

# Protecting the Harvest by Protecting Your Assets: A PACA Primer

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# How Does PACA Work?

## Go to the Head of the Class:

- **Reduce receivables and preserve cash flow.**
- PACA can take you to the front of the creditors' line and move you ahead of secured creditors, including Banks.
- The people in a position to control the debtor corporation become vulnerable. The corporate principals can be reached because they have *personal fiduciary obligations* as trustees of the PACA trust.
- The "ostrich defense" is typically insufficient to protect the corporate principals. Thus, even a silent partner, who was in a position to act can be liable, even if somebody else dissipated the PACA trust assets.

## The Floating Trust



Buyer holds produce and re-sale proceeds in trust for the Seller until Seller is fully paid.

**Co-mingling** PACA assets with non-PACA assets makes everything subject to PACA, making the trust float from asset to asset.

**Non-PACA Assets + PACA Assets = PACA**

**Unless:**

the Debtor can trace the non-PACA asset.

## A Buyer can breach the PACA trust by paying:

- Rent
- Equipment Leases
- Utilities
- Employees

In other industries, a typical company can use the revenue it generates to pay its regular business expenses before paying its suppliers. Such an action in the produce industry violates the PACA trustee's duty to maintain the PACA trust assets "freely available" to pay the suppliers.

## Tracing assets is the Buyer's burden.

Buyer has burden to prove an asset is not purchased with PACA Trust funds.

### For Example:

- Sales proceeds are regularly deposited into Company A's operating account.
- The operating account also contained a pre-produce capital contribution (such as personal funds from shareholder buying into the company).
- Because they are co-mingled, all of the money is converted to PACA trust assets. If funds from the operating account are used to buy a tractor, unless the Buyer can prove the tractor was purchased with separate funds, the tractor becomes a PACA trust asset.

## Remember:

The Buyer has the burden to prove that an asset a PACA trust creditor is trying to recover came from non-PACA funds.

This is difficult to do since most companies have money coming in and going out of one operating account all the time.

However, tracing can be done, especially if the proverbial tractor was purchased with proceeds from a loan, or some other separate source of funds.

# What Produce Does PACA Cover?

FRESH FRUITS & VEGETABLES, of every kind of character, including cherries in brine.

Including Produce That Is:

- Cut, Chopped , Washed, Preservatives Added, Surface Dried

Does NOT include Produce That Is:

- Dehydrated or Dried Beyond Surface Moisture Grain, Corn Feed, Potato Chips, etc. Any other process which changes the produce's essential character.

## The Big Rule Change –(The French Fry Rule):

The USDA amended its rules around May of 2003 to specifically *allow* breaded produce. This extension of PACA significantly helps companies which process potatoes into french fries or have other batter coated products.





# Does PACA Apply To Me?

- PACA applies to growers, shippers, brokers.
- Whether or not you have a PACA license.
- If you sell, receive or contract for produce in wholesale or jobbing quantities, one ton (2,000 pounds) or more in weight in any day, or \$230,000 in a calendar year, the PACA applies to you. <sup>7</sup> C.F.R. §46.2(x).
- Since PACA imposes certain duties, why not use its benefits?

## OTHER QUESTIONS

### Do I need a PACA License to be protected by PACA?

- No, even if the USDA does not require you to have a license you can still take advantage of the PACA trust, but it will be a lot easier if you do have a license.

### Are foreign companies subject to PACA?

- Maybe. Foreign companies who sell to U.S. companies can still take advantage of the PACA Trust and enforce their claims against a U.S. purchaser provided they properly serve a PACA Trust Notice.
- A U.S. company who sells to a foreign company still has PACA trust rights, but enforcement may be tricky. The law is undecided on the private remedies outside of arbitration venues such as the Dispute Resolution Corporation (for Canadian companies). If a court will construe the sales contract to be made at the U.S. seller's place of business it is possible to sue in a U.S. court and then register the judgment abroad.

