Veggie Wars: Legal Update on the Perishable Agricultural Commodities Act & Related Produce Laws

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VEGGIE WARS

PACA LAW UPDATE

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PACA Legal Update

- Basic Training
- Skirmishes between PACA Beneficiaries
- Personal Liability Land Mines
- Disarming Non-Dischargeability
- Factoring Companies – Friend, Foe, Frenemy?

BASIC TRAINING: What is PACA?

- Perishable Agricultural Commodities Act
- Administered by United States Department of Agriculture
- Federal law established in 1930

- Code of Conduct/Rules of Fair Trade For Produce Industry
- Licensing
- Complaint process
- Unfair conduct
  - **FOCUS: Section 5 – PACA Trust (1984 Amendments)**

PACA Unfair Conduct vs. PACA Trust

Section 2 Unfair Conduct – VIOLATIONS:	Section 5 PACA Trust – FOCUS OF CASE DECISIONS
Make, for a **fraudulent** purpose, any **false or misleading statement** in connection with any transaction involving any perishable agricultural	
Fail to **deliver** good under contract	
Discard, dump, or destroy without reasonable cause	
Unfair, unreasonable, discriminatory, or deceptive practice in connection with the **weighing, counting**	
Misrepresent by word, act, mark, stencil, label, statement, or deed, the character, kind, grade, quality, quantity, size, pack, weight, condition, degree of maturity, or State, country, or region of origin of any perishable agricultural commodity received, shipped	
Fail or refuse truly and correctly to **account** and make full **prompt payment**	
Fail to maintain the trust assets	

How and why was PACA enacted?

- In 1930, Congress originally enacted PACA to provide protections to produce sellers (selling on short payment terms) in cases where a buyer failed to make payment as provided by contract
- State court collection lawsuits did not adequately provide protection
- Public interest to protect food supply and interstate commerce
- Fair and ethical trading
- Ensure orderly trading through supply chain

Who is subject to PACA?

PACA LICENSEE

- Person or entity licensed by the USDA-PACA

OR

DEALER: PERSON OR ENTITY

- Dealer in "wholesale and jobbing quantities"
- Buys or sells 2,000 pounds of perishable agricultural commodities in any given day
- In interstate or foreign commerce

AND

RETAILERS

- Dealer in "wholesale and jobbing quantities"
- Purchase $230,000 or more worth of fresh or frozen fruits and vegetables in a calendar year
- May include restaurants

FROZEN FOOD BROKERS

- Dealer in "wholesale and jobbing quantities"
- Negotiate $230,000 or more worth of fresh or frozen fruits and vegetables in a calendar year

What are the PACA Trust Provisions

Seller's Rights:

- Puts sellers of fresh and frozen fruits and vegetables in a **super priority status** in PACA Trust Assets in the event their buyers become insolvent or file for bankruptcy protection

What are the PACA Trust Provisions

Buyer must hold in **trust** until supplier is fully paid:

- all inventories of food or products derived from perishable agricultural commodities
- any receivables or proceeds from the sale of such commodities or products

What is the "PACA Trust?"

- Statutory trust designed to protect unpaid suppliers of perishable agricultural commodities
- Creates a ***trust relationship*** between unpaid seller and buyer
- Provides sellers with "super-priority" collection rights

What is the "PACA Trust?"

The PACA Trust shares the same basic legal components as any trust relationship:

- Trustee: the person responsible for managing the trust: owners, officers, principals. The trustee has the highest standard of care known as a *fiduciary* duty. [Buyer]
- Beneficiary: the person who will benefit from the trust. [Supplier]
- Trust Assets: the property belonging to the trust.

