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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re:)	Chapter 11 Cases
)	Nos. 98-33952-TC
L.R. HOLDINGS, INC.,)	98-33953-TC
a Delaware corporation, and)	
LYON'S RESTAURANTS, INC.,)	[Jointly Administered for
a Delaware corporation,)	Procedural Purposes Only Under]
Debtors.)	Case No. 98-33952-TC
_____)	
ROYAL FOODS CO.,)	Adv. No. 98-3412-TC
Plaintiff,)	
vs.)	
L.R. HOLDINGS, INC., and)	MEMORANDUM RE PLAINTIFF'S THIRD
LYON'S RESTAURANTS, INC.,)	<u>MOTION FOR SUMMARY JUDGMENT</u>
Defendants.)	
_____)	

The court held a hearing regarding Plaintiff's Third Motion for Summary Judgment on July 12, 2002. Stephen P. McCarron appeared for Plaintiff Royal Foods Co. (Royal Foods). Terrence V. Ponsford appeared for Defendant and Intervenor, U.S. Bank National Association (Bank).

1 **BACKGROUND**

2 Royal Foods delivered perishable commodities to Lyon's
3 Restaurants. Lyon's filed a chapter 11 petition on September 9,
4 1998, owing Royal Foods more than \$1.2 million. Lyon's sold its
5 assets in the chapter 11 case for \$22.6 million. Bank holds a
6 valid lien on the sale proceeds securing a debt of more than \$25
7 million. Royal Foods contends that it has a claim to the sale
8 proceeds superior to that of the Bank under the Perishable
9 Agricultural Commodities Act, 7 U.S.C. § 499a et seq. (PACA).

10 This court denied Royal Foods' first motion for summary
11 judgment upon the legal conclusion that restaurants are not subject
12 to PACA. The district court reversed, holding that a restaurant is
13 a "dealer" subject to PACA if its buys perishable commodities in
14 "jobbing quantities."

15 This court granted Royal Foods' second motion for summary
16 judgment to the extent it sought a determination that Lyon's bought
17 produce in "jobbing quantities" and was thus a "dealer" in
18 perishable commodities subject to PACA. The court determined that
19 the second summary judgment motion did not properly request any
20 further relief.

21 In the present motion, Royal Foods seeks summary judgment on
22 all remaining issues. I determine that Royal Foods is entitled to
23 recover the amount of \$1,844,261.

24

25 **I. WHETHER ROYAL FOODS PRESERVED ITS RIGHTS UNDER PACA**

26 Royal Foods contends that Lyon's owes it \$1,220,025 for
27 perishable commodities delivered in 1998. Gummow declaration, ¶ 4.

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1 Bank does not contest this claim. Declaration of William C.
2 Kosturos, ¶ 6 & Exhibit B. Nor does Bank deny that Royal Foods
3 has a superior claim to the sales proceeds to the extent those
4 proceeds are held in trust for Royal Foods under PACA.

5 Bank does contend, however, that only \$207,313 of the amount
6 due is payable from funds held in trust under PACA. Bank asserts
7 that Royal Foods failed to preserve its PACA rights with respect to
8 deliveries before May 26, 1998, by failing to provide Lyon's timely
9 notice that the deliveries were subject to PACA. Bank also notes
10 that Lyon's paid Royal Foods \$1,012,712 after May 26, 1998.
11 Declaration of William C. Kosturos, ¶ 7. If this payment is
12 applied to post-May 26th deliveries, the amount due for those
13 deliveries is no more than \$207,313. Royal Foods should not be
14 permitted to apply the payment to pre-May 26th deliveries, Bank
15 argues, because such application would allow Royal Foods to receive
16 a preferential payment on a general unsecured claim.

17 The Bank's argument is unpersuasive. For the reasons set
18 forth below, I determine that Lyon's preserved its PACA rights
19 regarding all deliveries, and that the entire amount of its unpaid
20 claim, whether for pre- or post-May 26th deliveries, is payable from
21 funds held in trust under PACA.

