IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

In re: VEG LIQUIDATION, INC. f/k/a ALLENS, INC. and ALL VEG, LLC, Debtors	**No. 5:13-bk-73597** **Jointly Administered** **Ch. 11**

ALLENS, INC. and ALL VEG, LLC

v.

GREAT AMERICAN APPETIZERS, INC. **Objection to PACA Claim**

ORDER

On January 13, 2014, Allens, Inc. filed *Debtors' Omnibus Objection to PACA Claims* [omnibus objection] that includes three grounds for objecting to the PACA proof of claim of Great American Appetizers, Inc. [Great American] in the amount of $97,773.24. Those grounds for objection are: (1) that the interest rate of 24% that was contracted between the parties exceeded the lawful limit; (2) that Great American failed to provide documentation to support its claim of attorney fees; and (3) that the goods Great American sold to the debtor do not qualify for PACA trust protection.

The Court heard the debtor's objection to Great American's PACA claim on October 23 and 24, 2014. At the hearing, the debtor made an oral motion for partial directed verdict. The Court took the oral motion and the debtor's objection to Great American's PACA proof of claim under advisement at the conclusion of the two-day trial. For the reasons stated below, the Court sustains the debtor's objection to Great American's PACA proof of claim.

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(B). The following order constitutes findings of fact and conclusions of law in accordance with Federal Rule of

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Bankruptcy Procedure 7052, made applicable to this proceeding under Federal Rule of Bankruptcy Procedure 9014.

ANALYSIS

Great American manufactures frozen appetizers. The debtor, which was primarily in the business of producing and selling canned goods, also purchased and resold frozen foods packaged under its own label. In the two months prior to filing chapter 11 bankruptcy on October 28, 2013, the debtor purchased four products from Great American for resale: breaded jalapenos with cheddar cheese, spicy breaded pickle slices, fried green tomatoes, and battered corn nuggets. Great American's PACA claim in the amount of $97,773.24 arose from the debtor's purchase of those products.

The debtor's central objection is that the goods sold to the debtor are not perishable agricultural commodities entitled to PACA trust protection under 7 U.S.C. § 499a(b)(4). On this basis, the debtor asks the Court to disallow Great American's PACA proof of claim in total. Section 499a(b)(4) states that:

> The term "perishable agricultural commodity"–
>
> (A) Means any of the following, whether or not frozen or packed in ice: Fresh fruits and fresh vegetables of every kind and character . . . .

Regulations promulgated by the United States Department of Agriculture [USDA] further define the scope of PACA protection, such as by providing a list of operations that do not change the fresh nature of fruits and vegetables. In relevant part, 7 C.F.R. § 46.2 states that:

> (u) Fresh fruits and fresh vegetables include all produce in fresh form generally considered as perishable fruits and vegetables, whether or not packed in ice or held in common or cold storage, but does not include those perishable fruits and vegetables which have been manufactured into articles of food of a different kind or character. The effects of the following operations shall not be considered as changing a commodity into a food of a different kind or character: Water, steam, or oil blanching, battering, coating, chopping, color adding, curing, cutting, dicing, drying for the removal of surface

> moisture; fumigating, gassing, heating for insect control, ripening and coloring; removal of seed, pits, stems, calyx, husk, pods, rind, skin, peel, et cetera; polishing, precooling, refrigerating, shredding, slicing, trimming, washing with or without chemicals; waxing, adding of sugar or other sweetening agents; adding ascorbic acid or other agents to retard oxidation; mixing of several kinds of sliced, chopped, or diced fruit or vegetables for packaging in any type of containers; or comparable methods of preparation.
>
> (v) Frozen fruits and vegetables include all produce defined in paragraph (u) of this section when such produce is in frozen form.

PACA extends protection to "fresh" fruits and vegetables only, but neither the statute nor the regulation defines this standard outright. One court, turning to multiple dictionaries, determined that the various competing definitions of "fresh" do not resolve the inherent ambiguity of the statute's use of this word. *Fleming Cos., Inc. v. U.S. Dept. of Agric.*, 322 F. Supp. 2d 744, 757 (E.D. Tex. 2004).[1] For that reason, courts have relied on the parameters set forth by the permitted operations listed in 7 C.F.R. § 46.2(u) to conclude, generally, that PACA restricts protection to "[u]nprocessed or very minimally processed fruits and vegetables." *In re Long John Silver's Rests., Inc.*, 230 B.R. 29, 33 (Bankr. D. Del. 1999) (quoting *A & J Produce Corp. v. CIT Group/Factoring, Inc.*, 829 F. Supp.

