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An Agricultural Law Research Article

**The Effects of PACA's Perfection Mechanisms
on Colorado Agricultural Law**

by

Scott T. Rodgers

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The Effects of PACA's Perfection Mechanisms on Colorado Agricultural Law

by Scott T. Rodgers

Colorado has a substantial financial interest in perishable agricultural commodities. Therefore, lawyers need to recognize the protections afforded to these commodities when advising secured parties, merchants, dealers, or brokers. Sellers must move quickly to preserve and enforce their rights and should aggressively pursue those who ignore their obligation to preserve trust benefits. This article covers the perfection mechanisms under the Perishable Agricultural Commodities Act ("PACA"),¹ as well as the rights of secured creditors and sellers and related bankruptcy concerns. Given the specific time limitations mandated by PACA, practitioners who represent these sellers need to become familiar with the requirements.

Historical Background

In 1930, PACA was enacted to promote fair trading practices and suppress unfair and fraudulent business practices regarding the marketing of perishable commodities. In 1984, Congress significantly amended PACA by adding to 7 U.S.C. § 499(e) provisions that create a statutory trust for the benefit of agricultural producers when their inventory is transferred to produce dealers.² Currently, many merchants, dealers, and brokers use bank loans secured by the inventories, proceeds, or assigned receivables they obtain from the sale of perishable agricultural commodities. This

provides a secured position for lenders in case of insolvency. Under prior law, fresh fruit and vegetable sellers were considered unsecured creditors.

PACA was modified to impose a trust in favor of unpaid sellers and suppliers on inventories of commodities and products and proceeds of sale. This trust would work the same way as "Trust" amendments to the 1976 Packers and Stockyard Act.³ Congress passed the PACA amendment because it found that "a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which dealers who have not made payment give lenders a security interest in such commodities and that such arrangements are contrary to the public interest."⁴

The term "perishable agricultural commodity" includes all fresh fruits and vegetables that are frozen or packed on ice, as well as cherries in brine, as defined by the Secretary of the U.S. Department of Agriculture ("Secretary") in accordance with trade usages.⁵ The relevant provision of the 1984 PACA amendment provides that perishable agricultural commodities will be held in trust for unpaid suppliers, agents, or sellers until full payment has been received from the debtor. In general, however, the unpaid suppliers will lose the benefits unless written notice of intent to preserve the benefits of the trust is filed with the Secretary within thirty calendar days after payment is due.⁶

These trust assets will be maintained in a non-segregated, floating trust, and may be commingled with non-trust assets.⁷ Those holding trusts must maintain the assets so they are "freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities."⁸

Priority and Perfection

A PACA beneficiary has priority over a secured creditor on a purchaser's commod-

ity-related assets to the extent of the amount of the claim.⁹ A produce buyer's unpaid obligation "becomes a trust obligation . . . prior to and superior to any lien or secured interest in inventory held by the [buyer's] secured lender."¹⁰ The PACA trust's ability to affect distribution in bankruptcy is extremely potent. The trust effectively provides beneficiaries with a claim status that trumps that of all creditors, even secured creditors.¹¹ A secured lender will be forced to return trust property unless it can establish *bona fide* purchaser status (that is, that it received the property for value and without notice of trust).¹² Whether the producers in question gave a proper notice to create a PACA trust often is a litigated issue in cases involving PACA trusts.¹³

The beneficiary of a trust set up under PACA has priority over a secured creditor on a purchaser's commodity-related assets to the extent of the amount of the claim, provided that the seller gives timely notice to the Secretary and the purchaser. PACA requires that an unpaid seller provide written notice of the intent to preserve the benefits of the trust with the debtor and file the notice with the Secretary within thirty days after payment for the produce was due.¹⁴ The deadline for payment for a shipment to which a seller, supplier, or agent can agree and still qualify for coverage under the trust is thirty

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This newsletter is prepared by the CBA Business Law Section to apprise members of the Bar of current information concerning substantive law. This month's article was written by Scott T. Rodgers of Brega & Winters, Denver—(303) 866-9400. The author practices bankruptcy law and commercial litigation.

