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Perishable Agricultural Commodities Act Affecting Lender's Secured Priority Interests

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**PERISHABLE AGRICULTURAL COMMODITIES ACT
AFFECTING LENDER'S SECURED PRIORITY INTERESTS**

SANDRA M. FERRERA*

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I. INTRODUCTION

The Perishable Agricultural Commodities Act ("PACA") is a federally created statutory trust whose aim is intended at promoting efficiency and fairness among the agricultural produce industry. PACA was originally enacted in 1930 to encourage fair trading practices in the marketing of perishable commodities by suppressing unfair and fraudulent business practices in the marketing of fresh and frozen fruits and vegetables.¹ Congress was especially concerned with protecting small farmers and growers from "the sharp practices of financially irresponsible and unscrupulous brokers in perishable commodities" by providing that, in the event small farmers and growers are not paid for their produce, they are elevated to a priority position above that of all broker's secured creditors.² It is important to note that the original enactment of PACA dates back to the early 1930's when the United States economy was itself in an uproar. Agriculture which

* B.A. 1996, Florida International University; J.D. 1999, University of Miami School of Law. I wish to thank Professors David Abraham and Daniel Murray for their insight and commentary as I was preparing this comment. In addition, I would like to thank Andrew B. Hellinger, Esq. and Dara Collins, Esq. from the law firm of Mishan, Sloto, Greenberg, Hellinger and Udolph; for introducing me to the PACA statute and its importance in the market economy of perishable goods.

¹ See House Report No. 98-543, 98th Congress, 1st Session 4,5 (1983), U.S. Code Cong. & Admin. News 1984, 406 (House Report).

² *In re Country Club Market, Inc.*, 175 B.R. 1005, 1007 (Bankr. D. Minn. 1994) (citing *In re Lombardo Fruit & Produce Co.*, 12 F.3d 806, 808 (8th Cir. 1993).

had been seriously depressed since 1921, as a result of the expansion of production during wartime turned quickly into overproduction and falling prices. Consequently, farmers PACA sought to protect were in a terrible bargaining position with no means of prevailing in the market. In a sense, PACA was enacted as an insurance system whereby farmers and suppliers were guaranteed payment in the case of a mishap.

In 1984, Congress broadened the protection afforded by PACA because sellers of fresh produce were unsecured creditors and thus had no protection in light of produce buyers' practice of granting lending institutions security interests in their accounts receivable.³ The legislative and regulatory histories of PACA's trust provisions evidence a clear intent to prefer the sellers of perishable commodities to other creditors.⁴ 7 U.S.C. §499e(c) states, in pertinent part:

It is hereby found that a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers or brokers, who have not made payments for such commodities purchased, contracted to be purchased, or otherwise handled by them on behalf of another person, encumber or give lenders a security interest in such commodities, or on inventories of food or other products derived from such commodities, and any receivable or proceeds from the sale of such commodities or products, and that such arrangements are contrary to the public interest. This subsection is intended to remedy such burden...and to protect the public interest.⁵

In other words, Congress was specifically concerned with financing arrangements made between dealers of perishable goods and lenders. In setting up a trust for the benefit of all unpaid sellers it was Congress' intent that they be paid over secured lenders whose collateral is in the goods, accounts receivables or inventory. The statutory remedy imposed to alleviate the burden caused by the financing arrangements addressed in subsection (1) was codified in subsection (2) of § 499e(c). Subsection (2) provides, in pertinent part:

Perishable agricultural commodities received by a commission merchant, dealer or broker in all transactions, and all inventories of

³ *Id.*

⁴ *In re Snyder*, 171 B.R. 532, 537 (Bankr. D. Mary.1994).

⁵ 7 U.S.C. § 499e(c) (1999).

food or other products derived from perishable agricultural commodities, and any receivable or proceeds from the sale of such commodities or produces, 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.⁶

This subsection sets up a trust for the benefit of all unpaid sellers of the trust. Under this provision, the corpus of the trust consists of the produce, inventories of food or other products derived from the produce and any receivable or proceeds from their sale.⁷ Congress deemed nonpayment of sellers "a burden on commerce," and "contrary to the public interest" when it enacted the PACA trust amendment.⁸ Congress also intended to assure speedy payment to trust claimants, in addition to giving trust claimants priority over banks and other secured parties.⁹ The congressional finding codified at 7 U.S.C. §499(e)(c)(1)(1994), evidences the intent to give an unpaid suppliers' claim priority over the claim of a creditor with a security interest in the buyer's inventory and proceeds thereof.¹⁰ According to Congress, due to the need to sell perishable commodities quickly, sellers of perishable commodities are often placed in the position of being unsecured creditors of companies whose creditworthiness the seller is unable to verify. Due to the large number of defaults by purchasers, and the sellers' status as unsecured creditors, the sellers recover, if at all, only after banks and other lender's who have obtained security interests in the defaulting purchaser's inventories, proceeds and receivables.¹¹ Thus, the question that often arises in litigation is whether a lender whose loan is secured by the broker's accounts receivable or inventory should be made to disgorge payments it has received in breach of the statutory trust.

