62803 (Deering 2000).

⁴¹ *Mayfair Packing Co.*, 160 Cal. App. 3d at 74.

⁴² CAL. FOOD & AGRIC. CODE § 55601.5(g) (Deering 2000).

⁴³ *Somerset Importers, Ltd. v. Continental Vinters*, 790 F.2d 775, 778-782 (9th Cir. 1986).

⁴⁴ CAL. CIV. PROC. CODE § 1180 (Deering 2000).

⁴⁵ *Riley C. Walter, A Case for Avoidance of Secret Farmer Liens: The California Producer's Lien*, 4 SAN JOAQUIN AGRIC. L. REV. 37, 39 (1994).

⁴⁶ CAL. FOOD & AGRIC. CODE § 3 (Deering 2000).

is the statutory California producer's lien, which was created to improve the farmers' collection efforts.⁴⁷

The producer's lien entitles farmers to receive compensation for their "labor, care, and expense in growing and harvesting" their crops.⁴⁸ "Farm product includes every agricultural . . . or vegetable product of the soil . . ."⁴⁹ A producer is "any person that is engaged in the business of growing or producing any farm product."⁵⁰ A processor is:

[A]ny person that is engaged in the business of processing or manufacturing any farm product, that solicits, buys, contracts to buy, or otherwise takes title to, or possession or control of, any farm product from the producer of the farm product for the purpose of processing or manufacturing it and selling, reselling, or redelivering it in any dried, canned, extracted, fermented, distilled, frozen . . . or other preserved or processed form.⁵¹

The producer's lien requires that the crop be grown by the farmer and covers all products delivered to the processor and all processed or manufactured forms of the product.⁵² The lien covers "all . . . deliv-

⁴⁷ CAL. FOOD & AGRIC. CODE § 802 (Deering 2000) ("The Legislature finds and declares the following: (a) Agriculture is the number one industry in California, which is the leading agricultural state in the country. (b) Although California's cultivated land accounts for approximately [three] percent of the country's entire supply of farmland, the state has historically produced about [ten] percent of the farm cash receipts in the United States. (c) California leads the nation in the production of approximately [fifty] different crops and livestock products. (d) The diversity of the state's agriculture is truly impressive, for over 250 different commodities are grown here. (e) Family owned farms produce most of the food and fiber produced by the California agricultural industry. (f) The economic strength of the California's agricultural industry depends on farmers and ranchers being able to profitably market the commodities and products raised. (g) A profitable and healthy farming industry must be sustained by a sound natural resource base of soils, water, and air which is developed, conserved, and maintained to ensure sufficient quantities and the highest optimum quality possible.").

⁴⁸ CAL. FOOD & AGRIC. CODE § 55631 (Deering 2000).

⁴⁹ CAL. FOOD & AGRIC. CODE § 55403 (Deering 2000).

⁵⁰ CAL. FOOD & AGRIC. CODE § 55408 (Deering 2000).

⁵¹ CAL. FOOD & AGRIC. CODE § 55407 (Deering 2000).

⁵² CAL. FOOD & AGRIC. CODE § 55631 (Deering 2000) ("Every producer of any farm product that sells any product which is grown by him to any processor under contract, express or implied, in addition to all other rights and remedies which are provided for by law, has a lien upon such product and upon all processed or manufactured forms of such farm product for his labor, care, and expense in growing and harvesting such product. The lien shall be to the extent of the agreed price, if any, for such product so sold. If there is no agreed price or a method for determining it which is agreed upon, the extent of the lien is the value of the farm product as of the date of the delivery. Any portion of such product or the processed or manufactured forms of such product, in excess of the amount necessary to satisfy the total amount owed to

ered product from the date of delivery.”⁵³

The farmers’ right to the automatic, statutory producer’s lien on crops delivered to a processor, but not paid for, depends on whether they belong to a cooperative bargaining association or a non-profit cooperative, as defined by the Food and Agriculture Code. The lien automatically applies to “every producer of any farm product” who contracts to sell his crops to a processor. The lien only applies to non-profit cooperatives if they are acting as a “[section] 55631 producer bargaining association.”⁵⁴ As such, farmers who sell their crops to non-profit cooperatives have two concerns: (1) The ways in which they can institute consensual liens via security agreements; and (2) the ways in which their liens, once perfected, may unknowingly be released. Cooperative bargaining associations, on the other hand, have automatic, statutory lien protection and are only concerned with ways in which their members may be unknowingly releasing their liens. Depending on the type of lien created, statutory or consensual, many laws govern the ways that liens are released.⁵⁵

V. ASSOCIATIONS

California’s corporation laws, in general, govern associations.⁵⁶ California law provides that:

Three or more natural persons, a majority of whom are residents of [California], who are engaged in the production of any product, may form an association . . . for the purpose of . . . production, marketing, or selling . . . products of its members. The harvesting, preserving, drying, processing, canning, packing, [or] grading . . . any product of its members, or the manufacturing or making of the byproducts of any product of its members.⁵⁷

Under California’s Food and Agricultural Code, a group of farmers joined together to sell their crops is considered a non-profit cooperative association or a cooperative bargaining association.

producers under contract, shall be free and clear of such lien.”).

⁵³ CAL. FOOD & AGRIC. CODE § 55632 (Deering 2000).

⁵⁴ CAL. FOOD & AGRIC. CODE §§ 55631, 55631.5 (Deering 2000).

⁵⁵ See generally *In re* S.N.A. Nut Co., 197 B.R. 642 (Bankr. N.D. Ill. 1996) (California agricultural producer’s lien is valid under Cal. Food & Agric. Code §§ 55631-55640 without recording); *In re* Loretto Winery Ltd., 898 F.2d 715 (9th Cir. 1990) (holding a California agricultural producer’s lien valid under Cal. Food & Agric. Code §§ 55631-55640 without recording); *Churchill Nut Co. v. Wells Fargo Bank*, 251 B.R. 143, (Bankr. N.D. Cal. 2000).

⁵⁶ CAL. FOOD & AGRIC. CODE § 54040 (Deering 2000).

⁵⁷ CAL. FOOD & AGRIC. CODE § 54061(a)(b) (Deering 2000).

Non-profit cooperative associations are “not organized to make profit[s] for themselves, as such, or for their members, as such, but only for their members as producers.”⁵⁸ A producer is “any person engaged in the business of growing or producing any farm product.”⁵⁹ A “cooperative bargaining association” is a for-profit “farmer association . . . organized and functioning . . . for the purpose of group bargaining between its producer members and the first handler or processor, with respect to the sale of any agricultural commodity”⁶⁰

A. Non-Profit Cooperative Associations

Non-profit cooperative associations, including non-profit cooperatively owned processing canneries, do not get the automatic benefit of the producer’s lien like their cooperative bargaining association brethren do. The statute, embodied in Chapter Six, Division 20 of the California Food and Agricultural Code reads:

This chapter does not apply to or include any non-profit cooperative association[s] . . . agents of these organizations . . . activities of the organization, or agent, which involve the handling or dealing in any farm product of nonmembers of the organization, and activities of such an organization, or agent, which involve acting as a producer bargaining association asserting the lien rights of its members.⁶¹

The Fifth District Court of Appeal has held that a non-profit grape growers’ association was expressly excluded from every statute included in Chapter Six of the California Food and Agricultural Code.⁶² In *Allied Grape Growers v. Bronco Wine Co.*, the court held that “the Legislature has expressed a clear legislative intent that [non-profit] cooperatives shall not be entitled to the benefits of Chapter 6, and we can find no valid reason to hold to the contrary.”⁶³ The court further stated that the issue of whether non-profit cooperative associations should have equal protections should be raised with the legislature, not resolved in a court of law.⁶⁴ To protect their interests, farmers must take the necessary steps to institute consensual liens on their own.