22 PACA provides that any dealer who receives perishable com-
23 modities holds all proceeds of those commodities in trust for the
24 supplier until "full payment of the sums owing in connection with
25 such transactions has been received by such unpaid suppliers...."
26 7 U.S.C. § 499e(c)(2). The unpaid seller, however, "shall lose the
27 benefits of such trust unless such person has given written notice
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1 of intent to preserve the benefits of the trust" to the dealer.
2 Id. at § 499(e)(c)(3). Such notice may be provided in the
3 invoice sent to the dealer for the commodities in question. Id.
4 at § 499e(c)(4).

5 Bank does not contend that the PACA notice contained in the
6 post-May 26th invoices is insufficient, or that Royal Foods failed
7 to take any other step necessary to preserve its PACA rights
8 regarding post-May 26th deliveries. Bank's sole contention is that
9 Royal Foods failed to provide the required PACA notice regarding
10 pre-May 26th deliveries. See Bank Group's Opposition to Plaintiff's
11 Third Motion for Summary Judgment at 4-6.

12 I determine that Royal Foods has established beyond genuine
13 dispute that all the Royal Foods invoices contained the PACA
14 notice. In so determining, I note the following.

15 The Gummow declaration expressly states that every invoice
16 Royal Foods sent to Lyon's contained the PACA notice. Declaration
17 of George Gummow ¶¶ 6 & 7. The exhibits to the Gummow declaration
18 contain many of these invoices. Id. ¶ 8. Each invoice is on a
19 standard form that contains the PACA notice. Among these invoices
20 are several sent before May 26, 1998. These pre-May 26th invoices
21 are on the same standard form containing the PACA notice.

22 The only evidence submitted by Bank suggesting that any pre-
23 May 26th invoices did not contain the PACA notice is the declaration
24 of John Ghuzzi. The focus of that declaration is whether Lyon's
25 became obligated to pay 18 percent interest on invoices not paid
26 within 30 days. Ghuzzi states that Lyon's had consistently paid up
27 to 120 days after shipment, and that he and Gummow never discussed
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1 interest on delinquent invoices. In the course of the declaration,
2 Ghuzzi states: "In May 1998, Mr. Gummow presented me with a letter
3 agreement by which, for the first time, Royal Foods claimed that it
4 was selling its produce to Lyons under the Perishable Agricultural
5 Commodities Act." The Ghuzzi declaration is attached to this
6 decision as Appendix A.

7 The Ghuzzi declaration does not effectively controvert the
8 Gummow declaration. Mr. Ghuzzi does not directly address whether
9 Royal Foods' pre-May 26th invoices contained PACA notices. Ghuzzi's
10 statement that Royal Foods "claimed" for the first time in the
11 May 26th letter agreement that its sales were covered by PACA is
12 too vague to controvert: [i] Gummow's very specific statement
13 that every Royal Foods invoice contained the PACA notice; and
14 [ii] Gummow's authentication of numerous pre- and post-May 26th
15 invoices, all of which are printed on the same standard form
16 containing the PACA notice.

17 **II. WHETHER ALL OF THE FUNDS RESERVED ARE SUBJECT TO THE PACA**
18 **TRUST**

19 Bank next contends that only a small portion of the funds
20 from which Royal Foods seeks payment are proceeds from the sale
21 of perishable commodities held in trust for Royal Foods. Bank
22 asserts that perishable commodities constituted no more than 6.31%
23 of Lyon's cost of goods sold. Bank argues further that the only
24 assets that can be considered proceeds of perishable commodities
25 are Lyon's cash, inventory, and receivables as of the petition
26 date, which total \$1,488,828. The proceeds of perishables held in
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1 trust for Royal Foods, Bank argues, therefore constitute only 6.31%
2 of this \$1,488,828, or \$93,999.