This article discusses PACA and the "bona fide purchaser" analysis promulgated by courts in order to protect lender's from the harsh effects of PACA's statutory trust. Part I of this article provides the historical perspective

⁶ 7 U.S.C. § 499e(c)(2) (1999).

⁷ See 7 U.S.C. § 499e(c)(2) and n. 3.

⁸ *Id.*, see n. 3.

⁹ *Id.* at 3; see footnote 7.

¹⁰ Congress' intent in enacting the trust provisions was to "combat the prevalent slow, and no pay practices of the fresh produce industry. John J. Korbal, *Current Issues Involving Statutory Trusts Under the Perishable Agricultural Commodities Act*, 2 SanJALR 1 (1992).

¹¹ See *Endico Potatoes, Inc. v. CIT Group Factoring, Inc.*, 67 F.3d 1063, 1067 (2d Cir. 1995)(citing *JSG Trading Corp. v. Tray-Wrap, Inc.*, 917 F.2d 75, 77 (2d Cir. 1990); H.R.Rep. No. 543, at 3. In order to address this imbalance, Congress added § 499e(c) to PACA. *Id.*

and introduces the policies of PACA. Part II discusses the case law developing the "bona fide purchaser" trust analysis. Part III analyzes the possible reasoning behind the court's movement towards protecting lenders and considers changes desirable in the current commercial and social environment. Lastly, the conclusion addresses the issue of whether courts are in effect circumventing the Congressional intent of PACA by addressing the "bona fide purchaser" test to protect lenders.

II. ANALYSIS: DEVELOPMENT OF THE LAW

PACA allows a trust beneficiary to trace proceeds conveyed by the produce buyer to third parties.¹² These third parties are often lending institutions which believe themselves to be fully secured, who were in fact, unaware of the statute and its implications when they approved a loan for the buyer.¹³ The trust created by PACA therefore includes not only the perishable commodities sold, but also any receivables or proceeds from the resale of the commodities.¹⁴ PACA trust beneficiaries can seek to recover trust assets in the hands of certain third parties to whom produce buyers have dissipated PACA trust funds.¹⁵ A financial institution will often take as collateral for a loan a security interest in the buyer's inventories, receivables, and proceeds from the sale of produce and will often have a blanket security interest in all potential assets of the floating trust.¹⁶ This is precisely what the PACA trust was intended to protect against. In enacting the 1984 amendment, Congress was expressly concerned with an increase in hidden security agreements which encumber buyers assets and results in the diversion of money owed for produce away from suppliers.¹⁷ While the regulations do not prohibit a buyer or receiver from granting a secured interest in trust assets, they make it clear that the secured interest is secondary and specifically voidable in order to satisfy debts to unpaid sellers.¹⁸ However, through the developing case law over the past decade it becomes evident that the judiciary is moving away from the intent of Congress and providing more protection for lenders involved with PACA dealers.

¹² See Thomas J. Cunningham, *Perils of The Perishable Agriculture Commodities Act: Ambushed by the Turnip Man*, 27 UCC L.J. 139, 149 (1994).

¹³ See *Id.*

¹⁴ See *Id.*

¹⁵ John M. Himmelberg and Mitchell H. Stabbe, *The 1984 PACA Amendments After Six Years: Producing Sellers' Trust and Lenders' Disgust*, 43 ARK. L. REV. 523, 572 (1990).

¹⁶ *Id.* at 555.

¹⁷ *Id.*

¹⁸ *Id.* at 45738

A. *A Decade of Change: 1988-1998*

In 1988, the case of *Lyng v. Frydman*¹⁹ was decided where the Secretary of Agriculture filed an action against Frydman Co. and others seeking an order setting aside the corpus of the statutory trust established under the PACA. The plaintiff also brought in the defendant's bank as a co-defendant. Timely PACA notices were filed by unpaid sellers against Frydman, totaling \$448,664. Upon investigation, the Department of Agriculture learned that the sum of \$345,300 was withdrawn from the accounts receivable account in order to reduce a loan balance owed to the bank. The lender tried to argue that the funds it received were not subject to the trust because the statute could not be applied to impose a trust on funds already paid to third parties. However, the court held that this argument was without merit. In so doing, the court noted that the fact that the funds already passed to a secured lender did not alter PACA's analysis; to hold otherwise would defeat the clearly articulated purposes of the statute.²⁰ The court concluded that the statute, legislative history and relevant precedent establish that unpaid sellers of perishable agricultural commodities could recover funds subject to the trust even if they have been transferred to a secured creditor.²¹ Additionally, the court went on to say that the defenses of bona fide purchaser and holder in due course were inapplicable in cases involving PACA trust as they would render the statute ineffective.²² This case is fully consistent with the Congressional intent behind PACA. However, it also holds lenders strictly liable for their dealings with PACA dealers in the sense that no relief is provided to them upon their dealings with PACA beneficiaries.