If a farmer contracts a sale to the non-profit cooperative association in which the farmer is a member, and that association is the processor,

⁵⁸ CAL. FOOD & AGRIC. CODE § 54033 (Deering 2000).

⁵⁹ CAL. FOOD & AGRIC. CODE § 55408 (Deering 2000).

⁶⁰ CAL. FOOD & AGRIC. CODE § 54401 (Deering 2000).

⁶¹ CAL. FOOD & AGRIC. CODE § 55461 (Deering 2000).

⁶² *Allied Grape Growers v. Bronco Wine Co.*, 203 Cal. App. 3d 432, 455 (1988).

⁶³ *Id.*

⁶⁴ *Id.*

then the title to the crops “passes absolutely and unreservedly, except for recorded liens, to the association upon delivery or at any other specified time which is expressly and definitely agreed in the contract.”⁶⁵ As soon as a farmer delivers his crops to a processor without receiving payment, the farmer becomes an unsecured creditor of the processor. To become a secured creditor of the processor, and to protect his security interest in the event of nonpayment or insolvency, the farmer must expressly include a lien clause in his contract with the processor. Additionally, the lien must be recorded.⁶⁶ This lien clause creates a consensual lien. If the contract does not expressly contain a lien clause, the farmer must take his chances that the contract creates an equitable lien.⁶⁷ The equitable lien might be enforced by the courts in the event of non-payment if the farmer can demonstrate that he intended to retain a lien on the crops, or alternatively, on a theory of estoppel.⁶⁸ “Notwithstanding an agreement to the contrary,” a consensual lien prohibits the transfer of title to the processor.⁶⁹ In other words, although the farmer has relinquished actual possession of his crops, he still retains ownership.

Crops delivered to a processor are considered collateral in that the crops, once delivered, become part of the processor’s inventory.⁷⁰ Inventory is “raw materials . . . or materials used or consumed in a business.”⁷¹ A consensual lien creates a security interest in the collateral when a security agreement is executed and properly recorded. For a security interest to be enforceable against the debtor and third parties, the security agreement must establish that value was given, the debtor had the power to transfer rights in the collateral, and the debtor has signed a security agreement containing a “description of the collateral and a description of the land where the crops are growing.”⁷² Accord-

⁶⁵ CAL. FOOD & AGRIC. CODE § 54261 (Deering 2000).

⁶⁶ CAL. CIV. PROC. CODE § 488.405(a)(b) (Deering 2000) (A lien may be created by contract, to take immediate effect, as security for the performance of obligations not then in existence. The farmer wishing to secure a lien on farm products that have been delivered to a processor may do so by “filing a notice of attachment with the Secretary of State.”).

⁶⁷ *Farmers Ins. Exch. v. Zerin*, 53 Cal. App. 4th 445, 449 (1997).

⁶⁸ *Id.* (“A promise to pay a debt . . . without more, will not create an equitable lien . . .”).

⁶⁹ CAL. CIV. CODE § 2888 (Deering 2000).

⁷⁰ CAL. COM. CODE § 9105-1(c) (Deering 2000); *see Bank of California v. Thornton-Blue Pacific, Inc.*, 53 Cal. App. 4th 841, 846 (1997) (stating growers’ flowers became inventory upon delivery).

⁷¹ CAL. COM. CODE § 9109-4 (Deering 2000).

⁷² CAL. COM. CODE § 9203 (Deering 2000).

ing to the Ninth Circuit Court of Appeals, “no magic words [are] necessary to create [a] security interest.”⁷³

“[A] commercial security agreement . . . effectively secure[s] the payment . . . of any past, present, or future legally enforceable obligation of the debtor to the creditor . . . with any of the debtor’s . . . current or future personal property.”⁷⁴ A security interest attaches to collateral and is enforceable against the debtor when a security agreement is executed.⁷⁵ The original crops and any proceeds from the sale of the crops are covered, whether a copy of the security agreement is recorded or a separate financing statement is recorded.⁷⁶ “If a security interest in the [crops] was perfected [by recording a copy of the security agreement] and . . . the [crops became] part of a product or mass, the security interest continues in the product or mass if the [crops] are so manufactured, processed . . . or commingled their identity is lost”⁷⁷

Although the creation of a consensual lien and the perfection of a security interest are independent of each other, they are accomplished by filing a copy of the security agreement with the County Recorder or a financing statement with the Secretary of State.⁷⁸ A copy of the security agreement will suffice as a financing statement if it includes: “the names of the debtor [processor] and the secured party [farmer],” the signature of the debtor, the “address of the secured party from which information concerning the security interest may be obtained,” the “mailing address of the debtor,” and a statement describing the collateral with a description of the real estate where the crops are growing or are to be grown.⁷⁹ When protecting a security interest in crops, the proper place to file is “the office where a mortgage on the real estate would be recorded.” This is normally the county recorder’s office.⁸⁰ Once the lien is perfected (recorded), the farmer becomes a secured creditor of the processor and when it comes to payment en-

⁷³ *New West Fruit Corp. v. Coastal Berry Corp.*, 1 Cal. App. 4th 92, 95 (1991).

⁷⁴ *Id.*

⁷⁵ CAL. COM. CODE § 9203(1)-(4) (Deering 2000).

⁷⁶ *See* CAL. COM. CODE § 9306-1 (1)-(3) (Deering 2000).

⁷⁷ CAL. COM. CODE § 9315-1 (Deering 2000); *see Bank of California v. Thornton-Blue Pac. Inc.*, 53 Cal. App. 4th 841, 847 (1997).

⁷⁸ *See* CAL. COM. CODE § 9302-1 (Deering 2000); *see* CAL. COM. CODE § 9306-3(b) (Deering 2000); *see also New West Fruit Corp. v. Coastal Berry Corp.*, 1 Cal. App. 4th at 94.

⁷⁹ CAL. COM. CODE § 9402-1 (Deering 2000).

⁸⁰ CAL. COM. CODE § 9401-1(b) (Deering 2000).

forcement against a non-paying processor in state court, the farmer is next in line behind farmers that hold a producer's lien.

