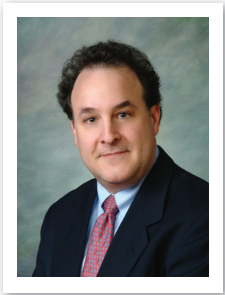


credit column

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PACA Trust Destroyed by Written Agreement Extending Payment Terms

The Perishable Agricultural Commodities Act (“PACA”) is a federal statute that creates special protections for sellers of fresh fruits and vegetables. Eligible produce sellers are the beneficiaries of a trust, consisting of all of the buyer’s perishable agricultural commodities and all products and proceeds, that has priority over the rights of the buyer’s secured and other creditors.

However, PACA rights are not automatic. A produce seller must comply with PACA’s rigorous eligibility requirements to obtain the protections of the PACA trust. One of PACA’s requirements precludes a produce seller from extending the buyer’s payment obligations to more than 30 days after the buyer’s receipt and acceptance of the goods. So what happens when a financially troubled buyer is in default of its obligations to the produce seller and requests that the seller enter into a settlement agreement that extends the payment of the buyer’s obligations beyond the maximum 30-day period allowed under PACA?

Well, the United States Court of Appeals for the Fifth Circuit, in *Bocchi Americas Associates, Inc. vs. Commerce Fresh Marketing, Inc.*, recently ruled that a produce seller had waived PACA protection by entering into a written agreement with its buyer that extended the buyer’s payment obligation beyond PACA’s maximum 30-day period. The written agreement did not even have to be a formal written agreement. The court found that a letter and a fax exchanged between the produce seller and buyer, together with the seller’s acceptance of partial payments from the buyer, constituted a written agreement extending payment terms that violated PACA’s maximum 30-day payment period. The Fifth Circuit’s decision is a



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renewed admonition to a produce seller that is seeking to preserve its PACA trust protection to proceed very carefully when responding to a financially distressed buyer’s pleas for an extension of time to pay past due invoices. The seller may find that its reward for being accommodating is the loss of its PACA rights.

The PACA Statute

Congress enacted PACA in 1930 to regulate the interstate sale and marketing of produce in response to the practice of unscrupulous brokers rejecting produce supplied by small farmers and growers in a declining market. Produce sellers were considered to be especially vulnerable to the perishability of their goods, the great distances for delivery of their product, and the expense and impracticality of recovering their product and otherwise enforcing their rights against the buyer.

In the early 1980's, Congress reexamined PACA in response to a sharp increase in defaults among produce buyers and decided to provide greater protection to produce sellers who often could not evaluate their buyer's creditworthiness prior to the sale. In 1984, Congress amended PACA to grant eligible produce suppliers and their agents a floating non-segregated statutory trust in all of the buyer's perishable agricultural commodity inventory and proceeds.

How PACA Works

The PACA trust applies only to perishable agricultural commodities. Perishable agricultural commodities are unprocessed or minimally processed fruits and vegetables, whether or not frozen or packed in ice.

PACA does not regulate all sales of perishable agricultural commodities. PACA applies to sales of perishable agricultural commodities to licensed commission merchants, brokers and dealers. Commission merchants and brokers buy and sell produce on behalf of third parties. A dealer buys or sells in wholesale or jobbing quantities of at least one ton of produce shipped, received or contracted for shipment or receipt on any given day.

An unpaid PACA seller must state, in writing, its intent to preserve PACA trust benefits within 30 days after (a) the expiration of the prescribed time for payment contained in regulations promulgated by the United States Department of Agriculture; (b) the due date for payment agreed to in writing prior to the sale; or (c) the seller's receipt of notice of dishonor of the payment. A PACA seller can satisfy this requirement by including a statement in the seller's bills or invoices that the goods are being sold subject to the PACA trust.

The PACA regulations also state that an eligible PACA seller's payment terms cannot exceed 30 days after the buyer's receipt and acceptance of the goods. A produce seller waives its PACA protections by entering into a written (and in some jurisdictions even an oral) agreement with the buyer that extends payment by the buyer beyond the maximum 30-day period allowed under PACA.