Just two years later, the case of *Lyng v. JDC Enterprises*²³ was decided. Once again, the Secretary of Agriculture filed an action to recover funds transferred from produce buyer to bank pursuant to the PACA. The court held that innocent third-parties cannot be made to disgorge trust assets already dissipated.²⁴ This case is distinguishable from *Frydman* because while some of the money lent by the bank was secured by the inventory, the majority of the funds were not so secured. Furthermore, proof submitted by the bank showed that the only amount secured by an interest in inventory (\$24,101.13)

¹⁹ No. C86-1210Y, 1988 WL 168632 (N.D. Ohio 1988).

²⁰ *Lyng* at *4.

²¹ *Id.* at *5

²² *Id.*

²³ *Lyng v. JDC Enterprises*, 117 B.R. 268 (Bankr. S.D. Texas 1990).

²⁴ *Id.* at 270.

resulted from the roll-over of an earlier note which was not so secured.²⁵ Thus, the bank had lent no new money secured by interest in inventory, and the lending arrangement at issue was not one meant to be remedied by PACA.²⁶ This case demonstrates that a lender can be fully protected when dealing with PACA dealers so long as the loan is not secured by the dealer's collateral or inventory in the produce.

Later that same year certain claimants under PACA sought to establish that the accounts receivable proceeds of the debtor were trust funds under the act. In *In re Richmond Produce Co., Inc.*,²⁷ the PACA Claimants argued that the Bank must refund certain monies it received and applied to reduce the debtor's indebtedness, on the ground that such monies are trust funds which the debtor transferred to the Bank in violation of the claimant's rights as PACA trust beneficiaries. In this case, the bank in question did not dispute that the monies it received from the debtor were trust funds under PACA. The Bank did, however, contend that under common law trust principles, a transferee of trust funds may not be required to return the funds if the transferee is a bona fide purchaser who received the funds, for value, without actual or constructive knowledge that the transfer constituted a breach of trust.²⁸ Additionally, the Bank argued that because it was unaware of the existence of PACA, it had no knowledge that certain of the debtor's suppliers claimed an interest in the debtor's receivable superior to the Bank's security interest.²⁹ As to the first situation, the court referred to the Congressional finding set forth in 7 U.S.C. § 499(e)(c)(1) that financing arrangements under which the buyer encumbers its inventory and accounts receivable are a burden on commerce. The court also referenced PACA's legislative history, which states that when a bank lends on the security of potential trust assets, the trust provisions of the act "would be known to and considered by prospective lenders in extending credit".³⁰ As to the second argument made by the bank, the court followed a historical Packers and Stockyard Act decision, *In re Gotham*,³¹ when it declared that "the Bank is deemed to have constructive notice of the trust because a federal statute created the trust."³² Thus, "mere

²⁵ *Id.*

²⁶ *Id.*

²⁷ *In re Richmond Produce, Inc.*, 112 B.R. 364 (Bankr. N.D. Cal. 1990).

²⁸ *Id.* at 376 (citing RESTATEMENT (SECOND) OF TRUSTS, §284 (199_)).

²⁹ *Id.* at 376, 377.

³⁰ *Richmond Produce*, 112 B.R. 364 at 377(citing C.H. Robinson, *infra* note 40, at 793, quoting H.R.Rep. No. 543, p. 4, reprinted in 1984 U.S.Code Cong. and Admin.News 405, at 407).

³¹ *In re Gotham Provision Co., Inc.*, 669 F.2d 1000 (5th Cir. 1982), *see also* *Richmond Produce* at 377.

³² *Id.* at 377 (citing *Gotham* at 1011).

ignorance” of the existence of PACA is insufficient to defeat trust rights of claimants protected thereunder.³³

In the 1991 case of *Advantage Produce Marketing Co, Inc. v. Caito Produce*,³⁴ the Plaintiff, Advantage Produce, a broker of perishable goods, brought forth a PACA action against Caito, the retailer of such goods and some of its creditors. On or about May of 1988, Advantage Produce began selling various types of fruits and vegetables to Defendant Caito; invoices were issued totaling \$105,070.93. Because Caito failed to make timely payment, Advantage Produce brought this lawsuit. Despite Caito’s failure to pay Advantage Produce, it nonetheless went about business as usual, making various payments to a number of its other creditors; included among these was the defendant bank. *Advantage Produce* put forth two arguments: (1) that all the defendants were recipients of the trust funds; and (2) that it is entitled to recover such amounts insofar as all were part of the trust imposed under PACA for their benefit.³⁵ The court held that the bona fide purchaser defense as outlined in trust law is not applicable where the transferee (Bank) takes the property with knowledge of the trust or the trustee (Advantage Produce) transfers the trust property in satisfaction of a debt owed by the trustee to the transferee.³⁶ Here, the court stated that the trust beneficiary’s ability to trace assets into the hands of a third party, like a lender, is specifically limited to two situations: (i) where the third party took the funds with knowledge that a trust had been imposed; (ii) where the third party has a security interest in the assets of the trust.³⁷ The bank had made three separate loans to Caito in the time in question to purchase vehicle’s and machinery. Because the Bank took a security interest in the vehicles which served as collateral for the debtor’s loan instead of trust assets, and because there was no evidence that the Bank took such funds with actual or constructive notice of the trust, the Bank was able to keep the money received free of the trust. In *Advantage Produce*, the court first recognized the availability of bona fide purchaser defense to third party lenders who lend money to purchasers of agricultural produce. The court goes on to state that it is not willing to entertain the plaintiff’s contention that the provisions of PACA were intended to provide a trust beneficiary with the ability to trace funds into the hands of third parties regardless of the circumstances.³⁸ “Such an interpretation of the PACA

³³ *Id.* at 378.