B. Cooperative Bargaining Association

It is important to understand that farmers selling crops to non-profit cooperatives are not entitled to the producer's lien; however, farmers selling to cooperative bargaining associations are. A cooperative bargaining "association and its members may make and execute marketing contracts which require the members to sell, for any period of time, but not over [fifteen] years, all or any specified part of any product or specified commodity exclusively to or through the association, or to any facilities which are created by the association."⁸¹ By entering into the marketing contract, farmers agree to sell their crops "exclusively to or through the [cooperative bargaining] association."⁸²

Producer's liens attach automatically when any farm product grown by the farmer is delivered to a cooperative bargaining association. They continue until the farmer releases the lien or the crops are no longer in the possession of the processor.⁸³ If the processor transfers possession of the products, then the producer's lien is extinguished.⁸⁴ If the processor does not pay the farmer for the products sold to a third party and tries to "defeat [the] producer's lien, [they are] subject to criminal penalties."⁸⁵

VI. LIENS

A. Producer's Lien Release

The farmer and the processor must follow fairly rigid requirements to release a producer's lien. Farmers doing business with a cooperative bargaining association do not need to file or give notice to perfect the

⁸¹ CAL. FOOD & AGRIC. CODE § 54261 (Deering 2000).

⁸² *Id.*

⁸³ CAL. FOOD & AGRIC. CODE § 55634 (Deering 2000) ("Every [producer's] lien . . . is on every farm product and any processed form of the farm product which is in the possession of the processor without segregation of the product."); see *In re SNA Nut Co.* 197 B.R. 642, 648 (Bankr. N.D. Ill. 1996); see also *In re Loretto Winery*, 898 F.2d 715, 722 (9th Cir. 1990) ("There are no formal requirements to perfect the lien, such as recording or filing. The lien attaches to all of the product, raw or in its processed forms, regardless of segregation, as long as they remain in the processor's possession.").

⁸⁴ U.S. Bank, N.A. v. Deseret Farms, 219 B.R. 880, 884 (Bankr. E.D. Cal. 1998).

⁸⁵ CAL. FOOD & AGRIC. CODE §§ 55901-55906 (Deering 2000); see generally *Churchill Nut Co. v. Wells Fargo Bank*, 251 B.R. 143, 147 (Bankr. N.D. Cal. 2000).

producer's lien because it attaches automatically.⁸⁶ The producer's lien is superior to "all other liens, claims, or encumbrances . . ." except claims for wages and warehouseman's liens.⁸⁷ The producer's lien will be released upon full payment "or upon arrangements being made for such payment which are satisfactory to the producer."⁸⁸ "If a suit is commenced by [a farmer] to enforce any lien, [the] lien . . . remain[s] in effect until . . ." payment is received or judgment is rendered.⁸⁹

For the processor to release a producer's lien, some form of payment to the farmer holding the lien, is required.⁹⁰ Because the producer's lien is unrecorded (also known as a "hidden lien,") lenders who finance processors and wish to secure their loans with a security interest in inventory have no means of ascertaining whether the processor's inventory is already encumbered by producer's liens. Lending institutions attempting to release the producer's lien have required processors to include a clause in their deferred payment contracts with farmers.⁹¹ The Ninth Circuit Court of Appeals has refused to enforce these clauses.

The Ninth Circuit Court of Appeals addressed whether farmers released their producer's liens as a matter of law by agreeing to a deferred payment plan under the California producer's lien statute. In *In re T.H. Richards Processing Co.*, tomato and pear farmers agreed that the processor "would pay [50%] of the [contract] price within one week of delivery . . . and [50%] one year after delivery . . ." ⁹² The court held that the release was not mandatory as a matter of law, but allowed the farmers to release their producer's liens "upon arrangements being made for . . . payment which are satisfactory to the producer."⁹³ The court reasoned that allowing a mandatory release of the lien by farmers who agreed to deferred payment plans would not comply with the California statute's legislative history, would make the processor's release procedures under section 55639 "superfluous," and would not further the State's purpose by preventing limitation on the

⁸⁶ CAL. FOOD & AGRIC. CODE § 55632 (Deering 2000); see *In re SNA Nut Co.*, 197 B.R. 642, 648 (Bankr. N.D. Ill. 1996) ("The producer's lien is subject to no formal perfection requirements such as recording or filing. It attaches to every purchased product and processed form of such product in the possession of the processor.").

⁸⁷ CAL. FOOD & AGRIC. CODE § 55633 (Deering 2000).

⁸⁸ CAL. FOOD & AGRIC. CODE § 55637 (Deering 2000).

⁸⁹ CAL. FOOD & AGRIC. CODE § 55636(a)(c) (Deering 2000).

⁹⁰ CAL. FOOD & AGRIC. CODE § 55639(a)-(e) (Deering 2000).

⁹¹ See generally *In re T.H. Richards Processing Co.*, 910 F.2d 639 (9th Cir. 1990).

⁹² *Id.* at 641.

⁹³ *Id.* at 645-647.

producer's lien.⁹⁴

The Ninth Circuit Court of Appeals has set the standard for release of producer's liens. Following the Ninth Circuit's lead, the Fifth Circuit Court of Appeal, in deciding a case involving Tulare County farmers, held that an agreement by farmers to a one-month deferred payment plan did not "necessarily imply [a] waiver of the producer's lien."⁹⁵ This is good news for California farmers. Unless they voluntarily sign a producer's lien release when contracting for the sale of their crops, they do not release their lien simply because they agree to deferred payment plans. It is vitally important that farmers understand the contracts that they sign because they could unknowingly release their liens.

B. Consensual Lien Release

Consensual liens are released through clauses in contracts. A release is a clause in a contract that is an abandonment or relinquishment of an underlying claim.⁹⁶ It is generally established that one who fails to read a contract before signing, in the absence of fraud or excusable neglect, is bound to the terms in the contract.⁹⁷

A written release requires no consideration, however, it does require mutual assent.⁹⁸ Mutual assent is achieved if both parties have a "meeting of the minds" concerning the same matters.⁹⁹ A release printed in ten-point type meets several of the minimum standards set by California.¹⁰⁰ If the release is printed in a type size that cannot easily be read by a person of ordinary vision, or is so small that it is "calculated to conceal and not to warn the unwary," the release is unenforceable.¹⁰¹ The release, when read as a whole, must "clearly . . . notify the prospective releaser . . . of the effect of signing the agreement" and not be written in language that it is not understandable to any layperson.¹⁰² Release clauses "should be read as a layman would read [them], interpreting the terms in an ordinary and popular sense as a person of average intelligence and experience would understand

⁹⁴ *Id.* at 644-647.

⁹⁵ *In re SNA Nut Co.*, 197 B.R. 642, 653 (Bankr. N.D. Ill. 1996).

⁹⁶ *Pellett v. Sonotone Corp.*, 26 Cal. 2d 705, 711 (1945).

⁹⁷ *Hulsey v. Elsinore Parachute Ctr.*, 168 Cal. App. 3d 333, 339 (1985).

⁹⁸ *Worthington v. State Bd. of Control*, 266 Cal. App. 2d 697, 700 (1968).

⁹⁹ *King v. Associated Constr. Corp.*, 183 Cal. App. 2d 818, 822 (1960).

¹⁰⁰ *Conservatorship of Link*, 158 Cal. App. 3d 138, 142 (1984).

¹⁰¹ *See Hulsey v. Elsinore Parachute Ctr.*, 168 Cal. App. 3d at 340; *Conservatorship of Link*, 158 Cal. App. 3d at 141.