Trustee's fiduciary duties

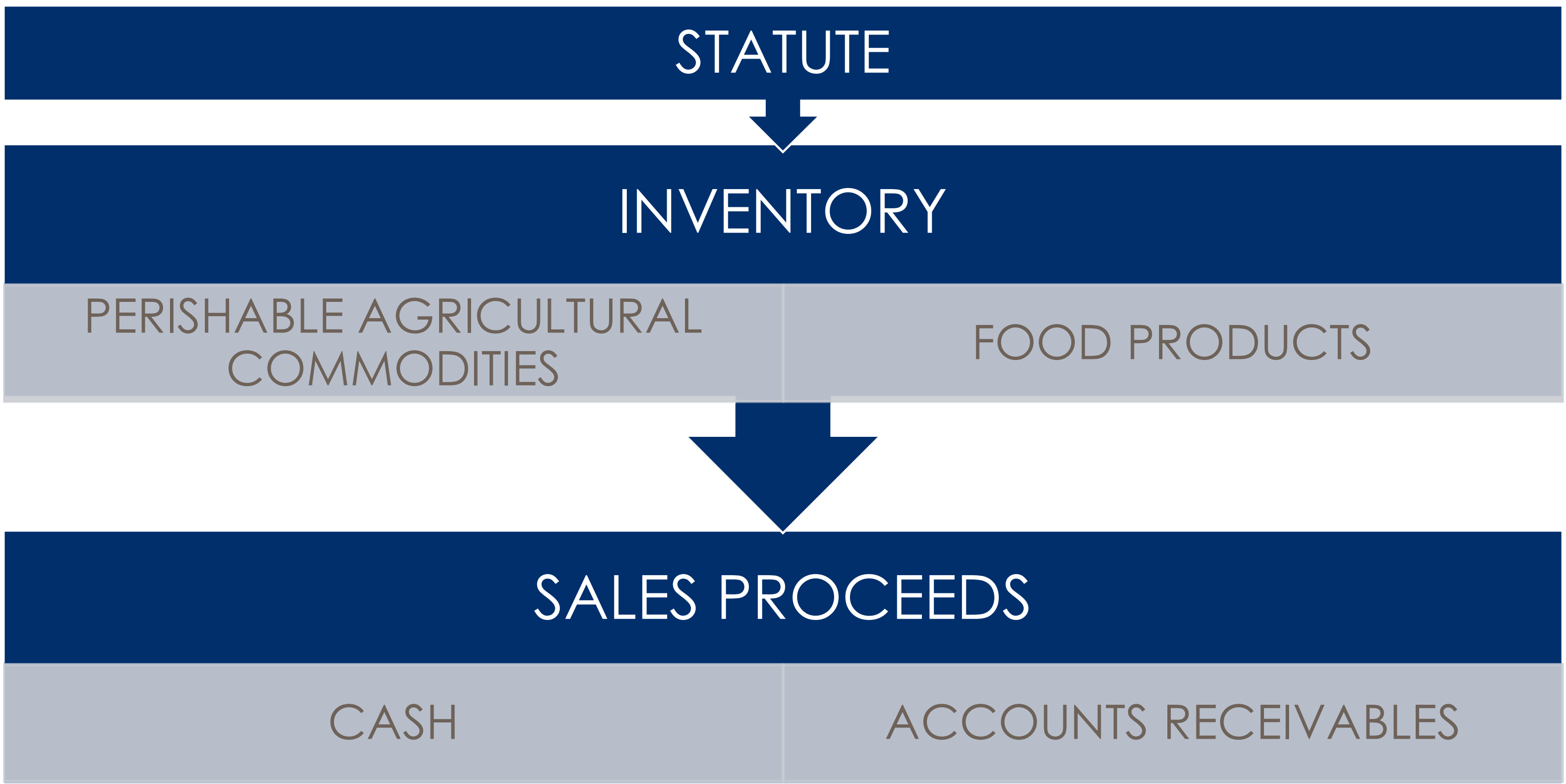
Trustee owes buyer *fiduciary duties*:

- Trustees are principals of the company in control of money
- Trustee will be liable to the Trust Beneficiary for not maintaining sufficient assets to timely and fully seller's PACA trust claim.
- Depending on degree of control of PACA trust assets, principals of buyer cannot discharge debt

What are PACA Trust assets?

- Presumptively all the buyer’s assets

What is a PACA Trust Asset?



What is a PACA Trust Asset?