³⁴ *Advantage Produce Marketing Company, Inc. v. Caito Produce*, No. C2-89-095, 1991 WL 424983 (S.D. Ohio 1991).

³⁵ *Id.* at *1.

³⁶ *Id.* at *3.

³⁷ *Advantage Produce* at *3, *4.

³⁸ *Id.* at *4

provision is much too expansive."³⁹ Thus, it seems that the court by stating that lender's are not to be held strictly liable for money received that is subject to the trust are going against the intent of Congress when it enacted the non-segregated "floating trust". When enacting the trust, Congress indicated that it did not believe that the trust provisions would burden lending institutions because the provisions "will be known to and considered by the prospective lenders in extending credit."⁴⁰ Thus, a lender should take whatever necessary precautions it deems warranted before making a loan to a dealer in this highly regulated industry.

B. *Bona Fide Purchaser Analysis*

In the 1992 case of *C.H. Robinson Co. v. Trust Company Bank, N.A.*,⁴¹ the Eleventh Circuit decided what can be described as a landmark decision in PACA law. The court declared that under general trust principles, *a bona fide purchaser receives trust property free of the trust* even if the property was transferred in breach of trust.⁴² (*emphasis added*).

- (1) If the trustee in breach of trust transfers trust property to, or creates a legal interest in the subject matter of the trust in, a person who takes for value and without notice of the breach of trust, and who is not knowingly taking part in an illegal transaction, the latter holds the interest so transferred or created free of the trust, and is under no liability to the beneficiary.⁴³
- (2) ...such a transferee is called a "bona fide purchaser".⁴⁴

The court noted that to qualify as a bona fide purchaser, a lender must show that any trust property they received was transferred 1) "for value" and 2) "without notice of the breach of trust".⁴⁵

³⁹ *Id.*

⁴⁰ *Lyng v. Frydman*, *supra* n. 18, (citing H.R.Rep. No. 543, 98th Cong., 2d Sess. (1983), reprinted in 1984 U.S.Code Cong. & Ad.News 405, 406).

⁴¹ *C.H. Robinson Co. v. Trust Company Bank, N.A.*, 952 F.2d 1311 (11th Cir. 1992).

⁴² *Id.* at 1313.

⁴³ *Id.* at 1313 & 1314 (citing RESTATEMENT (SECOND) OF TRUSTS, § 284(1) (199_)). *See also* Austin W. Scott & William F. Fratcher, *The Law of Trusts*, § 284 (4th ed. 1989).

⁴⁴ *See Chiquita Brands, Inc. v. MicBruce, Inc.*, 800 F. Supp. 1521, 1525 (N.D. Ohio 1992).

⁴⁵ The court held that Congress, in creating a statutory trust, must have intended that it operate in accordance with generally settled principles of trust law. Thus, the court refused to accept the district court's conclusion that creditors who hold security interests in trust assets are in effect strictly liable, i.e., are presumed to have actual knowledge, to the extent of their security interest in trust assets. Such a holding, the court found, would have the illogical result of placing secured lenders in a worse position than unsecured lenders. *Sheppard infra* n. 67 at *2.

FOR VALUE: Ordinarily, the transfer of trust assets in satisfaction of a previous debt is not for value.⁴⁶ Trust law, however, recognizes an exception to this principle if the property transferred is money.⁴⁷ The reasoning behind this exception is clear. "It is absolutely necessary for practical business transactions that the payee of money in due course of business shall not be put upon inquiry at his peril as to the title of the payor."⁴⁸

NOTICE OF BREACH OF TRUST: On appeal, the court held that the district court had erred in its conclusion that transferee liability under traditional trust law turns on "actual knowledge of the trust". Instead, "If the trustee transfers trust property in breach of trust to a transferee for value, the transferee takes free and clear of the trust although he had notice of the existence of the trust, unless he had notice that the trustee committed a breach of trust in making the transfer."⁴⁹

C.H. Robinson was initiated by unpaid sellers of perishable agricultural goods who filed an action under the PACA against the broker of the commodities and two banks which were alleged to have received loan payments in breach of trust. The total amount of goods sold to the defendant, B.H. Produce, was \$227,476.60.⁵⁰ In the relevant time period, B.H. Produce made loan payments of over \$130,000 to the defendant banks.⁵¹ The loan in question was made for \$160,428.23, and was a renewal of four prior notes. On the renewal note, the bank took a security interest in all the property of B.H. Produce as collateral, including various certificates of deposits, equipment, accounts receivables and inventory.⁵² The plaintiff thereafter sought to force the banks to return money paid to them by B.H. Produce. In response, the banks argued that they were bona fide purchasers without notice

⁴⁶ "If the trustee transfers trust property in consideration of the extinguishment of a pre-existing debt or other obligation, the transfer is not for value." *Robinson* at 1314 (citing RESTATEMENT (SECOND) OF TRUSTS §304(1) (199_)). See also Scott & Fratcher, *supra* n. 42, §304.