¹⁰² *Hulsey v. Elsinore Parachute Ctr.*, 168 Cal. App. 3d at 341.

them.”¹⁰³ Thus, farmers must read contracts carefully before they sign, especially if they contain release clauses; both consensual and producer’s lien rights can be waived by the signing of a release.¹⁰⁴

C. *Lien Enforcement Under California Law*

The only way for a farmer to enforce his lien, no matter what kind it is, is to bring a lawsuit against the processor or file an administrative agency claim with the Director of the California Department of Food and Agriculture. Historically, the Farm Products Trust Fund, under the direction of the State, was intended for use when farmers did not receive payment for their crops.¹⁰⁵ Unfortunately for California farmers, as of January 1, 1998, this fund no longer accepts claims.¹⁰⁶ The only drawback in enforcing the lien, whether it is through the court system or the administrative agency, is that if more than one farmer brings a suit against a processor, all of the farmers are given equal standing.¹⁰⁷ If there is not enough money to pay everyone, then the payments will be prorated among all the claimants.¹⁰⁸

In the event of non-payment by the processor, it is important for farmers to realize that they have a finite amount of time to file a lawsuit for breach of contract. To avoid being barred by the statute of limitations, the lawsuit must be filed within four years from the date the breach occurred, regardless of whether the farmer had actual knowledge of the breach.¹⁰⁹

Filing a lawsuit may be the best way for farmers to protect their interests. Any farmer with a lien against a processor may bring a lawsuit to foreclose the lien and seek an injunction to temporarily restrict the processor from transferring possession of any product without court approval.¹¹⁰ The temporary restraining order “may not prohibit” the processor from selling the product in the ordinary course of business, but it may place restrictions on the proceeds of the sale.¹¹¹ If the court finds that there is no money available to pay the farmer to satisfy his lien, and providing the processor still has possession of the product,

¹⁰³ *Miller v. Elite Ins. Co.*, 100 Cal. App. 3d 739, 752 (1980).

¹⁰⁴ See generally *In re T.H. Richards Processing Co.*, 910 F.2d 639, 644-647 (9th Cir. 1990); *In re SNA Nut Co.*, 197 B.R. 642, 653 (Bankr. N.D. Ill. 1996).

¹⁰⁵ CAL. FOOD & AGRIC. CODE § 56704 (Deering 2000).

¹⁰⁶ CAL. FOOD & AGRIC. CODE § 56701.5(a) (Deering 2000).

¹⁰⁷ CAL. FOOD & AGRIC. CODE § 55645 (Deering 2000).

¹⁰⁸ *Id.*

¹⁰⁹ CAL. COM. CODE § 2725(1)-(2) (Deering 2000).

¹¹⁰ CAL. FOOD & AGRIC. CODE §§ 55647, 55651 (Deering 2000).

¹¹¹ CAL. CIV. PROC. CODE § 513.020(a) (Deering 2000).

the farmer will be awarded the processed product in satisfaction of the claim.¹¹²

Farmers who have not been paid by processors may file an administrative agency claim with the Director of the California Department of Food and Agriculture. Within thirty days after receiving a verified complaint from a farmer for non-payment by a processor, the director can bring a lawsuit against the processor on behalf of the farmer. The processor may be subject to criminal action.¹¹³ By this method, California has attempted to provide farmers with an alternate way to collect from processors who do not pay.

VII. FEDERAL LAW AND THE PERISHABLE AGRICULTURAL COMMODITIES ACT (PACA)

Through the Perishable Agricultural Commodities Act (PACA), Federal law seeks to protect farmers' collection rights from non-paying processors. PACA was enacted in 1930 to encourage fair trading practices in the marketing of perishable commodities such as fruits and vegetables. "The term 'perishable agricultural commodity' [m]eans any of the following, whether or not frozen or packed in ice: [f]resh fruits and fresh vegetables of every kind and character; and [i]ncludes cherries in brine"¹¹⁴ "A principal purpose of PACA was 'to provide a practical remedy to small farmers and growers who were vulnerable to the sharp practices of financially irresponsible and unscrupulous brokers in perishable commodities.'¹¹⁵ "Many [produce] . . . brokers, in the normal course of their business transactions, operate on bank loans secured by [their] inventories, proceeds or assigned receivables from sales of perishable agricultural commodities. [This results in the lender having] a secured position in the case of [the broker's] insolvency."¹¹⁶ "Under [prior] law, [farmers selling] fresh fruits and vegetables [were] unsecured creditors and [received] little protection in any [lawsuit] for recovery of damages where a buyer ha[d] failed to

¹¹² CAL. FOOD & AGRIC. CODE § 55652 (Deering 2000).

¹¹³ CAL. FOOD & AGRIC. CODE §§ 55903, 55921 (Deering 2000).

¹¹⁴ 7 U.S.C § 499(a)(b)(4)(A)(B) (2000); cf. *In re L. Natural Foods Corp.*, 199 B.R. 882 (Bankr. E.D. Pa. 1996) (fresh fruit does not include dried apricots or prunes and fresh vegetables do not include French fries, frozen breaded cauliflower or onion rings.).

¹¹⁵ *In re L. Natural Foods Corp.*, 199 B.R. at 885.

¹¹⁶ Scott T. Rodgers, *Feature: Potatoes and Wild: Perfection and Enforcement Under the Perishable Agricultural Commodities Act*, 12 Me. BAR J. 302, 302 (1997).

make payment as required by the contract.”¹¹⁷ Under PACA, “only financially responsible persons should be engaged in the businesses subject to the Act.”¹¹⁸ PACA was “not intended to repeal” or interfere with the rights of parties under the law of sales. In the absence of applicable provisions, the “general law of sales will govern.”¹¹⁹

In 1984, Congress commented that:

[A] burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities . . . encumber or give lenders a security interest in such commodities, or on inventories of food or other products derived from such commodities, and any receivables or proceeds from the sale of such commodities or products . . .¹²⁰

In response, Congress amended the statute to create a statutory trust for the benefit of unpaid produce suppliers. The following trust provision was enacted:

Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities . . . until full payment of the sums owing in connection with such transactions has been [fully] received . . .¹²¹

¹¹⁷ *Id.* at 303.

¹¹⁸ *A.J. Conroy, Inc. v. Weyl-Zuckerman & Co.*, 39 F.Supp 784, 787 (N. D. Cal. 1941) (“[P].A.C.A. does not remove the applicability of the law of sales; it merely gives an additional remedy to growers, who were previously forced to resort to expensive trials . . . in which dealers . . . failed to live up to the provisions of their contracts.”); *see also* *Finer Foods Sales Co. v. Block*, 708 F.2d 774, 782 (1983).

¹¹⁹ *J.R. Simplot Co. v. L. Yukon & Son Produce Co.*, 227 F.2d 67, 71 (8th Cir. 1955).

¹²⁰ 7 U.S.C. § 499(e)(c)(1) (2000).

¹²¹ 7 U.S.C. § 499(e)(c)(2); *see* 7 U.S.C. § 499(e)(c)(3); 7 C.F.R. § 46.2; 7 C.F.R. § 46.46(e)(2) (the relevant provision of the PACA amendment provides that: “(e) Prompt payment and eligibility for trust benefits. (1) The times for prompt accounting and prompt payment are set out in Sec. 46.2(z) and (aa). Parties who elect to use different times for payment must reduce their agreement to writing before entering into the transaction and maintain a copy of their agreement in their records, and the times of payment must be disclosed on invoices, accountings, and other documents relating to the transaction. (2) The maximum time for payment for a shipment to which a seller, supplier, or agent can agree and still qualify for coverage under the trust is 30 days after receipt and acceptance of the commodities as defined in Sec. 46.2(dd) and paragraph (a)(1) of this section. (3) The trust provisions do not apply to transactions between a cooperative association . . . and its members.”).

