UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

S&H PACKING & SALES CO. INC., a California corporation, DBA SEASON PRODUCE CO,	:	No. 14-56059 (Consolidated)
Plaintiff,	:	
and	:	
G.W. PALMER & CO., INC., et al,	:	
Plaintiffs-Appellants,	:	
v.	:	
TANIMURA DISTRIBUTING, INC., a California corporation,	:	
Defendant,	:	
and	:	
AGRICAP FINANCIAL CORPORATION, a Delaware corporation,	:	
Defendant-Appellee,	:	
	:	
S&H PACKING & SALES CO. INC., a California corporation, DBA SEASON PRODUCE CO,	:	No. 14-56078 (Consolidated)
Plaintiff,	:	
and	:	

APACHE PRODUCE CO., INC., an Arizona corporation, DBA PLAIN JANE., et al,	:
Plaintiffs-Appellants	:
v.	:
TANIMURA DISTRIBUTING, INC., a California corporation,	:
Defendant,	:
and	:
AGRICAP FINANCIAL CORPORATION, a Delaware corporation,	:
Defendant-Appellee	:

On Appeal From the United States District Court For the
Central District of California, Los Angeles
D.C. No. 2:08-cv-05250-GW-FFM

PETITION FOR REHEARING EN BANC OF
G.W. PALMER & CO., INC, et al.

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March 2017

DISCLOSURE OF CORPORATE
AFFILIATIONS AND FINANCIAL INTEREST

Pursuant to F.R.A.P. 26.1, G. W. Palmer & Co., Inc., Gargiulo, Inc., Andrew & Williamson Sales Co., Inc., and East Coast Brokers & Packers, Inc. make the following disclosures:

1. Are Appellants subsidiaries or affiliates of a publicly owned corporation? NO

2. Is there a publicly owned corporation, not a party to the appeal, which has a financial interest in the outcome? NO

/s/ Louis W. Diess, III (Signature of Counsel)

March 8, 2017 (Date)

TABLE OF CONTENTS

Page No.

TABLE OF AUTHORITIES

Page No.

Cases

Statutes

Other Authorities

INTRODUCTION AND RULE 35(b)(1) STATEMENT

The sale of perishable agricultural commodities is a critically important industry for the states in the Ninth Circuit as well as nationwide. Slip op. at 30. In 1984, Congress created the statutory PACA trust to remedy a burden on commerce "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," all of which arrangements Congress declared contrary to the public interest. *Perishable Agricultural Commodities Act*, 7 U.S.C. §499e(c)(1) ("PACA"). This unequivocal declaration by Congress gives unpaid produce suppliers priority to the proceeds of produce sales over secured lenders, with produce dealers obligated to ensure that these statutory trust assets remain freely available to pay their unpaid produce suppliers first. 7 U.S.C. §499b(4), §499e(c)(2); 7 C.F.R. §46.46(a)(2).

Produce dealers are permitted to sell trust assets, including accounts receivable, for commercially reasonable value without breaching the PACA trust because in a true sale, title to the accounts receivable is transferred to the buyer and the accounts receivable are removed from the PACA trust. See *Nickey Gregory Co., LLC v. Agricap, LLC*, 597 F.3d 591, 598 (4th Cir. 2010); see also *A&J Produce*

Corp. v. Bronx Overall Economic Development Corp., 542 F.3d 54, 57 (2d Cir. 2008) citing *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d. 1063, 1069 (2d Cir. 1995). Conversely, if a produce dealer's lender is given a mere security interest in PACA accounts receivables, the lender has an interest that is subordinated and inferior to the priority rights of PACA trust beneficiaries. *Id.*

For this reason, it is not uncommon for a financing arrangement with a secured lender to masquerade as a sale agreement by using self-serving language sprinkled throughout its documentation that traditionally accompanies the sale of an asset. When the true nature of a transaction involving PACA accounts receivable is ambiguous, other courts, including the Fourth Circuit, Fifth Circuit, and Second Circuit, view the transfer of risk of non-payment of PACA accounts receivable to the buyer as the hallmark of a true sale, and apply a threshold "transfer-of-risk" test to determine the true substance of the agreement and the nature of the parties' roles: seller and buyer versus secured lender and borrower. See *Nickey Gregory Co., LLC v. Agricap, LLC,* 597 F.3d 591, 598 (4th Cir. 2010); *A&J Produce Corp. v. Bronx Overall Economic Development Corp.*, 542 F.3d 54 (2d Cir. 2008); *Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Vegetable Co.*, 336 F.3d 410 (5th Cir. 2003); *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063 (2nd Cir. 1995).

In the Ninth Circuit, the Court in *Boulder Fruit Express & Heger Organic Farm Sales v. Transportation Factoring, Inc.*, 251 F.3d 1268 (9th Cir. 2001), held

that a commercially reasonable sale of PACA accounts receivable for fair value to a factoring agent did not breach the PACA trust. However, the Ninth Circuit did not examine the substance of the rights or amount of risk transferred to the factoring agent in *Boulder Fruit*, or whether the transaction merited a determination that it was a sale rather than a secured lending agreement. Instead, the Court in *Boulder Fruit* only addressed the commercial reasonability of the transaction, and held it did not breach the PACA trust.