⁴⁷ "If the trustee transfers trust property in consideration of the extinguishment in whole or in part of a pre-existing debt or other obligation, the transfer is for value, if (a) the trust property is a negotiable or money..." *Robinson* at 1314 (citing RESTATEMENT (SECOND) OF TRUSTS §304(2) (199_)).

⁴⁸ *Id.* at 1314 (citing Scott & Fratcher, *supra* n. 42, §304 (quoting *Stephens v. Board of Education*, 79 N.Y. 183, 187 (1879)).

⁴⁹ *Id.* at 1314 (citing RESTATEMENT (SECOND) OF TRUSTS §296. See also, Scott & Fratcher, *supra* n. 42, §296). To argue that because the PACA trust amendments exist, all creditors are charged with constructive knowledge of their presence and effect would be to reason the viable trust principles which *Robinson* properly invokes out of existence and provide PACA producers with a priority against all parties, even ordinary course creditors, which would be unassailable in any circumstances, irrespective of the equities. *In re H.R. Hindle & Co., Inc.*, 149 B.R. 775, 789 (Bankr. E.D. Penn. 1993).

⁵⁰ *C.H. Robinson Co. v. B.H. Produce Co., Inc.*, 723 F.Supp. 785, 787 (N.D. Ga. 1989); *C.H. Robinson Co. v. Trust Co. Bank, N.A.*, 952 F.2d 1311 (11th Cir. 1992).

⁵¹ *Id.*

⁵² *Id.*

of the trust. The District Court held that the defendants could prevail on their assertion of the bona fide purchaser defense to the extent that the loans given B.H. Produce were not secured by trust assets (the receivables and inventory).⁵³

On appeal, the Eleventh Circuit disaffirmed the district court's holding that a PACA trust creditor may recover trust funds paid to a lender who happen to have a security interest in agricultural products.⁵⁴ In reaching its decision the court noted that the Bank never enforced its security agreement, it did not collect B.H. Produce's accounts receivable or take possession of the inventories which were subject to the PACA trust.⁵⁵ It merely received cash loan payments without notice that they were made in breach of trust.⁵⁶ Thus, on appeal the Eleventh Circuit broadened the protections afforded a lender who deals with a PACA trust dealer. In dicta, the court noted that the district court had erred in finding any liability at all on the Bank (liability was imposed to the extent that that the loans given were not secured by trust assets). However, because such an argument was not raised the district court's judgment was affirmed. The *Robinson* court on appeal stated that the district court, transcended traditional trust analysis and, in effect, held that lenders were strictly liable to the extent that they have a security interest in trust assets.⁵⁷ This the court noted was "contrary to past precedent and legislative intent".⁵⁸ Congress has provided unpaid sellers of perishable agricultural commodities with the benefits of a statutory trust, 7 U.S.C. §499(e)(c) and absent specific instructions to the contrary, Congress must have intended for such a trust to operate according to the settled principles of trust law.⁵⁹ Furthermore, the Eleventh Circuit decided that there was no legitimate basis for creating a special exception to these trust principles for secured lenders, as they are not guarantors of the PACA trust.⁶⁰ In effect, the Court made its own decision as to what Congress must have intended in order to get at the result it wanted. However, the past precedent and legislative intent that the Court makes reference to in its opinion does not in fact mention any such formulation of the PACA trust. Thus, after *Robinson*, a secured lender has a good chance of prevailing when dealing with PACA dealers so long as they can prove that they had no "actual notice" that the trust was being breached.

⁵³ *Id.* at 793.

⁵⁴ C.H. Robinson, 952 F.2d at 1314. "[S]uch an exception is inconsistent with established precedent and the intent of Congress". *Id.*

⁵⁵ *Id.* at 1316.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

From this point on, the farmers and growers which PACA was intended to protect must not only file suit against the PACA trustee its secured lender.