CASE LAW

FLOATING TRUST

BANK ACCOUNTS CONTAINING SALES PROCEEDS	COMMINGLED BANK ACCOUNTS

ASSETS PURCHASED WITH SALES PROCEEDS

EQUIPMENT, FIXTURES	REAL ESTATE	VEHICLES

What commodities are covered?

COVERED

- Fresh fruit and vegetables
- Frozen fruits and vegetables
- Adding chemicals to retard oxidation
- Water, blanching, hot oil spray
- Battering and coating

MAYBE

- Puree
- Dates
- Nuts

NOT COVERED

- Processing to change character
- Fresh fruit concentrate
- Dehydrated
- Cooked in oil

What are the elements of a valid PACA Trust claim?

COMMODITIES	• Covered fresh or frozen perishable agricultural commodities
INTERSTATE OR FOREIGN COMMERCE	• Perishable agricultural commodities moves or in contemplation of moving in interstate or foreign commerce
BUYER IS LICENSED OR SUBJECT TO LICENSE	• Dealers, wholesales, jobbers, commission merchants, brokers, and possibly retailers
PAYMENT TERMS	• Default PACA Prompt = 10 days • CANNOT exceed 30 days
NOTICE TO BUYER	• Send written notice of intent to preserve PACA Trust rights within 30 days of when payment is due • PACA LICENSEE: include statutory language on invoices

What is included in a PACA Trust claim?

Costs in connection with the sales transaction:

- Precooling and palletizing
- Gassing
- Freight
- Cold Storage
- Temperature recorders

- Attorney’s fees (if provided for by contract, i.e. invoice or credit application)
- Interest/Finance charges

Preserving PACA Trust Rights

- *Send separate written notice to buyer of intent to preserve PACA trust rights within 30 days of when payment is due*. 7 U.S.C. sec. 499e(c)(3)
- PACA licensees include this exact language on the face of each invoice (7 U.S.C. sec. 499e(c)(4)):

The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by Section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. §499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

Skirmishes between PACA beneficiaries

PACA Trust Creditors of Lenny Perry's Produce, Inc. v. Genecco Produce, Inc.
853 Fed.Appx. 769.(2d Cir. 2021)

- U.S.D.C., Western District of New York => Second Circuit
- Defendants-Appellants Genecco Produce, Inc. ("GPI") and principal appealed a judgment entered against them in favor of Plaintiff-Appellees, PACA trust creditors of the bankrupt produce buyer Lenny Perry's Produce ("LPP").
- Plaintiffs filed an adversary complaint to recover monies GPI owed to LPP.
- GPI and LPP each purchased and sold produce to the other resulting in GPI appearing in the bankruptcy as both a PACA Trust creditor and a PACA Trust debtor of LPP.
- Defendants argued that GPI's debt to LPP should be fully offset by its debts to LPP, a result which would lead to GPI recovering more than its pro rata share of the PACA Trust assets.
- By recommendation by Bankruptcy Court, the District Court for the Western District of New York held, inter alia, that (1) GPI's debt to LPP was an asset of the LPP PACA Trust that could not be completely offset by LPP's debt to GPI, but (2) GPI could, as a creditor of LPP, recover its pro rata share of the PACA Trust ("GPI's Share") and use that to offset its liability to the PACA Trust.
- The Second Circuit affirmed and returned the case the Bankruptcy Court for determination of a sum certain to be paid by GPI to the PACA Trust after the offset for GPI's Share.