The per curiam opinion in this case upholding *Boulder Fruit* on stare decisis grounds directly conflicts with the existing opinions of the Fourth Circuit in *Nickey Gregory*, the Fifth Circuit in *Reaves Brokerage*, and the Second Circuit in *Endico Potatoes*, and eviscerates the seminal purpose of the PACA trust: to give unpaid produce suppliers priority to the proceeds of produce sales over secured lenders. 7 U.S.C. §499e(c)(1). The per curiam opinion holds that: 1) the *Boulder Fruit* court implicitly rejected the threshold transfer-of-risk test because otherwise the holding in *Boulder Fruit* necessarily would have been different, since no risk of non-payment was transferred in the *Boulder Fruit* transaction; 2) a minute degree of risk of non-payment was transferred to Agri-Cap here in comparison to *Boulder Fruit*; and 3) Tanimura's unpaid produce suppliers did not show the transaction with AgriCap was commercially unreasonable. Slip opinion at 9-10. Thus, the per curiam opinion holds that <u>any</u> <u>commercially</u> <u>reasonable</u> financing arrangement

trumps the priority trust rights of produce suppliers to the proceeds of produce sales expressly granted by Congress.

As expressly recognized by the concurring opinion of Circuit Judges Melloy and Gould, rehearing en banc is necessary because *Boulder Fruit* was wrongly decided, and the Ninth Circuit should join the Second, Fourth, and Fifth Circuits by adopting a separate, threshold transfer-of-risk test to ascertain the true substance of the transaction, prior to any assessment of the commercial reasonableness of a factoring agreement involving PACA receivables. The per curiam opinion of the Court fails to recognize that whether a factoring agreement involving PACA receivables is commercially reasonable is wholly irrelevant if the trust beneficiaries are not paid in full and the agreement is not a true sale, as in the case at bar. In such situations, the accounts receivables and their proceeds remain trust assets, and Congress has made clear and express policy choices in favor of unpaid produce growers over all secured lenders regarding priority to proceeds from the sale of produce. Finally, the conflict between the Circuits, and the result of the per curiam opinion of the Court, defeats Congressional intent and voids the PACA trust by elevating the interests of the secured lender over the unpaid produce suppliers to PACA trust assets, thereby substantially impairing an extremely important industry in this Circuit and nationwide. These critical issues demonstrate the need to grant a rehearing en banc.

Accordingly, pursuant to Ninth Circuit Rule 35-1, G.W. Palmer & Co., Inc., Andrew & Williamson Sales Co., Inc., East Coast Brokers and Packers, Inc., and Gargiulo, Inc. (collectively "Growers") ask this Court to grant rehearing en banc on the foregoing issues.

FACTUAL AND PROCEDURAL BACKGROUND

Tanimura Distributing, Inc. ("Tanimura") was a produce distributor licensed as a dealer under PACA, which entered into a financing agreement with AgriCap in February, 2008. *RE 10, 14-15*. In December, 2007, Tanimura applied for "financing" with AgriCap and provided AgriCap with financial information necessary for AgriCap to issue a term sheet "for a factoring line" and "to underwrite a loan." *RE 75-79*. AgriCap quickly responded by sending Tanimura a letter with a Preliminary Term Sheet summarizing the essential terms of the financing and collection services agreed to by the parties. *RE 89-93*. The financing and collection services consisted of a "factoring facility" (*RE 90*), under which AgriCap termed itself the "Lender," and Tanimura the "Seller," with the principals of Tanimura termed the "Personal Guarantors." *RE 92*. To obtain the financing, Tanimura entered into the following agreements with AgriCap: a Factoring and Security Agreement (the "Factoring Agreement") granting AgriCap a blanket security interest on all of Tanimura's assets, which was a precondition to receiving financing under the Factoring and Security Agreement (*RE 94-109*); a Subordination

Agreement, which subordinated all debts of Tanimura to the payment of any debt owed to AgriCap (*RE 121-129*); and a Personal Guarantee by a principal of Tanimura of all debts to AgriCap (*RE 110-120*). In addition, AgriCap entered into a separate Subordination Agreement with Preferred Bank, another secured lender of Tanimura, so that Preferred Bank's secured interest in Tanimura's accounts receivable was subordinated to that of AgriCap's. *RE 132-144*. AgriCap filed a UCC-1 Financing Statement perfecting its security interest in all of the property of Tanimura under the Security Agreement, including all produce inventory, produce receivables and produce proceeds. *RE 130-131*.

Under the agreement, AgriCap advanced 80% of the face value of each receivable and withheld 20% in a Reserve Account until the receivable was collected. *RE 95-96, ¶¶ 1.4, 1.29; RE 14-15*. The agreement provided AgriCap with the unilateral ability to increase the reserve account in AgriCap's sole discretion. Tanimura paid a "factoring fee" equal to 1.5% of the amount of the receivable to AgriCap, plus 0.07% for each day the receivable remained outstanding after 30 days, resulting in an APR of 25.94% under AgriCap's calculations. *RE 82.* Tanimura was also responsible for additional fees and charges under the Factoring Agreement. *RE 96-97, ¶¶ 1.13, 1.14, RE 117, 119-120.* AgriCap deducted all of these charges from the sums AgriCap placed in the Reserve Account. *RE 97, ¶ 2.6.* The receivables were assigned to AgriCap, who collected the proceeds of the

receivables directly from Tanimura's customers, and applied the proceeds against the advances. Tanimura was required to "repurchase" accounts that AgriCap subsequently deemed unsatisfactory, and/or that remained uncollected after 90 days, and a sum in excess of $900,000 was charged back to Tanimura by AgriCap over the course of the financing arrangement. *RE 15*.