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[1] In a decision explaining why canned goods do not qualify for PACA protection, the USDA relied on a dictionary definition of "fresh":

> Congress used "fresh" to describe a "perishable agricultural commodity," the common definition of which explicitly excludes canned goods. See The American Heritage Dictionary 534 (2d ed. 1984) (defining "fresh" as "not preserved, as by canning, smoking or freezing." The rationale of PACA and the common definition are in accord. There is no indication that Congress intended something other than the ordinary meaning. Therefore, PACA was not intended to include canned goods.

In re Fleming Cos., Inc., Cavendish Farms, et al. v. Fleming Cos., Inc. et al., No. 03-1049-SLR, 2004 WL 3804788, at *3 (U.S.D.A. Nov. 8, 2004). However, the USDA's use of the dictionary definition underscores the lack of clarity in the word "fresh." In addition to canning, the dictionary definition cited by the USDA also precludes freezing, which 7 U.S.C. § 499a(b)(4) and 7 C.F.R. § 46.2(v) specifically allow. The USDA does not acknowledge this inconsistency in its decision.

651, 658 (S.D.N.Y. 1993). In addition to being fresh, the fruits and vegetables in question cannot be manufactured into "articles of food of a different kind or character." That transformation disqualifies the finished product from PACA protection.
The statute and regulation also do not define at what point fruits and vegetables become a food of a different kind or character. One court explained that PACA protection only extends to foods for which "'a change in form . . . does not change the essential nature of the item, such as slicing, or a change which is meant only to temporarily preserve the fruit or vegetable, such as freezing or adding a preservative chemical." *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063, 1070 (2d Cir. 1995) (quoting *A & J Produce Corp.*, 829 F. Supp at 658).

Marco Meyer, partial owner and chief operating officer of Great American, testified regarding Great American's manufacturing processes of its products. Vegetables in various forms were purchased as ingredients: whole green tomatoes for the fried green tomatoes, frozen corn kernels for the battered corn nuggets, pickle slices (rather than raw cucumbers) for the spicy breaded pickle slices, and either raw halved jalapenos or jalapenos pre-stuffed with cheddar cheese. In preparation for processing, Great American sliced the green tomatoes and blanched them in water, and, in the case of the raw halved jalapenos, inserted what Meyers referred to as a cheddar cheese "slug." The frozen corn kernels were mixed with sugar, starch, and flour, formed into balls, and sprayed with a chemical to promote cohesiveness. Following these preparations, for each of the four products, multiple alternating coatings of wet and dry ingredients were applied to create an exterior shell, or breading, around the vegetables. For the corn nuggets only, an oil blanch followed. All products were then frozen and packaged. Meyer testified that the shelf-life of each of the products was 18 months when kept frozen. Once thawed, the products' life span was hours according to Meyer.

The alternating wet and dry ingredients used to create an exterior shell varied according to the product but were similar in content and purpose. The wet ingredients, described as a batter (and analogized as being like a very thin pancake batter), served to adhere later

applications of the dry ingredients to the vegetables. The dry ingredients were composed of various mixtures, including bread crumbs, "a blend of flour, starches, and flavors," and cornmeal combined with other ingredients. Seasonings were added to both the wet and dry ingredients that formed the breading.

While the addition of the exterior shell did not substantially change the vegetables themselves from the state in which Great American acquired them, the end product differed greatly as a result of the exterior breading shell. The debtor's expert witness, Dr. Gillian Dagan, testified that Great American's manufacturing processes introduced wheat and dairy allergens and fat (including saturated fat), none of which would be found in native jalapenos, tomatoes, cucumbers, or corn. In addition, the dry coatings and the batter coatings together added a significant amount of carbohydrates. The appearance was altered to the extent that a casual observer would be unable to identify the vegetables without pulling off the breading shell, and the texture and flavor of the finished products were also very different from the vegetables in their native form. Nevertheless, Great American asserts that these products qualify for PACA trust protection for three reasons: (1) that because the vegetables themselves would qualify for PACA trust protection, the finished products should also qualify, (2) that its manufacturing processes are all acceptable operations under 7 C.F.R. § 46.2(u), including breading (which Great American argues is synonymous with battering and coating), and (3) because the invoices from Great American to the debtor contain language holding out the products as perishable agricultural commodities protected under PACA.

None of these arguments overcomes the Court's conclusion that Great American has manufactured food of a different kind or character based on indisputable changes in appearance, texture, flavor, and nutritional profile. The only case of which the Court is aware that directly examines breaded appetizers and similar foods dispels Great American's first argument. *See A & J Produce Corp.*, 829 F. Supp. 651 (S.D.NY. 1993), aff'd in part, rev'd in part sub nom. *Endico Potatoes, Inc. et al. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063 (2d Cir. 1995). In *A & J Produce Corp.*, the district court summarily

denied the applicability of PACA trust protection to frozen onion rings, breaded cauliflower, and zucchini sticks with almost no discussion, noting only that the foods "have undergone a fundamental change from the fresh state of the vegetables." *Id.* at 658-59. The court also considered foods such as cole slaw, potato salad, and cream cheese with scallions, all of which contained ingredients that, alone, could qualify for PACA protection. The court ruled that each of these foods, in which the percentage of "fresh ingredients" ranged from 86 percent to 4 percent, was also not subject to PACA trust protection because of the same type of fundamental change. *Id.* at 659. The Second Circuit affirmed the district court as to this method, specifically noting that each disallowed product contained "less than 90 percent fresh ingredients." *Endico*, 67 F.3d at 1071.