Personal Liability Land Mines

S. Katzman Produce Inc. v. Yadid
999 F.3d 867 (2d Cir. 2021)

- U.S.D.C., Southern District of New York => Second Circuit
- Defendant Eliran Yadid appeals a judgment - jointly and severally liable with his codefendants Orel Produce, Inc., and his dad, Moshe Yadid to pay PACA creditors $473,268.82, plus interest and attorneys' fees.
- The court granted plaintiffs' MSJ holding Eliran liable on the ground that he was a person in control of the trust assets.
- Orel was wholly owned by Moshe, who was its only officer.
- Son claims Dad made all the decisions; took instructions from Dad.
- Son signed contracts and personally guaranteed equipment finance; signed checks including payments to produce suppliers; withdrew cash, paid himself a weekly $900 salary and transferred $40k 2018 into his personal bank account; claims dad instructed him and "he received no personal benefit."
- Son claims he worked part time, ran errands, made sales, signed checks when dad was unavailable.
- Son maintained near-daily text message contact with Plaintiff's controller as he attempted to work out Orel's debts; participated in meetings on behalf of Orel, without his father present, to make financial arrangements for the Company, and applied for a loan on behalf of Orel, overseeing the distribution of the loan proceeds.
- The suppliers contended that the son was an officer and director of the dealer corporations and had ordered produce from them and assured them that they would be paid.
- Under traditional trust principles: "[a]n individual who is in the position to control the trust assets and who does not preserve them for the beneficiaries has breached a fiduciary duty and is personally liable for that tortious act. ... [A] PACA trust in effect imposes liability on a trustee, whether a corporation or a controlling person of that corporation, who uses the trust assets for any purpose other than repayment of the supplier."
- Affirmed district court's ruling that Eliran as a matter of law is responsible for dissipation of $40,000 of Orel's assets.
- Genuine issues of fact to be tried as to whether he had sufficient control of Orel's assets to make him liable for misuse of PACA trust assets, and that summary judgment was thus inappropriate.


Disarming Non-Dischargeability

In re Forrest
47 F.4th 1229 (11th Cir. 2022)

- U.S.B.C., Middle District of Florida => Eleventh Circuit => **Petition for Certiorari filed 11-30-22**
- The Forrests were owners of Central Market of FL, Inc. – failed to pay for $261,504.15 for produce from Spring Valley Produce, Inc.
- The Forrests filed for Chapter 7 to discharge business debt.
- SVP filed adversary complaint objecting to discharge of debt under 11 U.S.C. § 523(a)(4) (defalcation while in a fiduciary capacity)
- Court looked at early Supreme Court cases - the Fiduciary Capacity Exception does not apply to trusts implied by contract but applies to technical trusts or trusts in the technical sense but doesn't define technical trust.
- Test to deterring fiduciary capacity:
  - ✓ A trustee, who holds
  - ✓ An identifiable trust res, for the benefit of
  - ✓ identifiable beneficiaries
  - ⃠ Fails trust-like duties of segregating trust assets and duty to refrain from using trust assets for non-trust purpose
- Resembles a constructive or resulting trust - PACA did not impose sufficient trust-like duties to create technical trust, and it did not impose duty to refrain from using trust-assets for non-trust purpose – not an exception to discharge.
- Affirmed.

Factoring Companies – Friend, Foe, or Frenemy?

In re Spiech Farms, LLC,
840 Fed.Appx. 861 (6th Cir. 2021)