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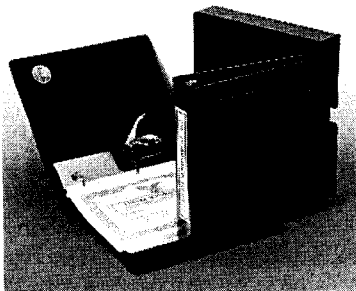
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days after receipt and acceptance of the commodities.¹⁵

To preserve their trust status, the producers are required to notify the Secretary and the debtor of their intentions.¹⁶ Notice of intent to preserve benefits under the trust is required to be in writing and to state that it is "a notice of intent to preserve trust benefits." It also must include the name and address of the trust beneficiary, seller, commission merchant, or agent and the debtor, as applicable. Moreover, the notice should state the date of the transaction, commodity, invoice price, terms of payment, and the amount past due and unpaid.¹⁷

Notice Requirements and Trust Preservation

The courts are split regarding the level of detail the notice must contain to preserve the seller's PACA trust rights. Some courts have strictly construed the notice requirement, holding that actual notice was insufficient if the seller did not comply with the formal notice requirements of the statute.¹⁸ However, other courts have held that the PACA trust is preserved, even though a seller's notice does not specifically list each of the suppliers and does not include information about the transaction date, contract terms, payment due date, and amount of fruit picked. Courts have held that these defects are not fatal in light of the purpose of PACA.¹⁹

As a practical matter, secured lenders who want to determine whether notices have been filed face a difficult hurdle. Lender requests to determine whether a debtor-commodities buyer has had trust notices filed against that debtor may be deemed by the Department of Agriculture to be requests for commercial or financial information, which is confidential and not subject to disclosure.²⁰

Personal Liability and Bankruptcy

A number of cases have held that corporate officers may be personally liable for breach of PACA trusts.²¹ In some instances, counsel for produce suppliers may be entitled to attorney fees when establishing such a trust.²²

PACA creates a *bona fide* trust; therefore, assets included in the trust are not property of the bankruptcy estate.²³ However, bankruptcy courts universally have held that PACA trust funds remain subject to the control of the bankruptcy court.²⁴

In addition, bankruptcy courts seem to agree that all PACA creditors who have properly retained their interest in the statutory PACA trust have an equal share in the trust, on a *pro rata* basis, even if they did not participate in the bankruptcy proceedings.²⁵

Further, some courts have held that a PACA debtor does serve in a "fiduciary capacity" for the benefit of produce suppliers, within the meaning of the discharge exception in 11 U.S.C. § 523(a)(4), for a debt arising out of a debtor's fraud or defalcation while acting in a fiduciary capacity.²⁶ Finally, the filing of a PACA notice does not violate the automatic stay nor does the automatic stay excuse PACA's filing requirements. Sellers need to file the appropriate notice immediately with the Secretary and the debtor.²⁷

Agricultural Performance

The following agricultural statistics have been included to provide a general overview of perishable crop production and issues related thereto. In 1998, Colorado fruit crops did much better than they did in 1997. There was minimal freeze damage, and seasonal development was normal, with only light hail damage in a few localities. Regarding fruit production, apple and tart cherry crops nearly doubled over the previous year, peach crops almost tripled, and pear production was almost one-third larger. In 1998, the state's four major fruit crops totaled 93.3 million pounds, which was almost double the 47.9 million pounds produced in 1997 when all crops suffered freeze losses early in the year. The total 1998 value of production use from the crops was \$19.7 million, up from \$10.5 million a year earlier (87 percent). Apples had the highest production yield, and peaches ranked first in terms of total production value.²⁸

During 1998, vegetable production in Colorado was just under 11.0 million cwt. Vegetable produce had a total value of \$131.9 million, which was up 21 percent from the \$109.3 million earned for the same quantity produced in 1997. Cabbage, lettuce, onion, and sweet corn production was higher than the previous year. However, production was smaller for the following crops: cantaloupe, carrot, cucumber, and spinach.²⁹

On the next page, Tables 1 and 2 provide general information about the cash receipts for certain perishable agricultural commodities in Colorado.³⁰

Conclusion

Since 1984, sellers of fresh fruits and vegetables have used strong-arm methods of forcing payment. To protect their rights, sellers must move within thirty days to provide notice of intent to preserve trust benefits. If the amendment to PACA is followed, PACA beneficiaries can trump secured creditors. This ability to obtain payment may also impose personal liability on corporate officers who cannot use bankruptcy as an escape hatch. Because millions of dollars worth of fruits and vegetables are produced in Colorado each year, PACA is a statute worthy of attention.

NOTES

1. 7 U.S.C. § 499.

2. 7 U.S.C. § 499e(c); *Frio Ice, S.A. v. Sunfruit, Inc.*, 918 F.2d 154-56 (11th Cir. 1990).

3. Congress intended to provide for sellers of produce the sort of protection against other creditors of delinquent purchasers/dealers that was contemplated for livestock dealers in the Packers and Stockyard Act of 1921. H.R. Rep. No. 98-543, 98th Cong., 1st Sess., 4 (1983), reprinted in 1984 U.S. Code Cong. & Ad. News 406, 407. See also *In re Fresh Approach, Inc.*, 48 B.R. 926, 928 (Bankr.N.D.Tex. 1985).

4. 7 U.S.C. § 499e(c)(1); *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F.Supp. 346-47 (S.D.N.Y. 1993); *Continental Fruit v. Thomas J. Gatzliolis & Co.*, 774 F.Supp. 449, 451 (N.D.Ill. 1991).

