

DEVELOPING PACA TRUST PRINCIPLES

By: Ralph Wood,

The trust provisions of the Federal Perishable Agricultural Commodities Act ("PACA") were added to the Act more than twenty-five years ago but the meaning of these provisions is still being worked out in the courts, despite an overhaul of the statute in 1995. The nuances of interpretation can be of critical importance to all sellers of fresh and frozen fruits and vegetables on credit.

The trust provisions were intended to give sellers of produce special rights as to the collection of amounts due them. PACA creates a statutory trust over the produce and proceeds of its sale in the hands of a purchaser who is PACA licensed (or should be) for the benefit of qualifying sellers.

Who has PACA trust rights? The 1995 amendments made it easier for PACA licensees to qualify for trust rights by placing a notice on their invoices, but there are still many pitfalls which may disqualify a seller. Farmers that are selling their own produce do not need to be licensed and, if they are not, can't use the easy notice on invoice to get protected. Instead, they have to give a timely written notice after an invoice is past due. Intrastate sellers are not covered at all and must rely on state procedures. Under Department of Agriculture Regulations, in order to qualify for the trust, written payment terms may not exceed 30 days. The courts are currently in conflict as to

whether oral payment terms may exceed 10 days even though the Regulations require a writing for such extended terms.

What does the trust cover? Every qualifying seller has an equal claim to any trust assets regardless of their origin. Once a buyer resells produce and mingles the proceeds with its general assets it bears an almost impossible burden to keep any of its assets out of the trust. The buyer has the burden to show that a particular asset did not derive from an account in which produce proceeds were deposited or that all produce sellers were paid thereafter. For example, one Appeals Court held that a buyer's co-op Units in the Hunts Point produce market, which were not purchased with the proceeds from the seller's produce sales, could, nevertheless, be trust assets if some prior produce transaction proceeds

This case, however, implies that a lease might not be a trust asset even though trust proceeds are used to pay rent. When supermarkets go bankrupt, their most important asset may be their lease. Nevertheless, even though such markets are normally subject to PACA, I have been unable to find a reported case determining whether a lease can be a trust asset. A case my firm is handling, in which the proceeds of the sale of such a lease in bankruptcy is in issue, is on its way to the US

Court of Appeals. Since PACA trusts follow normal trust principles, we have cited a 1911 case, decided by renowned jurist Learned Hand, holding that rental payments made with trust assets are to be counted in determining the trust beneficiaries' interest in the lease.

Remedies? Since the trust assets do not belong to the buyer, they can be recovered by the Seller, up to the amount of a valid trust claim, even if the buyer is in bankruptcy. A seller, who can show that its buyer is dissipating trust assets, can obtain an injunction in Federal District Court prohibiting the buyer from paying any non-trust debts until the PACA claims are paid. Courts have also held the principals of the buyer liable for unpaid trust claims and refused to permit these claims to be avoided by such a principal's bankruptcy filing. Recently, PACA debtors, who want to cooperate to avoid the personal liability of their principals, have been agreeing with their PACA creditors to go into Federal District Court under an agreed upon procedure for liquidating the debtor and distributing the proceeds among the PACA trust beneficiaries.

Trust assets may also be recoverable from secured lenders. However, a defense has been developed by the courts to protect third parties who got trust assets from the buyer for value and without notice of the PACA trust claims. The precise extent of this defense is currently being hotly litigated in a number of pending PACA suits against banks. Since an Appeals Court, in a case that my firm is defending, reversed a summary judgment ruling in favor of a bank based on this de-

fense, PACA claimants have reportedly gone so far as to sue banks based upon their mere maintenance of checking accounts containing trust proceeds. While Congress clearly intended to permit a PACA trust beneficiary to prevail over a foreclosing secured lender of the buyer, it is clear that Congress did not intend to make banks automatically liable for all trust assets passing through their hands.

A number of courts have found the seller's attorney's fees for collecting PACA trust funds to be part of the PACA trust claim, particularly where the Seller's sales terms provided for this. A recent case pending before a Court of Appeals raises the issue whether a buyer's counsel can be paid out of trust proceeds for his/her efforts to collect proceeds on behalf of the buyer. Even though the sellers may have benefitted from the buyer's attorney's efforts, this case holds that the buyer's attorney can not be paid where the proceeds were insufficient to pay the PACA trust claims in full.