In early August, 2008, Tanimura ceased operating, owing Growers a total of $845,238.35 for produce supplied to Tanimura from April 2, 2008 through July 11, 2008. *RE 177-360*. AgriCap received in excess of $20,600,000.00 from Tanimura's accounts receivable over the course of the financing arrangement, with the precise amount received by AgriCap in excess of $20,600,000.00 in dispute. *RE 19, n. 14*. On August 11, 2008, Tanimura and its principals, along with AgriCap, were sued in the District Court by Tanimura's unpaid produce suppliers seeking to enforce their trust rights under the PACA. *RE 474*. On August 13, 2008, Tanimura filed for chapter 7 bankruptcy protection and listed AgriCap as a secured creditor in its bankruptcy petition. *RE 11*. After Tanimura's bankruptcy filing, AgriCap continued to collect Tanimura's accounts receivable. *RE 15*.

In November 2012, the District Court granted AgriCap's cross-motion for summary judgment, finding that pursuant to *Boulder Fruit*, no transfer-of-risk analysis or inquiry into whether the transaction between AgriCap and Tanimura was

truly a sale was required, with the sole inquiry for the court being whether the factoring agreement was commercially reasonable. *RE 5-23, 488*.

On February 27, 2017, the panel issued a per curiam opinion holding that the doctrine of stare decisis and the decision in *Boulder Fruit* controlled the outcome in the present case. According to the panel, the *Boulder Fruit* court had implicitly rejected the transfer-of-risk test, and a small degree of risk of non-payment was transferred to AgriCap via the Factoring Agreement at issue here, at least in comparison to the agreement in *Boulder Fruit*. Slip op. at 9-10. In addition, the panel noted Growers did not seriously contend on appeal that the Factoring Agreement was otherwise commercially unreasonable. *Id*. at 10. However, in a 19 page concurrence, two judges from the panel wrote that *Boulder Fruit* was wrongly decided, and the Ninth Circuit, sitting en banc, should eliminate the circuit split and join the Second, Fourth and Fifth Circuits by adopting a threshold transfer-of-risk test to determine whether agreements involving the transfer of trust assets effected a true sale of assets. *Id*. at 11-30.

REASONS FOR GRANTING REHEARING EN BANC

I. The Per Curiam Opinion Directly Conflicts With Decisions By The Fourth, Fifth and Second Circuits and Substantially Affects a Rule of National Application

This Court should grant rehearing en banc because the per curiam decision of the panel is irreconcilable with the existing opinions of the Fourth Circuit in *Nickey*

Gregory, the Fifth Circuit in *Reaves Brokerage*, and the Second Circuit in *Endico Potatoes* on the same issue in which national uniformity is necessary. The Ninth Circuit in *Boulder Fruit* began its opinion by referencing the definition of "factoring" in *Black's Law Dictionary* (7th ed. 1999). *Id.* at 1271. That definition is: "factoring, n. the buying of accounts receivable at a discount. The price is discounted because the factor (who buys them) assumes the risk of delay in collection and loss on the accounts receivable." The Court in *Boulder Fruit* then acknowledged that under the PACA trust, the use of trust assets as collateral to secure a debt did not create a priority security interest for the lender that trumped the interests of PACA trust beneficiaries. *Id.* Thus, one could infer the Court in *Boulder Fruit* was aware of the significantly different outcomes in priority for the produce suppliers that resulted from a true sale of PACA receivables versus a financing arrangement with a security interest in PACA receivables.

However, for reasons unknown, the Ninth Circuit in *Boulder Fruit* did not analyze whether the factoring agreement at issue there constituted a true sale of receivables with a transfer of risk of loss, or was merely a transfer of collateral for a secured loan. Instead, the Ninth Circuit characterized the transaction as a sale or factoring agreement, and determined the transaction was commercially reasonable. Slip op. at 18.

Other courts have been faced with similar ambiguous transactions involving PACA accounts receivable where the agreements are sprinkled with terms like "sale," "purchase," and "factoring agreement." Aware of Congressional intent regarding priority to PACA trust assets of unpaid produce suppliers over the interests of secured lenders, these courts have looked beyond the self-serving labels found in the transactional documents. Instead, they have applied the "risk-of-loss" test as a threshold matter to determine whether a true sale of accounts receivable, with an actual transfer of risk of non-payment on the accounts, has occurred; or, if the transaction was, in reality, a secured lending transaction because the financing company did not assume the risk of nonpayment by the account debtor. See *Nickey Gregory Co., LLC v. Agricap, LLC*, 597 F.3d 591, 598 (4th Cir. 2010); *A&J Produce Corp. v. Bronx Overall Economic Development Corp.*, 542 F.3d 54 (2d Cir. 2008); *Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Vegetable Co.*, 336 F.3d 410 (5th Cir. 2003); *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063 (2nd Cir. 1995), and *Overton Distributors, Inc. v. Heritage Bank*, 179 F. Supp 2d 818, 828 (M.D. Tenn. 2002), *rev'd on other grounds* 340 F. 3d 361 (6th Cir. 2003).

In *Nickey Gregory*, the nearly identical AgriCap financing agreement did not pass the risk-of-loss test applied by the Fourth Circuit, which determined that AgriCap did not assume the risk of delay in collection or loss on the accounts receivable, and that the financing agreement was not a sale but a loan secured by

accounts receivable, with AgriCap's interest in the accounts subordinate to the claims of the unpaid produce sellers. *Nickey Gregory Co., LLC v. Agricap, LLC,* 597 F.3d 591, 598-603 (4th Cir. 2010). Here, the District Court, bound by stare decisis and the decision in *Boulder Fruit*, held that no transfer of risk analysis or inquiry into whether the transaction between AgriCap and Tanimura was truly a sale was required, with the sole inquiry for the court being whether the transaction was commercially reasonable.