Because so many PACA claims arise in the context of a dealer filing for bankruptcy, the Bankruptcy Courts have likewise had to address the 1984 amendments to the PACA. In the case of *In re Hindle*,⁶¹ the producers filed an adversary proceeding against a Chapter 11 debtor-commodities dealer and secured lender, seeking determination that inventory and proceeds from transfers were held in a non-segregated PACA trust and were not property of the debtor's estate. Prior to filing its bankruptcy, the Debtor was a licensed dealer of perishable agricultural commodities in Philadelphia since 1938. In 1986, the Debtor began to have an extensive loan relationship with Glendale National Bank of New Jersey.⁶² From 1987 to the time of suit, all of the Bank's loans were secured by the Debtor's accounts receivable and inventory.⁶³ In reaching its decision, the Bankruptcy Court upheld *Robinson* as the correct statement of applicable law.⁶⁴

This court is not impressed with the Producer's suggestion that the reasoning of the *Robinson* case is contrary to public policy. The PACA trust amendments already provide producers with extraordinary protections. Congress chose a trust to do so. The producers must accept the limitations on their rights which arise under the common law relative to trusts. The concept of a "floating trust" is in itself a significant departure from common law trust principles because it eliminates the tracing requirement. This court is extremely reluctant to provide additional protections to producers beyond those extraordinary and perhaps excessive ones which Congress has already provided.⁶⁵

The court goes on to state that Glendale must, first, prove that it neither knew nor had reason to know that the funds which it obtained were trust funds and their seizure would be violative of the PACA trust amendments. Also, it has the burden of proving that its seizure of the funds in issue was "for value", i.e., that there was adequate consideration therefor.⁶⁶ Furthermore, the court agrees with *Richmond Produce* that "a creditor's mere subjective ignorance of the intricacies and workings of the PACA trust amendments is not a complete defense to a claim that funds received are part of a trust res."⁶⁷ "On the other hand, to argue that because the PACA trust amendment exists, all

⁶¹ *In re H.R. Hindle & Co., Inc.*, 149 B.R. 775 (Bankr. E.D. Pa. 1993).

⁶² *Id.* at 779.

⁶³ *Id.* at 787.

⁶⁴ *Id.* at 787.

⁶⁵ *Hindle* at 788, 789.

⁶⁶ *Hindle* at 789.

⁶⁷ *Id.*

creditors are charged with constructive knowledge of their presence and effect would be to reason the viable general trust principles which *Robinson* properly invokes out of existence."⁶⁸

Similar, to the Eleventh Circuit, the Third Circuit also recognized that the bona fide purchaser defense is available to parties such as lenders who receive PACA funds in repayment of loans. Succinctly stated, the Third Circuit in *Sheppard v. KB Fruit & Vegetable, Inc.*,⁶⁹ stated, "we are in agreement with the *C.H. Robinson* court that absent specific instructions to the contrary, Congress must have intended for (the PACA) trust to operate according to settled principles of trust law."⁷⁰ In *Sheppard*, the court held that lenders who receive agricultural trust funds in repayment of loans qualify as bona fide purchasers entitled to retain the trust funds unless they have notice that they are receiving trust funds in breach of the trust.

In *A&J Produce v. C.I.T. Group Factoring, Inc.*,⁷¹ the court held that CIT, the secured lender, was not a bona fide purchaser for value as it tried to contend. In reaching this conclusion, the court noted that "when secured lenders use their security agreement to foreclose on property or otherwise enforce their contractual rights, they essentially force the transfer of trust property in satisfaction of an antecedent debt".⁷² Any such transfer, including transfers of negotiable instruments and money, through the exercise of rights under a security agreement is not for value. Most trust assets such as inventory or accounts receivable will be converted to money before being transferred.⁷³ The court in reaching its determination distinguished between the facts in *Robinson*, where the bank received cash loan payments and the present case, and the facts in *A&J Produce*, where CIT advanced loans and in return took over the accounts receivable of the company which did business with the dealers of the perishable goods.

C. Duty of Inquiry Analysis

In another important case on PACA law, *Consumers Produce Company, Inc. of Pittsburgh v. Volante Wholesale Produce, Inc.*,⁷⁴ a seller of produce

⁶⁸ *Id.*

⁶⁹ *Sheppard v. KB Fruit & Vegetable, Inc.*, No. 91-6624, 1993 WL 21008 (E.D. Pa. 1993).

⁷⁰ *Sheppard* at *4. [Citing H.R. rep. No. 543, 98th Cong.2d Sess.(1983), reprinted in 1984 Us Code Cong. & Admin. News 405]

⁷¹ *A&J Produce Corp. v. CIT Group/Factoring, Inc.*, 829 F. Supp. 651 (S.D.N.Y. 1993).

⁷² *Id.* at 656.

⁷³ *Id.* at 656, 657. To hold otherwise, would essentially permit secured creditors to "trump" unpaid beneficiaries of PACA trusts simply by enforcing their security agreement. *Id.*

⁷⁴ *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F. 3d 1374 (3rd Cir. 1994); *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc. of Pittsburgh*, 1994 WL 69347, 90-1551, (W.D.Pa. 1994).

tried to argue that when a purchaser breaches a PACA trust by transferring trust assets to lenders with security interests in those assets, the mere existence of the PACA statute provides notice of breach of trust to those lenders and defeats the bona fide purchaser defense. However, the Third Circuit noted that such a reading would in effect hold lenders strictly liable to trust beneficiaries for any trust assets received in breach of trust.⁷⁵ Instead, the court held that when addressing whether the lender should have known of the trustee's breach of trust, the parties should utilize a "duty of inquiry" analysis derived from the Restatement (Second) of Trusts.⁷⁶ This case by case factual inquiry arises when a person knows facts which under the circumstances suggest (1) that the person is dealing with a trustee and (2) that the trustee may be committing a breach of trust.⁷⁷ In the PACA trust context, a duty of inquiry arises when a third-party transferee has knowledge that a produce purchaser/trustee is not paying produce suppliers or is in financial difficulty.⁷⁸

In *Consumers Produce*, the court entered into a factual determination and concluded that the bank was a bona fide purchaser for value which successfully discharged its burden of showing that it was without notice of the trustee's breach of PACA trust in relation to the loan repayments made in the ordinary course of business.⁷⁹ As such, the bank was not required to disgorge the loan payments received in breach of trust.