A. PACA Trust

PACA trusts can help the farmer collect from a non-paying processor. "One of the primary concerns of the [PACA] legislation is the status of unpaid sellers at the time of a broker's bankruptcy or insolvency."¹²² The PACA trust provision subordinates a lender's security interest in the produce sellers' trust assets held by produce buyers.¹²³ "PACA grants the sellers of such commodities the right to recover against the purchasers and puts the sellers in a position superior to all other creditors."¹²⁴ In other words, beneficiaries under a PACA trust move to the front of the line for payment when the processor files bankruptcy.

Like an unsecured creditor, a produce seller desiring to benefit from the PACA trust must perfect its interest in order to gain priority over third parties.¹²⁵ Similar to the California Producer's Lien for cooperative bargaining associations, the PACA trust automatically arises when a produce seller delivers its crop to a dealer.¹²⁶ But PACA trust beneficiaries are required to perfect their lien or lose the protection, much like California's non-profit cooperative associations.¹²⁷ Also like California's non-profit cooperatives, PACA trust provisions do not apply to transactions between a cooperative association and its members as defined in the federal Agricultural Marketing Act.¹²⁸

The regulations for establishing and perfecting a PACA trust are simple. The farmer, as the trust beneficiary, is required to give written notice to the buyer and to the Secretary of Agriculture of his intent to preserve the benefits of the trust within thirty days of delivering the produce.¹²⁹ The notice must:

[B]e in writing, must include the statement that it is a notice of intent to preserve trust benefits, and must include information which establishes for each shipment: (i) The name and the address of the trust beneficiary, seller-supplier, commission merchant, or agent and the debtor as applicable; (ii) The date of the transaction, commodity, contract terms, invoice,

¹²² *In re United Fruit and Produce Co.*, 119 B.R. 10, 11 (Bankr. E.D. Conn. 1990).

¹²³ *In re United Fruit & Produce Co.*, 242 B.R. 295, 301 (Bankr. W.D. Conn. 1999).

¹²⁴ *Id.*

¹²⁵ 7 C.F.R. § 46.46(f) (2000).

¹²⁶ *In re San Joaquin Food Serv., Inc.*, 958 F.2d 938, 939 (9th Cir. 1992).

¹²⁷ 7 U.S.C. § 499(e)(c)(3) (2000).

¹²⁸ 7 U.S.C. § 499(e)(c)(2) (2000) ("The provisions of this subsection shall not apply to transactions between a cooperative association, as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. 1141(j)(a), and its members.").

¹²⁹ 7 U.S.C. § 499(e)(c)(3) (2000).

price, and the date payment was due, . . . and (iv) The amount unpaid and past due.¹³⁰

When the parties contract for a payment time different from the ten-day maximum set by the Secretary, a copy of the agreement must be kept with each party's records. The terms of payment must be disclosed on all invoices and every document relating to the transaction.¹³¹ If the processor is a PACA licensee, "ordinary and usual billing or invoice statements . . ." may be used "to provide notice of the [produce supplier's] intent to preserve the trust . . ." by including specific language as set out in the statute, otherwise a separate notice is required.¹³²

In California, PACA requirements are strictly enforced. Once the parties agree to operate under a contract that deviates from the Secretary's regulations, they cannot claim PACA protection if they do not follow the requirements of the statute.¹³³ While some courts have upheld trust benefits based on the "substantial compliance" doctrine, the Ninth Circuit Court of Appeals flatly rejects it.¹³⁴

In *In re San Joaquin Food Service, Inc.*, the Ninth Circuit Court of Appeals held that the statute requires literal compliance.¹³⁵ The Court

¹³⁰ Scott T. Rodgers, *Feature: Potatoes and Wild Blueberries: Perfection and Enforcement Under the Perishable Agricultural Commodities Act*, 12 Me. B. J. 302, 305 (1997) (citing *In re H.R. Hindle & Co.*, 149 B.R. 775, 786 (Bankr. E.D. Pa. 1993)).

¹³¹ 7 U.S.C. § 499(e)(c)(3) (2000).

¹³² 7 U.S.C. § 499(e)(c)(4) (2000) (The statute reads "In addition to the method of preserving the benefits of the trust specified in paragraph (3), a [PACA] licensee may use ordinary and usual billing or invoice statements to provide notice of the licensee's intent to preserve the trust. The bill or invoice statement must include the information required by the last sentence of paragraph (3) and contain on the face of the statement the following: 'The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. § 499(e) (c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.'"). The last sentence of the third paragraph of 7 U.S.C. § 499(e)(c)(3) states: ("When the parties expressly agree to a payment time period different from that established by the Secretary, a copy of any such agreement shall be filed in the records of each party to the transaction and the terms of payment shall be disclosed on invoices, accountings, and other documents relating to the transaction.").

¹³³ *In re San Joaquin Food Serv., Inc.*, 958 F.2d 938, 941 (9th Cir. 1992).

¹³⁴ *Id.* at 939; *In re Richmond Produce Co.*, 112 B.R. 364, 372 (Bankr. N.D. Cal. 1990); see *Hull Co. v. Hauser's Foods, Inc.*, 924 F.2d 777, 783 (8th Cir. 1991); *In re Lombardo Fruit & Produce Co.*, 107 B.R. 654, 660-662 (Bankr. E.D. Mo. 1989).

¹³⁵ *In re San Joaquin Food Serv., Inc.*, 958 F.2d at 940 (9th Cir. 1992).

has denied PACA trust benefits to a produce seller who “failed to give the required notice of intent to preserve trust benefits directly to the buyer.”¹³⁶ The Court has also denied PACA trust benefits to a produce seller who did not comply with the statute’s invoice requirement when contracting for a payment term different from that established by the Secretary.¹³⁷

Sellers who sign contracts agreeing to accept *any* payment thirty days after delivery are ineligible for the benefits of a PACA trust.¹³⁸ The reason behind this rule is that any contract allowing payment after thirty days is “a burden on commerce in perishable agricultural commodities”¹³⁹ Once again the Ninth Circuit Court of Appeals literally applied 7 C.F.R. 46.46(f)(2) citing “with respect to private agreements under § 499(e)(c)(3)(ii), that ‘the maximum time for payment’ in which the parties can agree, and still qualify for PACA protection, ‘is [thirty] days after receipt and acceptance of the [produce.]’ ”¹⁴⁰

B. *The Effect of Bankruptcy on a PACA Trust*

Farmers who are beneficiaries under a PACA trust have concerns when the processor files for bankruptcy. In bankruptcy, a statutory trust is a legislative device that protects a certain class of creditors in much the same way a statutory lien does.¹⁴¹ When a processor files a bankruptcy petition, the PACA trust assets do not become property of the estate because they are an equitable interest.¹⁴² Equitable interests for the benefit of others are not part of the debtor’s bankruptcy estate.¹⁴³ Creditors who have complied with the PACA requirements may

¹³⁶ Consolidated Marketing, Inc. v. Marvin Properties, Inc., 854 F.2d 1183, 1186 (9th Cir. 1988).