In their concurring opinion, Circuit Judges Melloy and Gould concluded that neither the AgriCap factoring agreement with Tanimura nor the factoring agreement in *Boulder Fruit* transferred the primary risk of non-payment, and neither agreement effected a true sale of trust assets, but instead were mere secured financing arrangements. Slip op. at 26-29. Similarly, Circuit Judges Melloy and Gould opined in their concurrence that commercial reasonability could not be ascertained until the substance of the rights and risks transferred was examined:

> We conclude this transfer-of-risk test must apply to avoid reliance on self-serving labels inserted into factoring agreements to defeat clear congressional intent. We also conclude it follows quite naturally that it is not even possible to assess the commercial reasonableness of a factoring agreement without first understanding the true nature of transferred risks and transferred rights.

Slip op. at 24.

Given the significance of the produce industry to the State of California and other states in the Ninth Circuit, as well as the nation, there is an overriding need for national uniformity in the application of the PACA trust law, which gives unpaid produce suppliers priority to the proceeds of produce sales over secured lenders. A rehearing en banc would provide the Ninth Circuit with the opportunity to consider aligning itself with the transfer-of-risk approach taken by the Fourth, Fifth, and Second Circuits in reviewing transactions involving PACA accounts receivable to achieve the fundamental purpose of the PACA trust: to assure payment of produce sales proceeds to produce suppliers ahead of secured lenders. 7 U.S.C. §499e(c)(1).

II. The Per Curiam Opinion Directly Conflicts With the Express Purpose of The PACA Trust

The statutory PACA trust was expressly enacted by Congress to remedy a burden on commerce caused by financing arrangements in which buyers of produce, who have not paid for the perishable agricultural commodities, encumber or give lenders a security interest in the produce receivables or sales proceeds. 7 U.S.C. §499e(c)(1). Accordingly, the seminal purpose of the PACA trust is to give unpaid produce suppliers priority to the proceeds of produce sales over all secured lenders.

In the Ninth Circuit, the express purpose of the PACA trust has been significantly eroded by *Boulder Fruit* and the per curiam opinion. Thus, unpaid produce suppliers only have priority to the proceeds of produce sales over secured

lenders *if the lending arrangement is commercially unreasonable.* This results in eviscerating the clear policy choices of Congress in enacting the PACA trust to place all secured lenders in a position subordinate to unpaid produce suppliers, with the burden of due diligence upon the lending industry. *Nickey Gregory*, 597 F.3d at 599; *Endico Potatoes*, 67 F.3d at 1067. A rehearing en banc would provide the Ninth Circuit with the opportunity to ensure that Congressional intent in enacting the PACA trust is not thwarted.

III. Rehearing En Banc Is Necessary To Overrule Prior Panel Precedent

Under *Boulder Fruit*, secured lenders have priority to PACA trust assets over unpaid produce suppliers. However, subsequent panels are bound by prior panel decisions, and only the en banc court may overrule panel precedent. See *United States v. Lucas*, 963 F.3d 243, 247 (9th Cir. 1992). Accordingly, rehearing en banc on the analysis to be applied regarding the true nature of a transaction involving PACA accounts receivable is necessary and appropriate.

CONCLUSION

For the foregoing reasons, G. W. Palmer & Co., Inc., Gargiulo, Inc., Andrew & Williamson Sales Co., Inc., and East Coast Brokers & Packers, Inc. respectfully request the Court to: grant the petition for rehearing en banc; adopt the threshold transfer-of-risk analysis of the Fourth, Fifth and Second Circuits; and eliminate the

split among the Circuits in analyzing transactions involving PACA accounts receivable to achieve the fundamental purpose of the PACA trust, which is to alleviate the burden on commerce caused by giving secured lenders priority to the proceeds from the sale of produce over unpaid produce suppliers.

Dated: March 8, 2017

Respectfully submitted,

McCARRON & DIESS

By: /s/ Louis W. Diess, III

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Brief complies with the type-volume limitations of Rule 32 of the Federal Rules of Appellate Procedure and contains 3120 words per the word processing software used to prepare this Brief, which was Microsoft Word 97.

/s/ Louis W. Diess, III
Louis W. Diess, III

STATEMENT OF RELATED CASES

Pursuant to Circuit Rule of Court 28-2.6, Appellants state that Consolidated Appeal 14-56078 is the only known related case pending in this Court, involving the same issue raised in this appeal.

/s/ Louis W. Diess, III
Louis W. Diess, III

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Petition for Rehearing En Banc was served via the Court's CM/ECF system, this 8th day of March, 2017 to: Christoph C. Heisenberg, Esq., Hinckley & Heisenberg LLP, 880 Third Avenue, 13th Floor, New York, NY 10022, David Raizman, Esq., Ogletree Deakins, 12th Floor, 400 South Hope Street, Los Angeles, California 90071, Attorneys for Appellees, Robert P. Lewis, Jr., Law Office of Robert P. Lewis, Jr., 1107 Fair Oaks Avenue, Suite 487, South Pasadena, California 91030-3311, Appellant for Consolidated Appellants.

/s/ Louis W. Diess, III
Louis W. Diess, III

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

S&H PACKING & SALES CO. INC., a California corporation, DBA SEASON PRODUCE CO, Plaintiff, and G.W. PALMER & CO., INC., et al, Plaintiffs-Appellants, v. TANIMURA DISTRIBUTING, INC., a California corporation, Defendant, and AGRICAP FINANCIAL CORPORATION, a Delaware corporation, Defendant-Appellee.	No. 14-56059 (Consolidated)
S&H PACKING & SALES CO. INC., a California corporation, DBA SEASON PRODUCE CO, Plaintiff, and APACHE PRODUCE CO., INC., an Arizona corporation, DBA PLAIN JANE., et al, Plaintiffs-Appellants, v. TANIMURA DISTRIBUTING, INC., a California corporation, Defendant, and AGRICAP FINANCIAL CORPORATION, a Delaware corporation, Defendant-Appellee.	No. 14-56078 (Consolidated)

On Appeal From the United States District Court For the Central District of California, Los Angeles D.C. No. 2:08-cv-05250-GW-FFM

APPELLEE'S RESPONSE TO PLAINTIFF-APPELLANTS' PETITION FOR REHEARING EN BANC

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APPELLEE'S CORPORATE DISCLOSURE STATEMENT PURSUANT TO FRAP 26.1.