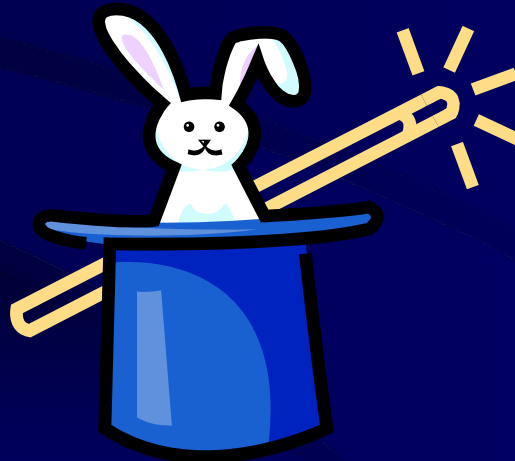
# How Can I Protect My PACA Rights?

## Be Careful or You Can Lose Your PACA Trust Rights.

- The Seller must notify the Buyer of his intent to preserve PACA Trust Rights. There two ways to do this:
  - 1) Invoice Method or 2) Filing a Separate Trust Notice
- 1. The Invoice Method. Your invoice can serve as your trust notice. This method is by far the simpler method and only available to PACA licensees. Both the amount of paperwork involved and the chance of sending the trust notice too late are greatly reduced. In order to take advantage of this simpler method, a PACA trust must have the "magic language" on its invoices.

## The Magic Invoice Language

"The perishable agricultural commodities listed on this invoice are sold subject to 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."



## 2. The Separate Trust Notice.

Non-PACA licensees and licensees who do not use the invoice method, can take advantage of PACA's trust protection by filing with the Buyer a separate notice outlining the Seller's intent to protect its rights.

It is no longer necessary to file the notice with the USDA. Sending the notice to the Buyer is sufficient.

The notice must identify the transaction and set forth the:

- Quantity
- Type of Produce
- Price, and
- Buyer & Seller's Name and Address

## Timing is Everything

- Timing is critical for either method. A trust notice, whether included on the invoice or separate, must be served no later than thirty (30) days after payment is due.
- Payment terms can vary but are typically Net 10.
- Payment terms greater than Net 10 must be in writing before the sale in order to change payment terms and gain more time to serve the trust notice. An oral agreement is insufficient.
- A Seller runs the risk of being late with his trust notice and losing his PACA trust rights. If that happens, the Seller has to wait in line for payment with all the other unsecured creditors and risk having the claim discharged in bankruptcy.

## Further Cautions:

- Payment terms that go beyond 30 days will cause a Seller to lose its PACA trust rights.
- Entering into a written agreement to extend payment after the Buyer is already in default is likely to be considered as an extension of credit beyond the 30 days allowed by PACA and *will result in the loss of PACA trust rights.*

While it is human nature to give someone a second chance, an unpaid Seller has to remain vigilant and not extend credit beyond 30 days.

# How Can I Maximize My Claim?

## INCREASE PENALTIES FOR NON-PAYMENT

Invoice language can be used as a deterrent. For example:

- Add a sales term that "*Past due balances are subject to interest of 1.5 % per month (18% per annum)*";
- Add a sales term that "*The Buyer agrees to pay all costs of collection, including attorneys' fees.*"
- More and more courts across the country enforce interest and attorneys' fees as part of a PACA claim.

Adding attorneys' fees and interest shifts the burden and expense onto the Delinquent Buyer.



## THE NUCLEAR OPTION – The TRO

In some cases an unpaid Seller faced with a Buyer hemorrhaging money can obtain a Temporary Restraining Order ("TRO") to freeze the Buyer's assets, including bank accounts. This essentially shuts down the Buyer's business and even prevents making payroll until all Sellers are paid.

The TRO gets the recalcitrant Buyer/Debtor's attention and makes him more willing to reach a settlement. If the Buyer is overloaded with debt and his business will be carved up to pay his creditors, the unpaid seller holding a valid PACA claim can claim its fair share, along with other PACA creditors.