¹³⁷ *In re* San Joaquin Food Serv., Inc., 958 F.2d at 941.

¹³⁸ 7 C.F.R. § 46.46(e)(2) (2000).

¹³⁹ 7 U.S.C. § 499(e)(c)(1) (2000).

¹⁴⁰ *In re* Altabon Foods, Inc., 998 F.2d 718, 719 (9th Cir. 1993).

¹⁴¹ John Eleazarian, Bankruptcy Professor, Lecture at San Joaquin College of Law, (June 2000).

¹⁴² *Begier v. IRS*, 496 U.S. 53, 59 (1990) (“Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not ‘property of the estate.’ ”); *see also* 11 U.S.C. § 541(d).

¹⁴³ *See* 11 U.S.C. § 541(d) (2000) (“Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . or (2) of this section only to the extent of the debtor’s legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.”); *In re* Super Spud, 77 B.R. 930, 931 (Bankr. M.D. Fla 1987) (“The corpus of a secured PACA trust is just such an equitable interest and is not to be considered property of the debtor’s estate [under 11 U.C.S. § 541(d)].”).

not need to file proofs of claim in bankruptcy cases in order to recover their funds.¹⁴⁴

The beneficiary of a PACA trust is entitled to priority as to all PACA trust assets of the debtor. This puts them first in line to receive payment, “ahead of the claims of creditors who have valid security interests, ahead of the administrative costs and expenses incurred in [bankruptcy] court, and ahead of all other priority and general creditors.”¹⁴⁵ However, if there are not enough funds in the trust to pay all PACA claims, then the trust beneficiaries share pro-rata distributions.¹⁴⁶ Despite the fact that PACA trust funds are not property of the estate under 11 U.S.C § 541(d), and not available to non-PACA creditors, these funds may remain subject to Bankruptcy Court control. Trust funds may be collected by a Chapter 7 trustee and divided among trust beneficiaries pro-rata where such funds will be insufficient to satisfy PACA claims in full.¹⁴⁷

VIII. WHEN A PROCESSOR FILES FOR BANKRUPTCY

For farmers who are not beneficiaries under a PACA trust, it is important to understand the difference between a secured and an unsecured claim and the affects on the farmer. Farmers must be aware that their rights as creditors may change, reduce, or vanish, depending on the Bankruptcy Code provisions. The farmer must also realize that any liens might be avoided altogether.¹⁴⁸ If the farmer has no lien, he is considered an unsecured creditor, and his claim may be discharged entirely. When a farmer receives a notice of a bankruptcy, he should submit to the court a proof of claim. This consists of: a written statement of his claim, a copy of the contract, and proof that his security interest has been perfected.¹⁴⁹ In this way, a farmer places himself in line for payment.

In general, when a processor files for bankruptcy, the debtor-processor must provide a list of creditors and a schedule of all assets and liabilities to the bankruptcy court.¹⁵⁰ Creditors whose claims are

¹⁴⁴ *In re United Fruit and Produce Co.*, 119 B.R. 10, 12 (Bankr. D. Conn. 1990).

¹⁴⁵ *In re Super Spud*, 77 B.R. at 932.

¹⁴⁶ *See In re United Fruit & Produce Co.*, 86 B.R. 14, 16 (Bankr. D. Conn. 1988).

¹⁴⁷ *Id.* at 23.

¹⁴⁸ *Saltarelli & Steponovich v. Douglas*, 40 Cal. App. 4th 1, 5 (1995) (liens not avoided or discharged survive bankruptcy).

¹⁴⁹ F.R. BANKR. P. 3001(a) – (d) (2000).

¹⁵⁰ 11 U.S.C. § 521(1) (2000).

secured are treated more favorably than those that are unsecured.¹⁵¹ A secured claim is held by a creditor with a valid, perfected lien against property of the debtor.¹⁵² Farmers with a consensual or producer's lien have a secured claim. An unsecured claim holder is a creditor that does not have a lien against the debtor's property.¹⁵³ Farmers who unknowingly released or waived their producer's lien, never created a consensual lien, or did not perfect a PACA trust have an unsecured claim. A processor can file two types of bankruptcies: a Chapter 7 or a Chapter 11.

In a Chapter 7, or liquidation bankruptcy, a bankruptcy trustee collects the nonexempt property of the debtor and sells the property for cash to distribute to the debtor's creditors.¹⁵⁴ The trustee is a representative of the creditors, appointed by the United States Trustee.¹⁵⁵ Bankruptcy under a Chapter 11, or rehabilitation plan, allows the debtor to retain its current property and operate its business while it tries to confirm a plan of reorganization to pay creditor claims. That plan may be funded with the debtor's future earnings, liquidation assets, or both.¹⁵⁶ Normally, the trustee in a Chapter 11 case is the debtor and is called the "debtor in possession" with all the rights, powers, and duties of a trustee.¹⁵⁷

A. *Unfinished Business — Executory Contracts*

If the processor files for bankruptcy, and has not finished the contract with the farmer, the farmer is at the mercy of the bankruptcy trustee. If the farmer and a processor have entered into a contract that has not expired by its own terms, and both sides have existing obligations to fulfill, the contract is called an "executory contract."¹⁵⁸ When a bankruptcy is filed, the trustee or debtor in possession, with the court's approval, can either assume or reject executory contracts.¹⁵⁹ If the trustee assumes the contract, the debtor's obligations under the contract become obligations of the bankruptcy estate. If an "assumed" contract is subsequently breached, the farmer is entitled to an "admin-

¹⁵¹ John Eleazarian, Bankruptcy Professor, Lecture at San Joaquin College of Law (June 2000).

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ 11 U.S.C. § 1107 (2000).

¹⁵⁸ *See generally* 11 U.S.C. § 365 (2000).

¹⁵⁹ *Id.*

istrative expense” priority for both his prepetition and post petition rights.¹⁶⁰ In other words, if the contract is assumed, the farmer moves to the front of the collection line.

However, if the contract is rejected, the farmer becomes an unsecured creditor. “[R]ejection . . . constitutes a breach . . .” that is deemed to have occurred prior to the filing of the petition and the farmer consequently moves to the position of an unsecured creditor, at the back of the collection line.¹⁶¹ Whether the contract is assumed or rejected by the trustee, the Ninth Circuit Bankruptcy Court considers the contract property of the estate, meaning that the farmer may be barred from terminating the contract.¹⁶² This seems unfair to the farmer who, whether the contract is assumed or rejected by the trustee, cannot terminate the contract without going to court.

B. Liens

The Bankruptcy Code defines a lien as a “charge against or interest in property to secure payment of a debt or performance of an obligation.”¹⁶³ A trustee in a Chapter 7 bankruptcy case “after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.”¹⁶⁴ If the lien is in dispute, Bankruptcy Rule 7001 requires an “adversary proceeding ‘to determine the validity, priority, or extent of a lien or other interest in property’ ”¹⁶⁵

Lien enforcement in bankruptcy may be difficult due to the automatic stay. The automatic stay is the debtor’s most powerful weapon in the Bankruptcy Code because it stops all collection activity.¹⁶⁶ The stay prevents “any act to create, perfect, or enforce any lien against property of the estate.”¹⁶⁷ Because a lien creates an interest in property of the debtor to secure payment of a debt, any interest or rights in the property belonging to the debtor at the time of the bankruptcy filing

¹⁶⁰ DAVID G. EPSTEIN ET AL., BANKRUPTCY § 5-6, at 235 (1st ed. 1993).