AgriCap LLC does not have any parent corporation(s) nor are there any publicly held corporations that own 10% or more of its stock or has a financial interest in the outcome.

/s/Christoph Heisenberg March 30, 2017
counsel

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

TABLE OF AUTHORITIES

Statutes

Other Authorities

Regulations

I. APPELLEE'S COUNTER-STATEMENT OF THE CASE

This petition for hearing *en banc* ("Pet.") asks the Court to overrule its long-standing and well-reasoned precedent that is founded on the text of the Perishable Agricultural Commodities Act ("PACA"), 7 U.S.C. §§ 499a-499t, and to replace it with an inapplicable test that even the creating court has declined to apply in these circumstances. In *Boulder Fruit Express & Heger Organic Farm Sales v. Transportation Factoring, Inc.*, 251 F.3d 1268 (9th Cir. 2001), *cert. denied*, 122 S. Ct. 1077 (2002) ("*Boulder Fruit*"), this Court properly determined that a trustee's exchange of assets "for fair value is entirely consistent with the trustee's primary duty" because an exchange of value causes no economic harm to the trust beneficiaries. *Boulder Fruit*, 251 F.3d at 1271. This principle applies to all exchanges, not just transactions deemed to satisfy the "true sale" standard.

Petitioners incorrectly suggest *en banc* review is warranted because "there is an overriding need for national uniformity" (Circuit Rule 35.1) and that *Boulder Fruit* puts this Court in conflict with other circuits, including the Second Circuit. To the contrary, *Boulder Fruit* is squarely in line with the Second Circuit, which is particularly noteworthy because the Second Circuit authored the "true sale" decision on which Petitioners rely. *Boulder Fruit*'s recognition that the "true sale" test is not a dispositive threshold test was confirmed three years later when the Second Circuit reached the same conclusion. "We agree with the Ninth Circuit in *Boulder Fruit*."

E. Armata, Inc. v. Korea Commercial Bank of N.Y., 367 F.3d 123 (2d Cir. 2004). Far from *Boulder Fruit* representing an outlier needing reevaluation in order to create national uniformity, this Court's decision constitutes the prevailing view. The Second Circuit's determination that the "true sale" test is not determinative of PACA liability should put to rest Petitioners' arguments that this Court should adopt such a rule.

Lastly, *Boulder Fruit* also determined that monies paid directly by the account debtors to the factoring company are not property of the trust, and therefore the factoring company is not receiving the trustee's assets or enforcing a security interest. That contrasts fundamentally with the cases relied upon by Petitioners, which did involve an independent debt, and in which the PACA trustee itself collect and then assign payments to the purported factor. *Boulder Fruit*'s determination that the collected sums were not part of the trustee's property constitutes an unassailable holding, and for purposes of this motion, constitutes application of state law that does not warrant *en banc* review. Accordingly, there is simply no need for an *en banc* hearing to revisit this Court's well-reasoned and longstanding precedent.

II. FACTUAL BACKGROUND TO THE COURT'S DECISION

The Court's Per Curium decision affirmed the District Court's finding on summary judgment that the challenged transactions were undertaken pursuant to a factoring agreement drafted to comport with this Court's guidance in *Boulder Fruit*

and therefore did not violate PACA. The summary judgment motion established that the transactions involved exchanges of fair value, in which the trust received value equivalent to the value of the receivables it transferred.[1] It also established benefits to the PACA beneficiaries, i.e. by creating funds that were ironically used to pay the PACA creditors who have brought this action. Before commencing its relationship with AgriCap, Tanimura Distributing, Inc. ("TDI") had a lengthy 32 day period before it received payment from its account debtors, which meant that there were delays before the PACA creditors (i.e. the growers, including Petitioners) were paid. (SRE 4). To correct this problem, TDI monetized its receivables by selling them to AgriCap in factoring transactions modeled after those that occurred in *Boulder Fruit*. The factoring agreement allowed TDI to transfer receivables to AgriCap, and in exchange, to receive an immediate cash payment that it used to pay its PACA creditors, including Petitioners. By being able to pay its suppliers sooner, TDI became eligible to receive better terms from those suppliers. (SRE122-123). The purchase price consisted of an initial guaranteed payment of 80% of the receivables' face value, and a further payment, the amount of which varied depending based upon

[1] In total, AgriCap acquired receivables on which it was able to collect $20,628,102.68 (SRE 98-99). In return, AgriCap paid TDI $20,425,309.06 (*id.*) and TDI used this to pay the beneficiaries (SRE 9).

a formula. (RE95). On average, TDI received 97% of the invoice's value, meaning the second payment typically was 17%.

The actual AgriCap-TDI factoring transactions demonstrate that there is no basis for petitioner's contention that the Agricap-TDI transactions were really loans rather than purchases of receivables. In return for that initial payment, and the right to the further payment, TDI immediately transferred each individual receivable to AgriCap "as absolute owner," (RE95, 97). Under Section 2.7, AgriCap expressly assumed ownership and the risk of loss due to, *inter alia*, the account debtor becoming insolvent. (SRE 7). At the time of acquiring each receivable, TDI placed a stamp on the invoice advising the account debtor that the "receivable has been assigned to and is owned by and payable only to Agricap Financial Corporation." (RE98, Agreement 2.11). TDI notified each customer that the receivable had been assigned to AgriCap, and each account debtor acknowledged such assignment. (RE405 to 409). AgriCap thereafter billed the vendors directly, with the face of the invoice bearing the statement "Invoices Were Purchased From: Tanimura Distributing, Inc." (RE400 to 404).