In *Consumers Produce*, the lender provided a \$565,000 term loan to Jeffrey Robinson to purchase the business of Volante.⁸⁰ Volante was a produce dealer subject to the provisions of PACA. On that same day, the lender provided Volante a line of Credit, for short term working capital needs.

⁷⁵ *Consumers Produce*, 16 F.3d at 1381. In reaching its decision the court noted that the explanatory note to the regulations implementing the PACA trust states that, "trust assets are available for other uses by the buyer or receiver. For example, trust assets may be used to pay other creditors. It is the buyer's responsibility as trustee to insure that it has sufficient assets to assure prompt payment of produce and that any beneficiary under the trust will receive full payment." Explanatory Note, 49 Fed.Reg. 45738 (1984).

⁷⁶ *Consumer Produce*, 16 F.3d at 1383. Under the Restatement (Second) of Trusts: (a) third person has notice of a breach of trust not only when he knows of the breach, but also when she should know of it; that is when he knows facts which under the circumstances would lead a reasonably intelligent and diligent person to inquire whether the trustee is a trustee and whether the he is committing a breach of trust, and if such inquiry when pursued with reasonable intelligence and diligence would give him knowledge or reason to know that the trustee is committing a breach of trust. § 297 comment (a) (emphasis added).

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ By considering of the fact that the trustee had concealed its financial troubles from the bank by (1) deliberately inflating the amount of Volante's accounts receivables in its borrowing base securities, and (2) skewing the figures in its quarterly financial statements and figures given to the outside CPA for the annual financial statements to make its company look profitable. *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F. 3d 1374, 1384 (3d Cir. 1994).

⁸⁰ *Id.* at 1378.

The loan and line of credit were both secured by a first priority lien against Volante's assets, thus, covering assets subject to the PACA trust. Thereafter, unpaid produce suppliers commenced this action against Volante and the lender to recover loan repayments made in breach of the PACA trust. The district court held that the lender was charged with constructive knowledge of the PACA statute and the trust created thereunder. The court found that the bank was also aware that Volante was a produce wholesaler whose principal business was the purchase and resale of produce on credit.⁸¹ Therefore, the bank was charged with knowledge that it was dealing with a PACA trustee.⁸² However, the district court held that that the bank was not aware of facts, that under the circumstances would have suggested that Volante was breaching the PACA trust by making its loan repayments.⁸³ The court noted, that Jeffrey Robinson, the owner of Volante, prevented the bank from learning of Volante's failure to pay produce suppliers and Volante's financial difficulties.⁸⁴ Therefore, the bank's duty of inquiry was never triggered, and it would be unreasonable to find that the bank should have known of Volante's breach of trust.⁸⁵ Thus, in effect, the courts are still broadening the protection afforded to lenders by engaging in the determination of whether or not the lender conducted the necessary duty of inquiry to determine whether or not the trustee is breaching the trust. After *Consumers Produce*, it seems that a lender will still be protected for recovering loan payments that are made in breach of trust so long as they make a substantial inquiry.

In the 1995 case of *Battle v. Fresh Preps Distribution, Inc.*,⁸⁶ the court followed the Third Circuit's decision that a lender's duty of inquiry arises when a person knows facts which under the circumstances suggest (1) that the person is dealing with a trustee and (2) that the trustee may be committing a breach of that trust.⁸⁷ In *Battle*, a beneficiary of the PACA trust proceeded against a trustee's lender on the ground that, after receiving notice of breach of PACA, the lender verbally modified its agreement with the trustee requiring it to make "pay downs" of 3% - 5% of their collected accounts receivable on the loan amounts outstanding.⁸⁸ Here the court held that notice of the breach merely initiated the duty of inquiry which the lender pursued diligently.⁸⁹

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F. 3d 137, 1384 (3d Cir. 1994).

⁸⁵ *Id.*

⁸⁶ *Battle v. Fresh Preps Distribution, Inc.*, 873 F. Supp. 1062 (E.D. Mich. 1995).

⁸⁷ *Id.* at 1067.

⁸⁸ *Id.* at 1066.

⁸⁹ *Id.* at 1068.