¹⁶¹ 11 U.S.C. § 365(g) (2000).

¹⁶² See generally *In re* Computer Communications, Inc., 824 F.2d 725 (9th Cir. 1987).

¹⁶³ 11 U.S.C. § 101(37) (2000).

¹⁶⁴ 11 U.S.C. § 725 (2000).

¹⁶⁵ F. R. BANKR. P. 7001-2 (2000); see *In re* Morabito Bros., Inc., 188 B.R. 114, 117 (Bankr. W.D.N.Y. 1995).

¹⁶⁶ 11 U.S.C. § 362(a) (2000).

¹⁶⁷ 11 U.S.C. § 362(a)(4) (2000).

passes to the estate.¹⁶⁸ Subsequently, the automatic stay prevents all lien perfection, enforcement, and creation against this right.¹⁶⁹ If the bankruptcy is filed within the perfection period, the creditor may still perfect his lien by giving the 30-day PACA notice; otherwise the farmer who attempts to perfect or enforce his lien after the processor files for bankruptcy is out of luck, as the lien is unenforceable.¹⁷⁰ The stay does not affect the farmer's secured status; it just delays enforcement. Put another way, "[t]he fact that a creditor did not enforce [its] perfected interest prior to bankruptcy does not invalidate the interest, it merely stays the enforcement of that interest pending the bankruptcy court's determination of the party's entitlement"¹⁷¹

A trustee or debtor in possession can avoid a statutory lien if it "is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser [who] purchases such property at the time of the commencement of the case, whether or not such a purchaser exists" ¹⁷² The debtor in possession, as trustee, "is accorded the status of a hypothetical bona fide purchaser" ¹⁷³ The Ninth Circuit Bankruptcy Court has held that state law determines if the lien is avoidable.¹⁷⁴ The producer's lien, unless "released by payment . . . attaches from the date of delivery of the product . . ." and if a series of deliveries was made, "it attaches from the date of the last delivery."¹⁷⁵

Bankruptcy Code section 545 allows the trustee to avoid certain statutory liens on any of the debtor's property. A statutory lien is a "lien arising solely by force of a statute . . . but does not include [a] security interest or [a] judicial lien" ¹⁷⁶ Because a security interest is not a statutory lien, the trustee may not use this section of the Bankruptcy Code to avoid the farmer's security interest.¹⁷⁷ As the pro-

¹⁶⁸ 11 U.S.C. § 362 (2000).

¹⁶⁹ 11 U.S.C. § 362(a)(4-5) (2000).

¹⁷⁰ Cf. 11 U.S.C. § 362(a)(4-5) (2000) (the stay applies to "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title").

¹⁷¹ *New York Life Ins. Co. v. Bremer Towers*, 714 F.Supp. 414, 418 (D. Minn. 1989).

¹⁷² 11 U.S.C. § 545(2) (2000).

¹⁷³ *Id.*; *In re Marguerite L. Miller*, 164 B.R. 644, 650 (Bankr. D. Mont. 1994).

¹⁷⁴ *In re Marguerite L. Miller*, 164 B.R. at 647 ("[T]he proper inquiry is whether the particular lien is good against a bona fide purchaser under the laws of the state . . .").

¹⁷⁵ CAL. FOOD & AGRIC. CODE §55635 (Deering 2000).

¹⁷⁶ 11 U.S.C. § 101(53) (2000).

¹⁷⁷ Cf. *Farrey v. Sanderfoot*, 500 U.S. 291, 296 (1991) (explaining that fixing occurs

ducer's lien is statutory, "[t]he trustee may avoid the fixing of [this] lien on property of the debtor [if the] lien first becomes effective against the debtor," when the debtor becomes insolvent; or if the lien "is not perfected or enforceable at the . . . commencement of the case against a bona fide purchaser that purchases such property at the time of commencement of the case, whether or not such a purchaser exists" ¹⁷⁸

The Ninth Circuit Court of Appeals held in the case of *In re Loretto Winery*, 898 F.2d 715 (9th Cir. 1990), that the California producer's lien, which was valid under state law without recording, was not avoidable by a trustee in bankruptcy under § 545-2, even though the lien was a "secret" lien that did not have to be recorded. The court noted that few cases had decided whether § 545-2 permits a trustee to avoid a statutory lien that has no formal perfection requirements. The Ninth Circuit Court of Appeals found that the proper inquiry was not whether such a lien was a "secret" lien, but whether under state law, the unrecorded lien at issue was good against a bona fide purchaser. The Ninth Circuit Court of Appeals concluded that where the lien was valid, it was non-avoidable under § 545-2. ¹⁷⁹

Because producer's liens begin with the delivery of the crop by the farmer, the lien attaches (is fixed) before the processor has any interest in the crops, and the processor acquires the crops subject to the statutory lien. ¹⁸⁰ Under the California agricultural producer's lien statute, a producer who sold a farm product "has a lien [on the] product and upon all processed or manufactured forms of [the] product," without formal recording. The lien attaches to every purchased product and processed form of the product regardless of segregation. It is only ex-

only on property in which the debtor had an interest before the lien attached); see generally *In re Merchant's Grain, Inc.*, 93 F.3d 1347, 1357 (7th Cir. 1997) ("[T]he trustee must challenge a statutory lien first by application of § 545 which permits the trustee to avoid the fixing of certain types of liens. If the fixing of the lien is not avoidable under that section alone, the trustee may not apply the § 547(b) [ninety]-day rule to avoid the fixing of the lien. However, if the fixing of the lien is avoidable under § 545, the trustee may apply the [ninety]-day provisions to recoup any transfers made pursuant to the avoidable lien.").

¹⁷⁸ 11 U.S.C. § 545(1-2) (2000).

¹⁷⁹ *In re Loretto Winery Ltd.*, 898 F.2d 715, 724-725 (9th Cir. 1990) (holding California producer's lien valid against a bona fide purchaser and thus the trustee under § 545(2)).

¹⁸⁰ Cf. *Tos v. Mayfair Packing Co.*, 160 Cal. App. 3d 67 (1985) (walnut processor had a valid California producer's lien that was enforceable against a bona fide purchaser).

tinguished upon relinquishment of possession by the processor.¹⁸¹ This means producer's liens are not avoidable under § 545 providing the debtor retains actual possession of the crop.¹⁸² It appears that the Bankruptcy Code looks favorably upon agricultural liens.¹⁸³

Bankruptcy Code section 547 concerns preferential transfers. When a debtor is faced with deciding whether to file for bankruptcy protection, creditors are usually desperately attempting to force the debtor to pay. Whatever assets a debtor transfers during the ninety-day time period prior to filing bankruptcy may be recoverable by the trustee as a preferential transfer. To accomplish this, five conditions must be satisfied.¹⁸⁴ Other than a sale for value or in the ordinary course of business, if a processor transfers possession of the crops within ninety days before filing bankruptcy, the trustee, under the preferential transfer statute, can avoid any transfer of the debtor's interest in property.¹⁸⁵

A transfer is defined as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."¹⁸⁶ One of the primary goals of the Bankruptcy Code is to ensure that all creditors in the same class are treated equally.¹⁸⁷ It follows

¹⁸¹ See generally *In re* S.N.A. Nut Co., 197 B.R. 642, 650-653 (Bankr. N.D. Ill. 1996).