If this Court similarly applies the ninety percent rule formulated by *A & J Produce Corp.* and *Endico*, each of Great American's products fails on that basis alone. The debtor's expert witness, Dr. Dagan, estimated the average weight pick-up for the battering and breading processes of each product, resulting in the following average compositions: 51 percent jalapeno (and cheese) in the breaded jalapenos with cheddar cheese; 70 percent pickle in the spicy breaded pickle slices; 70 percent tomato in the fried green tomatoes; and 60 percent corn (and other filling) in the battered corn nuggets. Meyer's own estimations were in a similar range. Regardless of the 90 percent rule, however, to the extent the vegetables used by Great American are considered perishable agricultural commodities under 7 U.S.C. § 499a(b)(4), each is only an ingredient in the finished products.[2] The Court finds that the finished products, as a sum of the ingredients, are

[2] At least one court has stated that pickles do not qualify as a perishable agricultural commodity under 7 U.S.C. § 499a(b)(4). *See Endico*, 67 F.3d at 1071. In regard to Great American's spicy breaded jalapeno peppers, Meyer testified that Great American purchased either halved peppers or halved peppers pre-stuffed with cheese. The Court has insufficient information to know which type was used for the spicy breaded jalapeno peppers that gave rise to part of the debt currently in dispute. However, to the extent that Great American purchased pre-stuffed peppers, it is also unlikely that those would qualify as a perishable agricultural commodity.

foods of a different kind or character.

Great American's second argument, that all of its manufacturing processes are permitted operations, also does not change the fact that those processes transform vegetables into foods of a different kind or character. In deciding a similar argument made by a juice producer, one court stated that

> [w]hile the creation of cider from apples involves steps, such as dicing, refridgerating [sic], and removing seeds, which are listed in the definition as activities that do not change an agricultural product to a non-agricultural product, *the essential nature of an apple* is changed when it is converted into cider.

Bear Mountain Orchards, Inc. v. Mich-Kim, Inc. et al., 2007 U.S. Dist. Lexis 88983, at *11 (E.D. Penn. Nov. 30, 2007) (emphasis added).

Further, the Court rejects Great American's argument that breading, while not listed as a permitted process, is synonymous with battering and coating, which are both permitted processes under the regulation. The processes of battering and coating, which were most recently added to the regulation in 2003, are described by the USDA in relation to the preparation of frozen french fries: potato strips are dipped in a mixture of water and starch, a crisping agent is added, the strips are air blown to leave behind only a thin layer of coating, and then the strips are oil-blanched and frozen. Most importantly for the purposes here, "*coating or battering does not alter the essential character of the potato products because the operation leaves them virtually indistinguishable in appearance and texture* from those that have not been coated or battered." Perishable Agricultural Commodities Act (PACA): Amending Regulations to Extend PACA Coverage to Fresh and Frozen Fruits and Vegetables That Are Coated or Battered, 68 Fed. Reg. 23377-01 (May 2, 2003) (to be codified at 7 C.F.R. pt. 46) (emphasis added). The breading processes employed by Great American are not comparable to this description, either in form or effect.

Lastly, Great American's third argument–that the parties effectively contracted with the understanding that the products were perishable agricultural commodities according to language on invoices–must fail because labels and misnomers, themselves, have no legal effect. The parties' use of PACA language in invoices cannot create federal protections that the statute itself does not grant. *Cf. Debruyn Produce Co. v. Richmond Produce Co.*, 112 B.R. 364, 369 (Bankr. N.D. Cal. 1990) ("[A]lthough the notice serves to preserve rights where previously accrued, no substantive rights or priorities are created by the filing of the notice . . . .").

For all of these reasons, the Court finds that the food products that Great American sold to the debtor do not qualify for PACA protection under 7 U.S.C. § 499a(b)(4), and, accordingly, Great American's PACA proof of claim in the amount of $97,773.24 is disallowed and relegated to the status of a general unsecured claim, to the extent Great American is entitled to such claim. The debtor's other grounds for objecting to Great American's PACA proof of claim are rendered moot by this finding. The Court need not make a separate finding on the debtor's motion for partial directed verdict made at the trial.

IT IS SO ORDERED.

Ben Barry
United States Bankruptcy Judge
Dated: 02/02/2015

cc: Mark A. Amendola
Michael Scotti
Maria J. DiConza
R. Ray Fulmer, II