As is the case in most purchase and sale agreements, the agreement required TDI to warrant certain things about the receivables being sold. While AgriCap assumed credit risk, it did require TDI to warrant that it was not selling an asset that it already knew the credit risk had become loss certainty, i.e., TDI had no knowledge

at the time of the sale that the counterparty was bankrupt. Although this warranty existed, it never came into play, and no receivables were ever returned. (SRE 12-51) Contrary to the suggestion that AgriCap had full recourse for invoices unpaid after 90 days, it in fact specifically assumed the risk of the account debtor becoming insolvent. (SRE 7). The agreement also provided for adjustments to the sale amount where, for example, the original invoice was adjusted between TDI and the account debtor due to an incorrect quantity being recorded on the invoice. (SRE 8). Those adjustments to reflect the actual sales amounted to approximately $900,000 during the entire course of the relationship.

III. *EN BANC* REVIEW IS NOT WARRANTED

"Petitions for rehearing are generally denied unless something of unusual importance — such as a life — is at stake, or a real and significant error was made by the original panel, or there is conflict within the circuit on a point of law." *Hart v. Massanari*, 266 F.3d 1155, 1172 n.29 (9th Cir. 2001). As demonstrated herein, *Boulder Fruit* was correctly decided and has guided business such as AgriCap in structuring their relationships. It should not be reconsidered *en banc*.

A. *BOULDER FRUIT* CORRECTLY BASED ITS BREACH OF TRUST ANALYSIS ON PACA'S ACTUAL STATUTORY DUTIES

Congress created the PACA trust in 1984 to maintain for produce sellers the value of their sales. Congress expressly created a floating trust, contemplating that the trustee would need to transfer trust assets to parties other than the beneficiaries.

The Regulations expressly contemplate the exchange of assets, providing that in the exchange the trust protection automatically migrates from the asset transferred away to the assets "derived therefrom." 7 C.F.R. § 46.46(b).

In such exchange, the rule is that "absent a breach of trust, when a trustee enters into a contract with a third party, any trust funds transferred to that third party in consideration of the contract are transferred free of trust unless the contract provides that the transferred funds shall be held in trust." *In re Hamilton Taft & Co.*, 53 F.3d 285, 288 (9th Cir. 1995). As *Boulder Fruit* correctly noted, third parties "are not guarantors of the PACA trust. They are liable only if they had some role in causing the breach or dissipation of the trust." *Boulder Fruit,* at 1272. This puts the inquiry squarely on whether the trustee failed to fulfill the "Trust maintenance" duties specified in 7 C.F.R. § 46.46(d), principally the duty to keep the value freely available to the beneficiaries, and not dissipate the trust value. Those duties therefore differentiate between exchanges in which the assets received in return do not dissipate the value, and transfers in which the trust does not receive value, or receives less-than-equivalent value. As *Boulder Fruit* properly evaluated, a transfer "for fair value is entirely consistent with the trustee's primary duty." *Id*., 251 F.3d at 1271. Nothing in the statue, its regulations or general trust principles restricts the *Hamilton* rule that the asset is transferred free of the trust to only a "true sale."

B. *BOULDER FRUIT* PROPERLY DETERMINED THAT ASSET EXCHANGES ARE CONSISTENT WITH PACA'S PURPOSE

Petitioners do not contend that the transactions violate those express textual provisions in 7 C.F.R. § 46.46(d), but argue the transactions nonetheless violate "the express purpose of the PACA trust." (Pet. at 12). Leaving aside the questionable argument that Congress had an "express purpose" that it inexplicably failed to implement, the legislative history and purpose that Petitioners rely upon does not support their argument for creating a broader remedy beyond the statute itself.

Petitioners attempt to justify creating a violation beyond the statute's actual language by misinterpreting the legislative history that led to its enactment. That legislative record reflects a concern about a specific type of transaction (bankruptcy priority), and created a remedy that specifically remedied that concern. Prior to the amendment, secured lenders were able to enforce their security interests in a bankruptcy to divert trust assets. H.R. Rep. No. 543, 98th Cong. 1st Sess. Pt. 5 (1983), reprinted in 1984 U.S. Code Cong. & Admin. News at 409 ("when there is a business failure, security interest holders divert debtors' assets away from produce sellers. Unsecured produce sellers recover little, if any, money when a defunct firm's assets are distributed."). Stated another way, enforcing a security interest created harm because it removed assets without providing any corresponding equivalent value.

The trust mechanism addressed that concern and does so automatically, because it precludes enforcement of the security interest as "the trust assets are excluded from the estate should the dealer go bankrupt." *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 282 (9th Cir. 1997). The trust creates a self-enforcing remedy, as a security interest cannot attach to trust assets, so a secured lender lacks the ability to enforce a security interest. The amendment therefore specifically accomplishes Congress' concern about arrangements that "encumber or give lenders a security interest in such commodities." 7 U.S.C. § 499e(c)(1).

That specific purpose and the remedy that flows from it, however, does not signal a broader purpose of precluding the trustee from entering into secured loan transactions:

> While the regulations do not prohibit a buyer or receiver from granting a secured interest in trust assets, they make it clear that the secured interest is secondary and specifically voidable ….