5. 7 U.S.C. § 499a(b)(4).

6. 7 U.S.C. § 499e(c)(3); 7 C.F.R. §§ 46.2(aa)(5) and 46.46(f)(2).

7. 7 C.F.R. § 46.46(b).

8. *Continental Fruit, supra*, note 4 at 451; see also *Magic Restaurants v. Bowie Produce*, 205 F.3d 108 (3rd Cir. 2000) (restaurants that handle large quantities of produce are dealers).

9. *Morris Okun, Inc., supra*, note 4 at 348.

10. *Sanzone-Palmisano Co. v. M. Seaman Enterprises*, 986 F.2d 1010, 1012 (6th Cir. 1993), *cit'g In re Prange Foods Corp.*, 63 B.R. 211, 214 (Bankr.W.D.Mich. 1986).

11. *In re H.R. Hindle & Co.*, 149 B.R. 775, 785 (Bankr.E.D.Pa. 1993).

12. *C.H. Robinson Co. v. Trust Co., N.A.*, 952 F.2d 1311, 1315 (11th Cir. 1992).

13. *In re East Coast Brokers & Packers, Inc.*, 961 F.2d 1543 (11th Cir. 1992); *Hull Co. v. Hauser's Foods, Inc.*, 924 F.2d 777 (8th Cir. 1991); *C.H. Robinson Co. v. E.H. Produce Co.*, 723 F.Supp. 785 (N.D.Ga. 1989), *aff'd*, 952 F.2d 1311 (11th Cir. 1992), *reh'g denied*, 961 F.2d 224 (11th Cir. 1992) (genuine issue of material facts existed as to whether seller filed notice of intent to preserve benefits of trust with purchaser within thirty calendar days of date payment was due).

14. 7 U.S.C. § 499e(c)(3); 7 C.F.R. § 46.46; *Sanzone-Palmisano Co., Inc., supra*, note 10 at 1011 n.1.

15. 7 C.F.R. § 46.46(e)(2); *In re Altabon Foods, Inc.*, 998 F.2d 718-19 (9th Cir. 1993).

16. 7 C.F.R. § 46.46(f)(1) addresses the notice requirement mandated in 7 U.S.C. § 499e(c)(3).

17. *In re H.R. Hindle & Co., supra*, note 11 at 786.

18. *In re Marvin Properties*, 76 B.R. 150 (9th Cir. BAP 1987); *In re D.K.M.B., Inc.*, 95 B.R. 774 (Bankr.D.Colo. 1989); *In re Milton Poulos, Inc.*, 947 F.2d 1351 (9th Cir. 1991) (to preserve benefits of PACA trust, produce seller must give written notice of intent to preserve benefits to both produce buyer and Secretary; indirect notice from Secretary to buyer is not sufficient). See also *In re Chipwich, Inc.*, 165 B.R. 135 (Bankr.S.D.N.Y. 1994) (PACA claimant had actual and constructive knowledge of Chapter 11 debtor's merger with another company. Thus, PACA trust notices were invalid that named other company instead of debtor).

19. *In re Carlton Fruit Co.*, 84 B.R. 810 (Bankr.M.D.Fla. 1988); *Hull Co., supra*, note 13 at 777, 779 (court held that PACA trust was preserved even though notice failed to state explicit intent to preserve trust benefits and payment was made); *In re Richmond Produce Co.*, 112 B.R. 364 (Bankr.N.D.Cal. 1990) (failure of notice of intent to preserve trust under PACA to include all information concerning transaction date, contract terms, price of commodities

Table 1

Fruits: Production, Price and Value, Colorado, 1991-98
(Value of utilized production in thousands of dollars)

	1991	1992	1993	1994	1995	1996	1997	1998
Apples	10,904	12,768	13,229	13,007	7,375	4,837	5,138	8,640
Peaches	646	5,165	5,287	5,742	7,932	7,934	4,297	9,036
Pears	925	1,137	1,670	1,097	1,000	480	762	1,494
Cherries	663	547	224	390	414	426	336	540

Table 2

Vegetables: Acreage, Production and Value, Colorado, 1993-98
(Total value in thousands of dollars)

	1993	1994	1995	1996	1997	1998
Cabbage	4,859	6,365	3,534	7,293	5,897	7,544
Cantaloupe	2,328	4,147	2,657	3,672	5,280	4,074
Carrots	9,150	11,780	23,085	10,189	24,000	16,960
Cucumbers	2,010	1,728	956	1,080	1,094	230
Lettuce	11,275	6,970	6,564	4,158	11,081	9,331
Onions	101,990	67,122	54,331	51,626	49,538	77,844

sold, and the like, did not render notices defective under PACA, where only express requirement of statute concerning contents of notice was that notice state claimant's intent to preserve its trust benefits).