3 The Bank's argument misconstrues the tracing rules established
4 in the caselaw construing PACA. A PACA claimant is not required to
5 trace the proceeds of perishable commodities. In re Kornblum &
6 Co., 81 F.3d 280, 284-87 (2nd Cir. 1996); In re Richmond Produce
7 Co., 112 B.R. 364, 378-79 (Bankr. N.D. Cal. 1990); In re Fresh
8 Approach, Inc., 51 B.R. 412, 422 (Bankr. N.D. Texas 1985). The
9 PACA trust presumptively applies to all assets used in the produce-
10 related business. Kornblum, supra, 81 F.3d at 284-87. The burden
11 is upon the competing claimant to show that any such assets were
12 paid for from a source other than the proceeds of perishable
13 commodities. Id. In the cases relied upon by bank, the competing
14 claimant proved that a certain portion of revenues derived from a
15 non-produce-related business. See Six L's Packing Co. v. West
16 Des Moines State Bank, 967 F.2d 256, 259 (8th Cir. 1992); Richmond
17 Produce, supra, 112 B.R. at 378-79.

18 In the present case, Bank has not shown that the assets sold
19 were purchased with funds other than the proceeds of the not-yet-
20 paid-for perishables. Bank has also not shown that any of the
21 income was derived from a non-produce-related business. Bank has
22 shown only that the cost of produce was a small portion of the cost
23 of operating a business that is clearly produce-related. Even in
24 the paradigm PACA case, a cannery, the cost of produce does not
25 represent the only cost involved in the preparation of the finished
26 product. The direct costs of canning also include rent,
27 machinery, labor, and canning supplies. Yet no court has held that

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1 the PACA trust applies only to a portion of the proceeds of the
2 canned goods.¹ Therefore, the entire amount of the sale proceeds
3 are subject to Royal Foods' PACA claim.
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5 **III. PREJUDGMENT INTEREST**

6 Royal Foods seeks prejudgment interest on all sums due at the
7 rate of 18 percent. Royal Foods relies upon the following language
8 in its standard-form invoice. "TERMS: All accounts are due and
9 payable in 30 days. A delinquency charge of **1½% per month or 18%**
10 **per annum** will be charged on accounts over 30 days" (emphasis in
11 original). Royal Foods notes that Lyon's never objected to the
12 invoice provision regarding interest.

13 Bank argues that summary judgment may not be granted regarding
14 prejudgment interest, because a genuine issue of fact remains as to
15 whether the interest provision of the invoice became a part of the
16 contract between the Royal Foods and Lyons. Bank submitted
17 evidence that Royal Foods never attempted to recover interest
18 before the current action, even though Lyon's payments were
19 consistently 90 days late. Declaration of John Ghuzzi, ¶ 3-7.
20 Furthermore, the May 26, 1998 letter agreement between Royal Foods
21 and Lyons provides for attorneys fees, but does not provide for
22 interest on delinquent payments. See copy of letter agreement
23 attached hereto as part of Appendix A.

24 I agree with Bank that these circumstances create a triable
25 issue of fact as to whether the invoice language fixing interest at
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27 ¹It is worthy of note that the Lyon's claim is less than ten
28 percent of the proceeds of the sale of the restaurant.

1 18 percent: (1) became part of the contract between the parties
2 under Section 2207 of the California Commercial Code; (2) was
3 waived by Royal Foods' failure to enforce it; or (3) was suspended
4 by the May 26th letter agreement.

5 That the interest rate specified in the Royal Foods invoices
6 may not be enforceable, however, does not mean that Royal Foods is
7 not entitled to recover prejudgment interest. It is beyond dispute
8 that the amounts owed to Royal Foods arise from Lyon's breach of a
9 contract. Under California law, Royal Foods is entitled to recover
10 prejudgment interest at the rate of ten percent. Section 3287 of
11 the California Civil Code provides in relevant part:

12 (a) Every person who is entitled to recover damages
13 certain, or capable of being made certain by calculation,
14 and the right to recover which is vested in him upon a
particular day, is entitled also to recover interest
thereon from that day....

15 (b) Every person who is entitled under any judgment
16 to receive damages based upon a cause of action in contract
17 where the claim was unliquidated, may also recover interest
18 thereon from a date prior to the entry of judgment as the
court may, in its discretion, fix, but in no event earlier
than the date the action was filed.