- U.S.B.C., Western District of Michigan => U.S.D.C., Western District of Michigan => Sixth Circuit
- Produce Pay is an agricultural financing company providing capital financing and market and trade programs to growers and distributors.
- Spiech was already indebted to Chemical Bank for $4 million through existing secured loans, Spiech sought assistance from Produce Pay as a "multi-service finance company."
- Spiech and Produce Pay entered into a "Distribution Agreement" that allowed Spiech to obtain short-term loans from Produce Pay as a partial advance on payments that Spiech was supposed to receive from its existing customers.
- Chemical Bank learned that Produce Pay filed a financing against Spiech's assets and called the loans.
- Spiech filed for Chapter 11 bankruptcy relief.
- Produce Pay asserted a PACA Trust claim against the bankruptcy estate for $1,002,273.70 to recover the cash advances it made to Spiech.
- After evidentiary hearing, bankruptcy court rejected Produce Pay's claim and found that Produce Pay was not the supplier or seller produce because: (1) the Agreement did not explicitly identify what produce would be sold; (2) Produce Pay only learned what produce was "for sale" after it was registered on Produce Pay's on-line platform; (3) by the time Produce Pay "bought" the produce, it was already delivered to Spiech's customers; and (4) Produce Pay did not receive a document of title until after a customer possessed the produce and title transferred to the customer.
- Court looked to the Second, Fourth, Fifth, and Ninth Circuits' "transfer-of-risk test" to determine if it was a sale or a loan. The transfer-of-risk test entails four factors: "[1] the right of the creditor to recover from the debtor any deficiency if the assets assigned are not sufficient to satisfy the debt, [2] the effect on the creditor's right to the assets assigned if the debtor were to pay the debt from independent funds, [3] whether the debtor has a right to any funds recovered from the sale of assets above that necessary to satisfy the debt, and [4] whether the assignment itself reduces the debt."
- Court found that Spiech did not sell Produce Pay its accounts receivables because Produce Pay assumed no risks with receivables collections. Spiech was tasked with collecting the accounts receivables and remitting one-half to Produce Pay. If Spiech's customers defaulted and Spiech did not remit the proceeds to Produce Pay within 30 days, Spiech was responsible for paying Produce Pay an increased "commission," making default lucrative for Produce Pay and transferring the risk back to Spiech.
- Affirmed.

Produce Pay, Inc. v. Izguerra Produce, Inc.
39 F.4th 1158 (9th Cir. 2022)

- U.S.D.C., Central District of California => Ninth Circuit
- Produce Pay is an operator of an online platform for buying and selling wholesale produce.
- In its complaint, Plaintiff-Appellant Produce Pay alleged that Defendant-Appellee Izguerra Produce, Inc. violated several provisions of the PACA and it also brought several state-law claims.
- After dismissing Produce Pay's PACA claims, the district court declined to exercise supplemental jurisdiction over the state law claims. roduce Pay's on-line platform connects growers in Mexico with distributors.
- Produce Pay obtains title to produce, but produce is shipped directly to distributor.
- Upon receipt distributor inspects and informs Produce Pay how much of the produce is marketable; distributor then sells on consignment and remits net proceeds to Produce Pay.
- Produce Pay takes a "marketplacing commission"
- Izguerra agreed to be a distributor on Produce Pay's on-line platform. Izguerra bore risk of not selling at "expected price" and receivable uncollectibility.
- April 2019, Izguerra bought 1,600 25-pound cartons of avocados on the on-line platform; Produce Pay invoiced Izguerra for $70,560; outstanding balance was $63,786.56.
- The district court granted Izguerra's motion to dismiss with prejudice concluding that as a matter of law Produce Pay was not a seller of wholesale produce and thus not entitled to PACA protections.
- District court applied the transfer-of-risk test articulated and factoring relationship involving in S&H Packing & Sales Co. v. Tanimura Distributing, Inc., 883 F.3d 797, 813 (9th Cir. 2018) (en banc) and in In re Spiech Farms, LLC, 840 F. App'x 861, 863 (6th Cir. 2021).
- However, Produce Pay did not factor Izguerra's accounts receivable; it did not "loan" the avocados to Izguerra, did not take a security interest in Izguerra's receivables, and did not file a financing statement.
- Produce Pay properly and plausibly alleged the elements of a PACA claim: (1) the commodities sold were perishable agricultural commodities, (2) the purchaser was a commission merchant, dealer, or broker, (3) the transaction occurred in contemplation of interstate or foreign commerce, (4) the seller has not received full payment on the transaction, and (5) the seller preserved its trust rights by including statutory language referencing the trust on its invoice.
- Held that plaintiff plausibly pled that it was "seller" entitled to PACA's protections. Reserved and remanded.