¹⁸² Cf. *In re* Merchants Grain, Inc., 93 F.3d at 1357 ("Unless the debtor had the property interest to which the lien attached . . . before the lien attached . . . he or she cannot avoid the fixing of the lien." "[T]he lien [is] not avoidable under § 545."); *In re* Loretto Winery, 898 F.2d at 721 (stating that only the processor's surrender of actual possession to the purchaser would have caused the lien to lapse).

¹⁸³ *In re* Merchants Grain, Inc., 93 F.3d at 1357.

¹⁸⁴ 11 U.S.C. § 547(b)(1-5) (2000) ("Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—(1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made—(A) on or within [ninety] days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and (5) that enables such creditor to receive more than such creditor would receive if—(A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title."); see generally *Union Bank v. Wolas*, 502 U.S. 151, 154-155 (1991).

¹⁸⁵ 11 U.S.C. § 547(b) (2000); see *Churchill Nut Co. v. Wells Fargo Bank*, 251 B.R. 143, 148 (Bankr. N.D. Cal. 2000).

¹⁸⁶ 11 U.S.C. § 101(54) (2000).

¹⁸⁷ John Eleazarian, Bankruptcy Professor, Lecture at San Joaquin College of Law (June 2000).

then, that if a transfer is made to a creditor within the ninety-day pre-bankruptcy filing period, and that transfer allowed the creditor to receive more than he would have as a creditor filing a claim in bankruptcy, then the transfer is avoidable.¹⁸⁸ If a creditor with a statutory lien against property of the debtor's estate received payment during the ninety-day pre-filing period, that payment would not be a voidable preference "unless there are other creditors in the same legal class, in addition to the secured creditor who received the preference."¹⁸⁹ In other words, if other farmers had similar liens against the processor, then all the farmers would be in the same legal class and the payment would be within the trustee's reach.¹⁹⁰

IX. CONCLUSION

Championing farmers' rights to collect monies owed to them from the sale of their crops requires a keen understanding of both California and Federal laws, including bankruptcy law. Equally important, all farmers must be familiar with contracts to fully understand their rights and remedies. When dealing with agricultural sales contracts, lien enforcement, and bankruptcy claims, these general guidelines, many of which came from Neil D. Hamilton's law review article, *Why Own the Farm When You Can Own the Farmer (and the Crop)?: Contract Production and Intellectual Property Protection of Grain Crops*, will be helpful for farmers:

1. All contracts are subject to negotiation. If the terms of the contract are not agreeable to them, farmers must speak up. The farmers' focus should be to ensure that they are on equal footing with their buyer, before the contract is signed. The sale of crops is a business transaction and should be treated as such, no matter how many times the parties have done business previously. Whoever writes the contract prepares it with their best interests in mind.

2. Farmers must know and be confident in the financial position of the party with whom they contract. Farmers become creditors once they deliver their crop. If they do not receive timely payment, their collection efforts may require either a lawsuit or an administrative agency claim; therefore, they should investigate their buyer's financial position.

3. Contract requirements for the sale of specific agricultural products, like grapes and edible nuts, are statutory.

¹⁸⁸ See *Churchill Nut Co.*, 251 B.R. at 148.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 149 ("The Bankruptcy Code aims to insure that all creditors in the same class are treated equally.").

4. Farmers who sell to cooperative associations are subject to their creditors' rights changing, depending on what kind of association buys the product, whether or not a lien is perfected, and whether the processor still has possession of the product.

5. If farmers fail to perfect their PACA claims within the statutory period and the required words are not printed on every invoice to the processor, or if payment is deferred by contract for more than thirty days, the farmers automatically lose their PACA trust, making the farmers unsecured creditors. Farmers, however, would still retain producer's and consensual liens.

6. If farmers receive anything from a processor within the ninety-day pre-bankruptcy filing time period, the bankruptcy trustee may demand its return, unless payment was made under the ordinary terms for payment.

7. Farmers must always perfect their liens. Unperfected liens become unsecured claims when a processor files bankruptcy.¹⁹¹

In our increasingly complex world, it is not enough for farmers to excel in crop production. Although many of the new generation of farmers have college educations in agribusiness, all farmers must also have a keen understanding of the complex intricacies of contract and bankruptcy law in order to protect their financial positions.¹⁹²

JODI LEA WOODSMITH

¹⁹¹ Neil D. Hamilton, *Why Own the Farm When You Can Own the Farmer (and the Crop)?: Contract Production and Intellectual Property Protection of Grain Crops*, 73 NEB. L. REV. 48, 66-67 (1994).

¹⁹² *Id.* at 77 (stating that today's farmer is "more aptly described as [an] agribusinessman" who "is involved in far more than simply planting and harvesting crops." "[F]armers [must] possess an extensive knowledge and sophistication regarding the purchase and sale of crops on various agricultural markets.").

Editor's Note: Following is an addendum to a Comment by Jodi Lea Woodsmith, published in Volume 12 of the San Joaquin Agricultural Law Review.

WHEN A FOOD PROCESSOR FILES BANKRUPTCY:
WHAT EVERY CALIFORNIA GROWER SHOULD
KNOW BEFORE CONTRACTING TO SELL CROPS

Addendum

In discussing the enforcement of the California Producer's Lien, the author, in reliance on the holding in *Allied Grape Growers v. Bronco Wine Co.*, 203 Cal.App.3d 432 (1988), stated that non-profit marketing cooperatives could not enforce the lien on behalf of their members. (*When A Food Processor Files Bankruptcy: What Every California Grower Should Know Before Contracting To Sell Crops*, 12 S.J. AGRIC. L. REV. 1, 112-114 (2002).) It was brought to the author's attention that this was an oversight.¹ In 1989, the Legislature overruled *Allied Grape Growers* by enacting California Food & Agricultural Code section 54182, which specifically authorizes "marketing or bargaining associations" to assert the Producer's Lien either in the association's name or the name of its members.² In enacting this statute, the Legislature declared its intention "that neither [s]ection 55461 nor [s]56161" is intended to prevent "a qualified Stats. 1989 ch. 835 § 1. association of producers from asserting" these lien rights.³

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¹ The author wishes to thank attorney Stephen Zovickian, Bingham McCutchen LLP, Three Embarcadero Center, San Francisco, CA 94111-4067, for bringing this to her attention.

² Cal. Food & Agric. Code § 54182(a) (Deering 2001) ("Any association organized and operating pursuant to this chapter or pursuant to similar laws of any other state, the District of Columbia, or the United States, which acts for its members as a producer marketing or bargaining association in its dealings with a person licensed pursuant to Chapter 6 (commencing with Section 55401) or Chapter 7 (commencing with Section 56101) in connection with any product produced by its members, may, either in its own name or in the name of its members, assert all the rights of a producer under either of these chapters with respect to any of those products.")

³ Stats. 1989 ch. 835 § 1.