19 Section 3289(b) of the Civil Code provides:

20 "If a contract entered into after January 1, 1986,
21 does not stipulate a legal rate of interest, the
obligation shall bear interest at a rate of 10
percent per annum after a breach."

22 This state law rate, not the Federal judgment rate, should
23 apply in the present case. Although the general rule is that a
24 Federal court should award prejudgment interest at the rate fixed
25 in 28 U.S.C. § 1961 for post-judgment interest, the Ninth Circuit
26 has repeatedly held that in a diversity action prejudgment interest
27 should be awarded at the rate fixed by applicable state law. See

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1 Citicorp Real Estate v. Smith, 155 F.3d 1097, 1107-08 (9th Cir.
2 1998); AT&T v. United Computer Systems, 98 F.3d 1206, 1209
3 (9th Cir. 1996); Northrop Corp. v. Triad International Marketing,
4 842 F.2d 1154, 1155 (9th Cir. 1988). For this purpose, the present
5 action is the equivalent of a diversity action, because it is in
6 substance a breach of contract action. Although PACA provides
7 Royal Foods certain remedies in addition to those available under
8 state law, those remedies are intended only to enable Royal Foods
9 to enforce its rights under state law to recover "the sums owing in
10 connection with such transactions." See 7 U.S.C. § 499e(c)(2).
11 Because PACA itself does not address attorneys fees or prejudgment
12 interest, the courts look to state law regarding these questions.
13 See JC Produce v. Paragon Steakhouse Restaurants, 70 F.Supp. 2d
14 1119, 1123 (E.D. Cal. 1999).

15 Royal Foods seeks prejudgment interest from October 1, 1998.
16 This is an appropriate date from which to calculate interest.
17 First, Royal Foods became entitled to recover portions of the total
18 amount due on many different dates. Thus, to calculate prejudgment
19 interest precisely would be very time-consuming, because it would
20 require calculating interest separately for the amount due under
21 each invoice. Second, it appears that the vast majority of the
22 debt became due between July 1, 1998 and October 8, 1998.² In
23 choosing October 1, 1998 as the start date, Royal Foods has

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25 ²Exhibit 2 to the Declaration of George Gummow shows that the
26 overwhelming majority of invoices were dated between June 1, 1998
27 and September 8, 1998, and were spread evenly over that period.
Under the May 26, 1998 letter agreement, payment was due 30 days
from receipt.

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1 calculated prejudgment interest in a manner that is advantageous to
2 Bank as well as convenient. I exercise the discretion afforded me
3 under Section 3287 of the Civil Code to calculate prejudgment
4 interest from October 1, 1998.

5 Prejudgment interest on the principal amount of \$1,220,025 at
6 the rate of 10 percent per annum from October 1, 1998 to the date
7 of this decision equals \$446,285.

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9 **IV. ATTORNEYS FEES**

10 Each Royal Foods invoice contained the following language
11 regarding attorneys fees: "Customers agree to pay all court costs
12 and reasonable attorneys fees, and/or reasonable collection costs
13 on all past due accounts." Bank submitted no evidence that Lyon's
14 ever objected to the attorney fee provision in the invoices.

15 The May 26, 1998 letter agreement between Royal foods and
16 Lyon's contain the following provision regarding attorneys fees.
17 "In the event it becomes necessary to commence legal action to
18 collect the sums due under such transactions, the prevailing party
19 will be entitled to recover reasonable attorneys fees and costs
20 incurred thereby." This letter agreement was signed on behalf of
21 Lyon's by its president and CEO, John Ghuzzi.

22 Royal Foods has submitted declarations and timesheets from its
23 counsel indicating that to date Royal Foods has incurred fees and
24 costs totalling \$177,951 in seeking to collect from Lyon's.

25 Bank does not challenge the reasonableness of the fees
26 incurred. Rather, Bank argues that some of the deliveries were

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1 made before the May 26th letter agreement and are thus not subject
2 to that agreement. The Bank also argues that the current
3 proceeding is not "an action to collect the sums due," but is
4 instead a dispute as to whether the deliveries to Lyon's were
5 subject to PACA. Both of Bank's arguments are unpersuasive.