Produce Alliance, LLC v. West Central Produce, Inc.
2022 WL 1285041, (9th Cir. 2022)

- U.S.D.C., Central District of California => Ninth Circuit
- West Central Produce entered into a Consent Order to allow for the orderly liquidation of West Central's PACA Trust Assets, and agreed to not remove, withdraw, transfer, conceal, pay, encumber, assign, sell or otherwise dissipate
- Consent Order defined Trust Assets to include "assets comingled with, purchased with maintain, or otherwise acquired with such proceeds"
- West Central acquired an assignment of certain produce suppliers' interest in PAA trust claims with checks from West Central bank accounts.
- Bank accounts contained funds that were commingled with the proceeds of non-Produce related goods.
- Assigned Litigation Rights became impressed with PACA trust because they were acquired with PACA trust assets.
- West Central then sold the Assigned Litigation Rights with a deep dispute to factoring company Produce Capital Group, Inc.
- ProCap asserted a PACA trust claim for $4.1 million.
- Court affirmed district court's order voiding the transaction because it violated the Consent Order.

Questions

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Perishable Agricultural Commodities Act

Harrison Pittman
Center Director

The Perishable Agricultural Commodities Act, or "PACA," was enacted in 1930 to regulate the marketing of perishable agricultural commodities in interstate and foreign commerce. The primary purposes of the PACA are to prevent unfair and fraudulent conduct in the marketing and selling of perishable agricultural commodities and to facilitate the orderly flow of perishable agricultural commodities in interstate and foreign commerce. It also provides important protections to sellers of "perishable agricultural commodities" that are relevant to many specialty crop producers.

PACA is administered and regulated by the Agricultural Marketing Service (AMS), an agency within the United States Department of Agriculture. AMS provides further information on PACA on its website, http://www.ams.usda.gov, as well as the National Agricultural Law Center at http://www.nationalaglawcenter.org/readingrooms/perishablecommodities/.

PACA is important for many specialty crop producers because it governs important aspects of transactions between sellers and buyers of fresh and frozen fruits and vegetables. In particular, the unfair conduct and the statutory trust provisions are particularly significant.

Key Definitions

PACA applies to "dealers", "commission merchants", and "brokers." In general, a "dealer" is "any person engaged in the business of buying or selling in wholesale or jobbing quantities . . . any perishable agricultural commodity" that has an invoice value in any calendar year in excess of $230,000.00. There are some exceptions to this definition that could become applicable under certain situations, but the general definition provided here is very instructive. A "commission merchant" is "any person engaged in the business of receiving . . . . any perishable agricultural commodity for sale, on commission, or for or on behalf of another." Finally, a "broker" is a person engaged in the business of negotiating sales and purchases of perishable agricultural commodities either for or on behalf of the seller or buyer. A person who is "an independent agent negotiating sales for or on behalf of the vendor" is not considered to be a broker, however, if "sales of such commodities negotiated by such person are sales of frozen fruits and vegetables having an invoice value not in excess of $230,000.00 in any calendar year."

Unfair Conduct

As noted, PACA prohibits certain types of conduct on the part of buyers and sellers, though issues arising in this arena commonly focus on the alleged conduct of commission merchants, dealers, and brokers. For example, it is unlawful for a commission merchant, dealer, or broker "to engage in or use any unfair, unreasonable, discriminatory, or deceptive practice in connection with the weighing, counting, or in any way determining the quantity of any perishable agricultural commodity received, bought, sold, shipped, or handled . . . ." It is also unlawful for a commission merchant, dealer, or broker to do any of the following:

- "to make, for a fraudulent purpose, any false or misleading statement in connection with any transaction involving any perishable agricultural commodity";
- "to fail, without reasonable cause, to perform any specification or duty, express or implied, arising out of any undertaking in connection with any such transaction"; and
- "to fail or refuse truly and correctly to account and make full payment promptly" with respect to any transaction.

PACA provides that a commission merchant, dealer, or broker that violates any of the unfair conduct provisions "shall be liable to the person or persons injured thereby for the full amount of damages . . . sustained in consequence of such violation." The injured person or persons may enforce such liability by bringing an action in federal district court or by filing a reparations proceeding against the commission merchant, dealer, or broker.

Licensing

The PACA requires that all commission merchants, dealers, and brokers obtain a valid and effective license from the USDA Secretary. PACA does not require growers who sell perishable agricultural commodities that they have grown to obtain a license, though sellers commonly choose to apply for a PACA license. From the grower's perspective, the license demonstrates that the buyer is a legitimate business person or business entity who can be trusted to honor contractual terms and PACA requirements.