Explanation of the Regulations Under the Perishable Agricultural Commodities Act; Addition of Provisions To Effect a Statutory Trust, Final Rule, 49 Fed. Reg. 45735, 45738 (1984) ("PACA Regs."). Therefore, an actual creditor seeking to recover money from the PACA merchant in its bankruptcy must be aware that its claim would not be secured.

This Court gave full effect to that purpose when it noted that it would be an "easy case" if it involved an actual creditor seeking to enforce a security interest to

obtain assets. *Boulder Fruit*, 251 F.3d at 1271. But, in *Boulder Fruit*, as here, the case did not involve that attempt. The factor, like AgriCap, already obtained the funds from the account debtor, and therefore had no need to enforce a security interest. It also was not a creditor, as TDI owed it no money. Instead, this case involves the separate question of whether a beneficiary can require a third party to disgorge funds received in a valid transfer because the trustee purportedly breached a duty in engaging in the transaction. *Boulder Fruit* recognized that in measuring that breach of trust it would be a mistake to go beyond Congress' definition of the duties in 7 C.F.R. 46.46(d), particularly where the transactions cause no harm to the trust. It would be a mistake to distinguish between a sale and a loan when the 1984 explanation accompanying the new trust state "the regulations do not prohibit a buyer or receiver from granting a secured interest in trust assets." PACA Regs. at 45738.

C. *BOULDER FRUIT* AND THE SECOND CIRCUIT ARE CONSISTENT AND REPRESENT THE PROPER ANALYSIS

The Petitioners argue that Circuit Rule 35.1 is satisfied by an overriding need for national uniformity, incorrectly suggesting that *Boulder Fruit* is an outlier, and that this Court "should join the Second, Fourth, Fifth Circuits" in making the "true sale" test a dispositive threshold test. (Pet. at 4). That conclusion overlooks the fact that the Second and Fifth Circuits utilized the "true sale" test not as a threshold test,

and that the Second Circuit later declined to use the "true sale" test as a threshold test, choosing instead expressly to adopt *Boulder Fruit*'s analysis.

The Second Circuit created the "true sale" test in *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063, 1064 (2d Cir. 1995) not as a threshold test to evaluate whether the trustee committed a breach, but to evaluate the *bona fide* purchaser defense. ("At issue in this action is the well-recognized principle from trust law that a *bona fide* purchaser of trust assets receives the assets free of any claim by the trust beneficiaries"). *Boulder Fruit* declined to apply *Endico Potatoes* as a threshold test, noting that "[w]hether a transferee of trust assets is a *bona fide* purchaser becomes relevant only as a defense after it has been determined that a breach of trust has occurred." *Boulder Fruit*. 67 F.3d at 1068.

In 2004 and 2005 three separate Second Circuit panels confirmed that limitation. That trilogy of cases addressed the claim that a breach of trust occurred when a lender "extended revolving overdraft privileges" and the trustee transferred PACA assets to pay that arrangement. By Petitioners' "true sale" threshold test, an acknowledged loan would not be a true sale. Each panel, however, agreed with this Court that the true sale test was not determinative. "We agree with the Ninth Circuit in *Boulder Fruit.*" *E.Armata v. Korea Commercial Bk. of NY*, 367 F.3d 123, 135 (2d Cir. 2004). "[T]he proper test was whether in 'making such a [transfer] . . . [the PACA trustee] in any way encumber[ed] the funds or render[ed] them less `freely

available' to PACA creditors." *D.M. Rothman v. Korea Commercial Bk. of NY*, 411 F.3d 90, 94 (2d Cir. 2005). See also *American Banana Co., Inc. v. Republic National Bank of New York*, 362 F.3d 33, 36-38 (2d Cir. 2004). In view of those decisions that the "true sale" test was not a determinative threshold test, from the same Court that originated the test, there can be no legitimate claim that the Second Circuit supports a threshold application of the "true sale" test.[2]

The Fifth Circuit's decision in *Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Veg. Co., Inc.*, 336 F.3d 410, 413 (5th Cir. 2003) also does not conflict with this Court's precedent. Like *Endico Potatoes*, it involved transactions in which title to the receivables was not transferred in a prior exchange. See *Reaves*, 336 F.3d at 415-16 ("Fidelity was not required to make any advances on receivables purchased with recourse until payment was received from the account debtor.") As in *Endico Potatoes*, the issue was whether a lender could retain its lien via the *bona fide* purchaser defense. *Id*. ("Accordingly, a '*bona fide* purchaser' of trust assets receives

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[2] Petitioners curiously cite *A&J Produce Corp. v. Bronx Overall Economic Development Corp.*, 542 F.3d 54 (2d Cir. 2008) as validating the "true sale" test, when it actually reinforces the test's limited application. As in *Endico Potatoes*, the case involved whether the lenders' lien was acquired as a *bona fide* purchaser, allowed it to foreclose on the trust asset. ("BOEDC initiated foreclosure proceedings against ABC seeking recourse to the collateral units.") As in *Endico Potatoes*, the Court concluded it would apply the transfer of risk test "to resolve whether the lien constituted a purchase for value."

the assets free of claims by trust beneficiaries… Lenders who receive trust assets through enforcement of a security agreement are not *bona fide* purchasers, however, because such transfers are not "for value."). Thus, both the *Endico Potatoes* and *Reaves* decisions address the *bona fide* purchaser test, not as a threshold question.

The Fourth Circuit's *Nickey Gregory Co. LLC v. AgriCap*, 597 F.3d 591 (4th Cir. 2010) decision is the only outlier, applying policy ahead of statutory language, adopting a rule that even the Second Circuit rejected. That decision constitutes the only circuit court willing to go beyond the express statutory duties to invalidate exchanges that caused no actual harm, presumably to protect South Carolina growers.[3] *Nickey Gregory*, not *Boulder Fruit*, is the outlier among the circuits, and its analysis does not hold up to this Court's and the Second Circuit's more rigorous PACA analysis upon which AgriCap and other factoring companies have relied.