6 It does not matter whether the present action concerns
7 deliveries made before or after the May 26th letter agreement,
8 because the fee provision in Royal Foods' invoices applies to all
9 deliveries. Section 2207 of the California Commercial Code
10 provides in relevant part:

11 (1) A definite and seasonable expression of
12 acceptance or a written confirmation which is sent
13 within a reasonable time operates as an acceptance
14 even though it states terms additional to or different
or different terms.

15 (2) The additional terms are to be construed as
16 proposals for addition to the contract. Between
merchants such terms become part of the contract unless:

17 (a) The offer expressly limits acceptance to the
18 terms of the offer;

19 (b) They materially alter it; or

20 (c) Notification of objection to them has already
21 been given or is given within a reasonable time after
notice of them is received.

22 Bank offered no evidence that Lyon's raised any objection to the
23 fee provision in Royal Foods' invoices. Nor did Lyon's engage in
24 any conduct inconsistent with the enforceability of that fee
25 provision--Lyon's never pursued collection without claiming fees.
26 Finally, in the May 26th letter agreement, Lyon's expressly agreed

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1 to a similar fee clause. Thus, the fee clause in Royal Foods'
2 invoices became part of the contract under section 2207.

3 The argument that Lyon's is not entitled to recover attorneys
4 fees because the current proceeding is not an action to collect
5 sums due under the contract is frivolous. Royal Foods seeks
6 nothing except payment for the produce delivered to Lyon's. That
7 Lyon's asserted certain federal law remedies in that action does
8 not change the essential character of the action. See JC Produce,
9 supra, 70 F.Supp at 1123.

10

11 **V. FUNDS FROM WHICH ROYAL FOODS MAY RECOVER**

12 Bank argues that it is not liable for any amount due that
13 exceeds the \$1.7 million set aside under a prior order to pay
14 Royal Foods' allowed PACA claim. Bank relies upon language in
15 Article V.C. of the confirmed plan, which states that Royal Foods
16 shall be paid from the \$1.7 million account. This argument is
17 unpersuasive.

18 The Ninth Circuit has held that under 11 U.S.C. § 524(e), a
19 chapter 11 plan of reorganization may not discharge liabilities
20 of a non-debtor. See In re Lowenschuss, 67 F.3d 1394, 1401-02
21 (9th Cir. 1995), cert. denied, 517 U.S. 1243 (1996). Ninth Circuit
22 decisions do give res judicata effect to provisions of a confirmed
23 plan no longer subject to appeal, even if the plan should not have
24 been confirmed. See Trulis v. Barton, 107 F.3d 685, 691 (9th Cir.
25 1995). A court, however, should not enforce plan language that
26 purports to grant a discharge broader than that provided for in the

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1 Bankruptcy Code, unless the plan language clearly compels such a
2 result. In re Miller, 253 B.R. 455, 459-60 (Bankr. N.D. Cal.
3 2000). The plan language cited by Bank does not provide clearly
4 that Bank's liability to Royal Foods is limited by the plan.

5 Bank remains liable for the entire amount Lyon's owed Royal
6 Foods, because Bank received approximately \$22 million proceeds
7 from the sale of Lyon's produce-related restaurant business. Under
8 the principles described in parts I and II, Bank holds the entire
9 amount of these proceeds in trust for Royal Foods until Royal Foods
10 receives full payment for the perishable commodities delivered to
11 Lyon's.

12

13 **CONCLUSION**

14 Summary judgment is granted in favor of Royal Foods as
15 follows. Royal Foods shall recover the sum of \$1,844,261, which
16 includes prejudgment interest, fees, and costs. This amount
17 shall be paid first from the \$1.7 million previously set aside for
18 this purpose and any interest earned on that amount. Any remaining
19 amount shall be paid by Bank. The court reserves for trial the
20 question whether Royal Foods is entitled to prejudgment interest
21 at the rate of 18 percent.

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25 Dated: August 28, 2002

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Thomas E. Carlson
United States Bankruptcy Judge

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