## GO AFTER THE INDIVIDUALS

Unlike regular corporate debt, an unpaid produce seller can go after the individuals behind the corporation. This includes anyone “in a position to control” the Buyer corporation, whether actively involved or not. Thus, one officer/owner cannot bury his head in the sand and claim he did not know what was happening to the produce money. The “Ostrich Defense” generally cannot prevent PACA liability.

A PACA judgment against an individual reaches into the person's pockets and imposes personal liability is generally not dischargeable in bankruptcy!

Thus, PACA rights can be enforced against a bankrupt Buyer!

## Time Limit Warning

A Seller cannot wait forever to file a PACA claim.

## Statute of Limitations

- 9 months to file with the USDA
- 2 year + to file in Court against the Buyer's Principals\*
- 5 – 10 years in Court against the Company\*\*
- Depends on your state's Statute of Limitations on breaches of fiduciary duties. This issue is not fully settled but at least one Appellate Court limited actions against individuals to 2 years from when invoices were due. Weis Buy v. Paglia, 411 F.3d 415 (3<sup>rd</sup> Cir. 2005).

\*\* Depends on Your State's Statute of Limitations for Contracts

# PACA Law in The 21<sup>st</sup> Century

## Electronic Data Interchange (“EDI”)

### What EDI is:

A produce Buyer taps into the Seller’s computer system and place an order directly. No invoice is issued.

### The Big Question:

If no invoice with trust language is issued, will the Seller lose his trust rights and losing his priority among other creditors?

## The Answer: Maybe!

Established law and regulations should be sufficient to extend PACA trust protection to EDI transactions provided certain steps are taken. However, there is no current case law or USDA regulations governing how the use of EDI affects PACA trust rights.

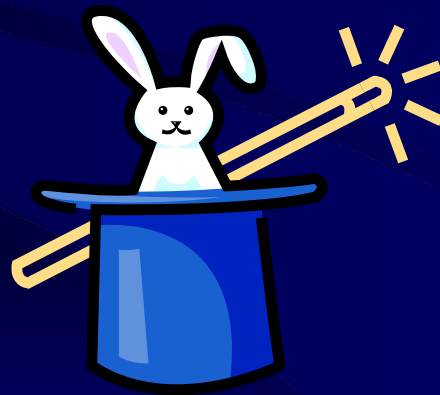
## What to Do:

A Seller's EDI must include:

- Normal billing information and
- Quote the required statutory language needed to preserve PACA trust rights.

## The Buyer's Screen Must Display the "Magic Language"

"The perishable agricultural commodities listed on this invoice are sold subject to 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."



## Why it Should Work:

PACA and USDA Regulations require that the statutory language appear on ordinary and usual billing statements, which under USDA Regulations means:

*“communication customarily used between parties to a transaction in perishable agricultural commodities in whatever form, documentary or electronic, for billing or invoicing purposes”* 7 CFR § 46.46(a)(5) (emphasis added).

Thus, placing the statutory language on EDI should be acceptable as long as EDI is the ordinary course of business between the Buyer and Seller.

## What Else to Add.

- Include Other Contract Terms
  - Any alteration of the Net 10 language:
  - Buyer agrees to pay interest on overdue balances
  - Buyer agrees to pay all collection costs, including attorney's fees.

## Retain Written Records.

Printing and keeping hard copies of EDI orders showing the required language and contract terms should enable a Seller to prove it preserved its trust rights.



# Conclusion

PACA is a powerful tool that lets you stand at the front of the creditors' line, ahead of secured creditors, including banks, and get to the people behind the corporation and hold owners and officers personally liable.

The unpaid Seller must take steps to preserve its rights and do what it can to maximize its recovery. Focus on the invoice by adding the statutory PACA language and the language for interest and fees.

**MOST IMPORTANTLY:** Speak to a knowledgeable attorney to find your own PACA solution.