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[3] The creation of non-statutory liability was made more perverse by the disgorgement remedy requiring the factor to disgorge all amounts that it collected on the receivables, without reference to the amounts the factor had paid for those receivables. That draconian remedy was contrary to hornbook remedies that "[t]he beneficiary or his representative must return to the party from whom he takes the traced property any consideration paid by such party which has gone to the benefit of the trust." G. Bogart, Law of Trusts and Trustees §866 (rev. 2d ed. 1995). Under those principles "the transferee is entitled to a credit of the amount which he paid for the property to the extent to which the trust estate has received a benefit therefrom." Restatement (Second) of Trusts §291(3); 3 A. Scott & W. Fratcher, Scott on Trusts, § 479 (4th ed.). Petitioners seek the same remedy here, and although the Panel expressed surprise at Petitioners' theory, its affirmance of summary judgment deprived the panel the opportunity to address the remedy.

D. *BOULDER FRUIT* CORRECTLY DETERMINED THAT THE FUNDS PAID DIRECTLY TO AGRICAP BY THE ACCOUNT DEBTORS, NOT THROUGH TDI, ARE NOT TDI'S PROPERTY

Petitioners' final argument asks the Court to adopt the fiction that the funds the account debtors paid directly to AgriCap somehow became TDI's property. *Boulder Fruit* correctly rejected that theory, based on a similar structure in which the factoring company received payment directly from the account debtors, and not through the trustee. *Boulder Fruit*'s determination, involving state law, *In re Contractors Equip. Supply Co.*, 861 F.2d 241, 244 (9th Cir. 1988), is correct. It therefore does not warrant this Circuit's *en banc* rehearing.

In *Boulder Fruit*, as here, the factoring company held title to the receivables, and received payment directly from the account debtor. "The ability of a buyer to demand that it receive payment directly from account debtors supports the finding that the transaction is a sale." *In re Dryden Advisory Services LLC*, 534 B.R. 612, 622 (Bankr. M.D. Pa. 2015). If the factor exercises its right to obtain payment directly it becomes "abundantly clear that the transfer of the accounts was a sale." *id*. Moreover, because the transactions were a contemporaneous exchange, there never was any separate debt on the part of TDI for which the receivable might serve as collateral. This represented a core fundamental distinction from *Endico Potatoes,* where there was a separate debt, and the account debtors continued to pay invoices to the trustee, who then endorsed the payment checks to the factor to reduce the

balance on a prior independent debt. ("CIT lent funds to Merberg on a revolving basis. Merberg's customers submitted payment directly to Merberg, which would then endorse the checks and deposit them in an account for the benefit of CIT"). Here, in contrast with *Endico Potatoes*, AgriCap had a direct right to be paid, and exercised that right. The fact that the payment was made directly, not indirectly through TDI assigning the payment to AgriCap, precludes a claim that AgriCap obtained the sums from TDI by enforcing a secured debt.

Petitioners' arguments about recourse are not relevant. Where "a seller conveys its entire interest in a receivable, the transfer is a true sale, even if the seller has a recourse obligation." *Dryden*, 534 B.R. at 623. AgriCap's express acceptance of risk of non-payment due to an Insolvency Event (SRE9) is virtually identical to similar clauses that accept the risk of "non-payment on Purchased Accounts, so long as the cause of non-payment is solely due to the occurrence of an account debtor's financial inability to pay, an 'Insolvency Event.'" *Dryden*, 534 B.R. at 623. Similarly, the right to adjust to account in the event of a disagreement between TDI and the account debtor does not detract from the true sale, which permits "all other risks associated with the sale of the accounts receivable, like commercial disputes, remain with the client." *Wechsler v. Hunt Health Systems, Ltd.*, 198 F. Supp. 2d 508, 520 (S.D.N.Y. 2002). Finally, Petitioners contend that the amount of the second payment involved some calculations of AgriCap's fee. "While this 'fee' provision

may be viewed as a substitute for interest indicative of a loan-type transaction, it just as readily may be characterized as the computation of the discount at which the accounts were purchased." *Dryden*, 534 B.R. at 624.

Those determinations were well founded in the facts, and *Boulder Fruit*'s factual determination does not constitute a basis for *en banc* rehearing.

IV. CONCLUSION

This Court's decision in *Boulder Fruit* Court correctly determined that PACA's test for failing to maintain assets is set forth in the text: does the transaction diminish the value of the trust? Both this Court, and the Second Circuit, properly concluded that exchanges, even if deemed to be a secured lending relationship, do not diminish the trust. There is no reason to re-evaluate the conclusion by granting Petitioner's request for an *en banc* hearing.

Dated: March 30, 2017

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Certificate of Compliance Pursuant to Circuit Rule 40.1

I hereby certify that the foregoing Response complies with the type-volume limitation of Circuit Rule 40.1 of the Federal Rules of Appellate Procedure and contains 3712 words per the Microsoft Word 2013 word processing software used to prepare the brief.

/s/Christoph Heisenberg
Christoph C. Heisenberg

STATEMENT OF RELATED CASES

Pursuant to Circuit Rule of Court 28-2.6, Appellee states that the Consolidated Appeal 14-56078 is the only known related case pending in this Court, involving the same issues raised in this appeal.

/s/Christoph Heisenberg
Christoph C. Heisenberg

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Appellee's Brief was served via the Court's CM/ECF system this 30th day of March 2017 to:

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