20. 5 U.S.C. § 552(b)(4). The author was denied access to this information after filing a Freedom of Information Act request. For more information, contact the Administrator, U.S. Department of Agriculture, Agricultural Marketing Service, P.O. Box 96456, Washington, DC 20090-6456.

21. *A & J Produce Corp. v. CIT Group/Factory, Inc.*, 829 F.Supp. 651, 655-56 (S.D.N.Y. 1993) (dealer in perishable agricultural commodities, as sole shareholder and fiduciary of PACA trust, could be held personally liable for breach of trust); *Bronia, Inc. v. Ho*, 873 F.Supp. 854, 861 (S.D.N.Y. 1995) (produce wholesaler's sole shareholder, officer, and director was personally liable for wholesaler's breach of PACA trust, even if he did not personally misappropriate trust assets); *Morris Okun, Inc.*, *supra*, note 4 at 348 (under PACA, sole shareholder of corporation licensed as dealer of perishable agricultural commodities was liable as corporate fiduciary to unpaid sellers of perishable goods); *Frio Ice, S.A. v. Sun Fruit, Inc.*, 724 F.Supp. 1373 (S.D.Fla. 1989), *rev'd on other grounds*, *Sunfruit, Inc.*, *supra*, note 2 at 154 (action under PACA,

requesting order requiring payment by buyer of commodity to seller out of trust created by PACA and seeking judgment for failure to pay such amount, could be maintained against individual who was principal and officer of buyer). *But see Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F.Supp. 706 (E.D.Pa. 1994) (corporate officers of licensed seller of perishable agricultural commodities are not automatically secondarily liable for payments that seller is required to make to suppliers, simply by virtue of their holding office).

22. *In re Milton Poulos, Inc.*, *supra*, note 18; *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F.Supp. 590 (S.D.N.Y. 1995) (perishable agricultural commodities seller was entitled to recover attorney fees from agricultural commodities dealer).

23. 11 U.S.C. § 541; *In re Country Club Market, Inc.*, 175 B.R. 1005, 1009 (D.Minn. 1994) (trust assets are not part of bankruptcy estate); *see also In re Fresh Approach, Inc.*, *supra*, note 3 at 926.

24. *Matter of United Fruit & Produce Co.*, 86 B.R. 14 (Bankr.D.Conn. 1988) (Despite fact that PACA trust funds are not estate property and not available to non-PACA creditors, such funds remain subject to bankruptcy control. Trustee may collect and divide these funds among beneficiaries.). *See also In re Super-*

spud, Inc., 77 B.R. 930 (Bankr.N.D.Fla. 1987); *Matter of United Fruit & Produce, Inc.*, 119 B.R. 10, 13 (Bankr.D.Conn. 1990); *In re Southland + Keystone*, 132 B.R. 632, 642-43 (9th Cir. BAP 1991).

25. *J.R. Brooks & Son, Inc. v. Normand's County Market, Inc.*, 98 B.R. 47, 51 (Bankr. N.D.Fla. 1989); *In re Milton Poulos, Inc.*, *supra*, note 18 at 1353; *Matter of United Fruit & Produce, Inc.*, *supra*, note 24 at 16 (trustee entitled to reasonable compensation out of PACA proceeds). *See also* Kress, "What Unsecured Creditors Need to Know About the Perishable Agricultural Commodities Act," *Am. Bankr. Inst. J.* 36 (Nov. 14, 1995).

26. *In re Stout*, 123 B.R. 412 (Bankr.W.D.Okla. 1990); *In re Harper*, 150 B.R. 416 (Bankr.E.D.Tenn. 1993) (both cases non-dischargeable under 11 U.S.C. § 523(a)(4)).

27. *In re Prange Food Corp.*, *supra*, note 10 at 211; *In re Monterey House, Inc.*, 71 B.R. 244 (Bankr.S.D.Tex. 1986) (claimants under PACA were not obligated to obtain lift of stay before filing their notice of intent to preserve their rights under PACA).

28. Colorado Agricultural Statistics Service, Colorado Agricultural Statistics 1999.

29. *Id.*

30. *Id.* ■

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Modification to May 2000 Business Law Newsletter

In the May 2000 article entitled "Legal and Practical Considerations in a Chinese-Foreign Joint Venture" by Alexa Chaing and Biaxia Liao, the last paragraph before the conclusion (on page 48) should be replaced with the following language: "Although the election in Taiwan in March created some uncertainty regarding the economic and political stability of the Taiwan Straits, people on both sides of the Straits are expected to place great value on peace in that region and share the goal of economic prosperity. In the authors' opinion, based on the historical ties over the Straits, it may be expected that the tension will subside and peace and economic growth will be maintained."⁷⁴

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information or to register: (303) 866-9213.