The requirement of a PACA license by a commission merchant, dealer, or broker is akin to the requirement of a driver obtaining a driver's license. A commission merchant, dealer, or broker that fails to obtain a valid and effective license shall be subject to monetary penalties, though some leniency may be provided if the failure to obtain the license was not willful. Importantly, if a commission merchant, dealer, or broker has violated any of the unfair conduct provisions, that person's PACA license may be suspended or possibly revoked, which effectively negates their ability to engage in the fruit and vegetable industry. A person who knowingly operates without a PACA license may be fined up to $1,200 for each violation and up to $350 for each day the violation continues.

Statutory Trust

For specialty crop producers, the statutory trust is a very important aspect of PACA since it is specifically designed to protect sellers of perishable agricultural commodities in the event a buyer becomes insolvent or otherwise refuses to pay for produce. The statutory trust provision under PACA specifically provides the following (emphasis added):

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

In other words, the buyer is required to maintain a statutory trust relative to fruits and vegetables received but not yet paid for. If a buyer becomes insolvent or declares bankruptcy, the statutory trust provides priority status to the unpaid seller against all other creditors in the world.

Consequently, the PACA statutory trust is often referred to as a "floating trust." Thus, a PACA trust beneficiary is not obligated to trace the assets to which the beneficiary's trust applies. When a controversy arises as to which assets are part of the PACA trust, the buyer has the burden of establishing which assets, if any, are not subject to the PACA trust. The PACA beneficiary only has the burden of proving the amount of its claim and that a floating pool of assets exists into which the produce-related assets have been commingled.

If a buyer files for bankruptcy, the trust assets do not become "property of the estate" because the buyer-debtor does not have an equitable interest in the trust assets. Rather, the buyer holds those assets for the benefit of the seller. Thus, a beneficiary of the PACA trust has priority over all other creditors with respect to the assets of the PACA trust.

However, the seller must take certain steps in order to protect his or her rights in the statutory trust. One method of preserving rights to the statutory trust is by simply including the following exact language on the face of the invoice:

> The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. § 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

It should be noted that this method is available only to those sellers who are licensed under PACA. Hence, many sellers will elect to be licensed so that they can preserve their statutory trust rights in this manner. Unlicensed sellers (or licensed sellers who do not want to include the foregoing language on their invoices) may preserve their statutory trust rights through a different method. This method requires that the seller provide written notice that specifies it is a "notice of intent to preserve trust benefits". In addition, the written notice must include the name(s) and address(es) of the seller, commission merchant, or agent, and the debtor as well as the date of the transaction. The written notice must also identify the commodity at issue, the invoice price, payment terms, and the amount owed.

This written notice must be given within thirty calendar days

- after expiration of the time prescribed by which payment must be made, as set forth in the regulations issued by the Secretary;
- after expiration of such other time by which payment must be made, as the parties have expressly agreed to in writing before entering into the transaction; or
- after the time the supplier, seller, or agent has received notice that the payment instrument promptly presented for payment has been dishonored.

If the payment terms extend beyond thirty days, the seller will lose his or her rights to the statutory trust. PACA also provides that if the parties to the transaction "expressly agree to a payment time period different from that established by the Secretary, a copy of any such agreement shall be filed in the records of each party to the transaction and the terms of payment must be disclosed" on the documents relating to the transaction. But, as noted, if this agreement extends the time for payment for more than thirty days, however, the seller cannot qualify for coverage under the trust.

Prompt Payment

PACA also requires produce buyers to make full payment promptly, and the regulations implementing PACA expound on PACA. While there are additional rules embedded in the regulations, the most common payment requirement is that payment be made 10 days from date of acceptance of the goods for purchase.

For more information, please refer to the National Agricultural Law Center's Reading Room on PACA, available at: http://www.nationalaglawcenter.org/readingrooms/perishablecommodities/, or contact the National Agricultural Law Center.