The PACA trust is a non-segregated "floating trust." The trust arises in favor of the produce seller upon delivery of the goods to the purchaser. The trust continues until the full payment of the produce seller's claim. The trust includes the produce supplied by the PACA supplier and all other PACA suppliers, all food products derived from such produce and all accounts receivable and other cash and non-cash proceeds from the sale of the produce, regardless of the source of the goods. No tracing is necessary—a produce seller's PACA trust fund claim attaches to all of the debtor's perishable agricultural commodity inventory and all proceeds, whether or not they can be traced from the original PACA produce. This allows the produce buyer to commingle PACA trust assets. Some courts have even held that when PACA produce proceeds are commingled with non-PACA proceeds, the PACA seller is still entitled to a full recovery from all proceeds (PACA and non-PACA alike) without the need to trace the proceeds of its produce. The

buyer must then prove the proceeds are not from PACA goods and, therefore, are not subject to the PACA trust.

As a result of the PACA trust, eligible produce suppliers have a superior right to recover the purchase price of their goods from the produce and other assets subject to the trust prior to the payment of the claims of all other creditors, including secured creditors. An unpaid PACA seller retains title to the goods. Since PACA trust assets are not the buyer's property, the buyer lacks a sufficient interest in the goods and proceeds subject to the trust for any security interest to attach until the produce seller is paid in full. Secured creditors may be directed to disgorge collateral proceeds from trust funds otherwise payable to PACA creditors.

PACA also imposes secondary liability on persons, such as the buyer's principals, who are in a position, but fail, to control the PACA trust assets. As a result, if the buyer's assets are insufficient to fully satisfy the produce seller's claim, the seller could seek payment from the buyer's principals. This is particularly important in cases like the *Bocchi Americas vs. Commerce Fresh Marketing* case where the produce seller would have otherwise been saddled with an uncollectible judgment against the buyer.

The Facts of *Bocchi Americas Associates, Inc. vs. Commerce Fresh Marketing, Inc.*

Bocchi Americas Associates, Inc. ("Bocchi") was a wholesale supplier of fresh fruits and vegetables. Between December 10, 2002 and June 27, 2003, Bocchi sold and delivered perishable agricultural commodities to Commerce Fresh Marketing, Inc. ("Commerce Fresh").

When Bocchi sent its final invoice to Commerce Fresh on June 27, 2003, Commerce Fresh claimed that its president and sole shareholder had sent a letter to Bocchi that included a check in the amount of \$2,000 and a proposal that Bocchi accept weekly payments of \$2,000 until the full balance owing by Commerce Fresh to Bocchi was paid in full. The letter stated in pertinent part:

"Enclosed please find a payment in the amount of \$2,000 to be applied to Commerce Fresh Marketing, Inc.'s account with Bocchi Americas Associates, Inc.... [sic] Pursuant to our agreement, Bocchi Americas, Inc.... [sic] will accept partial payments to be applied towards this account, on a weekly basis until the balance of \$103,132.85 is paid.

Should the above correctly reflect the terms of our payment agreement, please deposit the check, apply the amount against the account balance, and send a new statement reflecting the new balance due on the account."

Bocchi deposited the \$2,000 check, but denied receipt of Commerce Fresh's letter. Nevertheless, from July 2003 through October 2004, Bocchi accepted seven additional payments of \$2,000 from Commerce Fresh and applied them toward Commerce Fresh's outstanding invoices.

On December 9, 2003, Bocchi's president sent a fax to Commerce Fresh demanding that Commerce Fresh begin sending weekly payments to Bocchi to settle three overdue invoices. Commerce Fresh did not pay the overdue invoices. On June 23, 2004, Bocchi commenced a lawsuit against both Commerce Fresh and its president, claiming breach of contract and seeking damages for breach of the PACA trust.

On July 13, 2004, Commerce Fresh again wrote to Bocchi proposing monthly payments of \$2,000 until the end of 2004 and monthly payments of \$5,000 thereafter until Bocchi's claim was fully paid. Bocchi's president rejected this proposal in a handwritten fax that stated in part:

"Bocchi Americas does not wish to hinder the operations of Commerce Fresh but the complete balance due of \$158,577 is to be paid in full immediately.

A set monthly payment has never been agreed nor your proposed \$2,000.00 monthly payment cannot be deemed acceptable. All files must be paid as invoiced to you as stated.

Don, you promised to pay complete invoices in full within a year's time and only limited file payments have been done."

On November 10, 2004, Bocchi and Commerce Fresh agreed to a payment schedule for the outstanding balance owing by Commerce Fresh to Bocchi. Commerce Fresh agreed to pay the sum of \$5,000 in each of November and December 2004 and monthly payments of \$20,000 thereafter until the full payment of Bocchi's claim. Commerce Fresh made the first two payments, but defaulted on the remaining balance owing to Bocchi. Bocchi then proceeded with its lawsuit against Commerce Fresh and its president.

The United States District Court for the Southern District of Texas entered judgment against Commerce Fresh in the amount of \$123,000, the amount acknowledged by Commerce Fresh and Bocchi to be owing, together with pre-judgment and post-judgment interest and attorneys' fees. However, the District Court dismissed the lawsuit against Commerce Fresh's president. The court ruled that Bocchi had waived its PACA trust protection, that was the basis for Bocchi's claim against Commerce Fresh's president, by having agreed to extend Bocchi's payment terms beyond the maximum allowed under PACA. Bocchi timely appealed from the District Court's ruling.

The Fifth Circuit's Ruling Affirming Bocchi's Waiver of PACA Trust Protection

The Fifth Circuit first ruled a produce seller could forfeit its PACA trust protection by entering into a post-default settlement agreement with its financially troubled buyer that extends the time for payment of the buyer's obligations beyond the maximum 30-day period allowed by PACA. This is consistent with the holdings of five other United States Circuit Courts of Appeal, the Second, Third, Sixth, Seventh and Eighth Circuits.

The Court noted that PACA trust protection should be limited to sellers that extend short-term credit to buyers and promptly pursue judicial and administrative remedies if the buyer defaults. The court also did not want to encourage PACA sellers to offer extended payment arrangements to financially strapped produce buyers. This would undermine PACA's goal of protecting small sellers in need of prompt payment for survival and unfairly benefit PACA sellers at the expense of the defaulting buyer's secured and unsecured creditors.

The Fifth Circuit then ruled that a produce seller does not waive PACA trust protection by entering into an oral agreement with its buyer to extend the time for payment of seller's claim beyond the 30-day maximum allowed by PACA. The court ruled that PACA rights can be waived only as a result of a written agreement extending the buyer's payment obligations. This ruling follows the holdings of three United States Courts of Appeal, the Third, Seventh and Eighth Circuits, and rejects the Second Circuit's holding that allowed the waiver of PACA protection based upon an oral agreement extending payment terms.

The Fifth Circuit then considered whether Bocchi and Commerce Fresh had entered into a written extension agreement that forfeited Bocchi's PACA trust rights. The court ruled that a seller could waive its PACA rights through a series of writings that confirm the extended payment terms without the necessity for a formal written extension agreement. The writings confirming the extended terms just had to satisfy the Texas statute of frauds that was the governing law in the case. The Texas statute of frauds requires proof of a "memorandum" of a promise (1) in writing, and (2) signed by the party to be charged with the promise (Tex. Bus. & Com. Code Ann. § 26.01(a)).

The Fifth Circuit ruled that Bocchi and Commerce Fresh had entered into a written agreement extending Commerce Fresh's payment obligations beyond the maximum 30-day period allowed by PACA based upon Commerce Fresh's June 27, 2003 letter to Bocchi, and Bocchi's July 16, 2004 handwritten fax to Commerce Fresh. The June 27, 2003 letter contained Commerce Fresh's offer to extend the payment of its indebtedness to Bocchi and a means of acceptance by Bocchi's cashing Commerce Fresh's \$2,000 check. Bocchi then confirmed its agreement to the extended payment terms by stating in the July 16, 2004 fax:

"Don you promised to pay complete invoices in full within a year's time and only limited file payments have been done."

While Bocchi's fax lacked a signature, Bocchi's president's name was written in the "From" field and Bocchi's corporate letterhead was on the fax. Bocchi's acceptance of the initial \$2,000 check and several additional payments by Commerce Fresh further proved Bocchi's acquiescence to the extended payment terms.

Bottom line: Bocchi lost its PACA trust rights and could not assert any claims against Commerce Fresh's president based

upon a breach of the PACA trust because Bocchi had agreed in writing to extend Commerce Fresh's payment obligations beyond the 30-day maximum allowed under PACA.

Conclusion

While an unpaid produce seller's PACA rights are broad, they are not automatic. A produce seller can lose the benefits of the PACA trust if the seller and buyer enter into a post-default written agreement extending the payment of the produce seller's claim beyond the maximum 30-day terms allowed under PACA. And the Fifth Circuit made clear in *Bocchi Americas vs. Commerce Fresh*, that an extension agreement does not have to be a formal written agreement. The court ruled that Bocchi and Commerce Fresh had entered into a written extension agreement based upon Commerce Fresh's letter and Bocchi's fax, together with Bocchi's acceptance of partial payments from Commerce Fresh. That was enough for Bocchi to lose its PACA trust protection and preclude the assertion of a claim against Commerce Fresh's president. The old saying "a little kindness goes a long way" does not necessarily apply to PACA trust rights! ●

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