The court stated that “the produce purchaser is the trustee of the trust and creditors (lenders) are not insurers of unpaid beneficiaries (seller) when they receive trust assets in breach of trust.”⁹⁰ Therefore, the produce distributor’s bank would not be liable to the supplier under PACA for the loan payments it accepted from the produce distributor when it did not know the produce distributor was not paying its suppliers. After this decision, it appears that the court is no longer concerned with notice of the breach of trust, but rather with whether the lender made a diligent enough effort, and, if so, he will remain protected.⁹¹

In determining the lender’s liability in the case of *Endico Potatoes v. CIT Group Factoring, Inc.*,⁹² the Second Circuit begins its discussion by stating that, although not expressly stated in PACA, courts have unanimously held that the trust created by PACA is governed by general trust principles.⁹³ Here the court found that CIT, the lender, did not obtain an interest in the accounts receivable in exchange for value, but held only a security interest in those accounts subject to the rights of the trust beneficiaries.⁹⁴ In making its determination the Second Circuit found that the resolution of whether or not CIT’s loan advances constituted a purchase for value depended on the substance of the relationship between the lender and the supplier, and not simply the label attached to the transaction.⁹⁵ In making its determination, a court must look at the transfer of risk.⁹⁶ Where the lender has purchased the accounts receivable, the borrower’s debt is extinguished and the lender’s risk is a direct one, that is the lender (not the borrower) bears the risk of non-performance by the account debtor and as such should be liable for the debt. If the lender holds only a security interest, his risk is derivative or secondary, the borrower remains liable for the debt and bears the risk of non-payment by the account debtor. Thus, because CIT held only a security interest in the accounts receivable, and did not purchase those accounts for value, its interest was subject to the rights of the PACA trust beneficiaries.⁹⁷ The Second Circuit has engaged itself in a very broad factual analysis in trying to conclude

⁹⁰ *Id.*

⁹¹ The Lender has thoroughly documented its “inquiry” by way of correspondence and affidavits of the loan officer. *Id.* at 1067. Under the circumstances in this case, the Court cannot find that NBD received payments in violation of the trust. NBD’s duty of inquiry arose as early as December, 1993. The unwillingness of FP to cooperate, despite repeated requests and signed documents does not and cannot make NBD the guarantor of amounts owed by FP. *Id.* at 1068.

⁹² *Endico Potatoes v. CIT Group Factoring, Inc.*, 67 F.3d 1063 (2d Cir. 1995).

⁹³ *Id.* at 1067.

⁹⁴ *Id.* at 1069.

⁹⁵ *Id.* at 1068.

⁹⁶ *Id.*

⁹⁷ *Id.* at 1069

whether or not lenders should be protected. However, it is doubtful that such an inquiry was what Congress intended when PACA was enacted.

This duty of inquiry analysis that has recently been followed, gives lenders a great advantage in defending PACA suits. In the case of *Albee Tomato*⁹⁸, the district court for the Southern District of New York held that the bank had properly established that it was entitled to prevail on its bona fide purchaser defense as it was a transferee for value without notice of the breach of trust. The court first determined that KCB was a purchaser for value falling within the "money transfer exception" to the rule that a transfer of trust assets in satisfaction of an antecedent debt is not for value.⁹⁹ The court then moved on to determine whether KCB had notice of the breach of trust, either by actual or constructive knowledge.¹⁰⁰ The court concluded that the fact that the bank knew that Shalom often experienced a "time gap between sales and collection" and that its account was continually overdrawn did not prove that the lender had actual knowledge but was rather a normal consequence of the nature of the business.¹⁰¹ Furthermore, the court went on to conclude that KCB did not have constructive knowledge of the breach of trust.¹⁰² This was supported by the bank's sworn statement that it did not become aware of the financial difficulty experienced by Shalom until the commencement of the litigation.¹⁰³ This duty of inquiry standard that was originally outlined in *Consumers Produce*,¹⁰⁴ provides lenders with a good chance of meeting the second prong of the bona fide purchaser defense (that it had neither actual nor constructive knowledge of the alleged breach of trust), as the financial difficulty of the dealer is considered a "normal consequence of the industry". Thus, essentially all that a lender must essentially demonstrate is that it was a transferee of the trust assets "for value".

Today we have no clear line that defines when a lender will prevail under the PACA. In a recently decided Eleventh Circuit case, *Gargiulo v. G.M. Sales, Inc.*,¹⁰⁵ the Court of Appeals held that material issues of fact existed as

⁹⁸ *Albee Tomato, Inc. v. A.B. Shalom Produce Corp.*, No. 01888, 1995 WL 766306 (S.D.N.Y. 1995).

⁹⁹ *Id.* at *3. The record establishes that KCB never foreclosed on the accounts receivables or on any of Shalom's collateral and that KCB only received interest and finance payments.

¹⁰⁰ *Id.* at *4.

¹⁰¹ *Id.* at *4

¹⁰² *Id.* at *6.

¹⁰³ *Id.* at *5.

¹⁰⁴ Although not defined in *Consumers Produce*, the court suggests that "financial difficulty" includes circumstances where "the trustee has insufficient assets to both make the transfer (to the third party) and pay suppliers." *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F. 3d 1374, 1383 (3d Cir. 1994) *infra* n.6.

¹⁰⁵ *Gargiulo v. G.M. Sales, Inc.*, 131 F. 3d 995 (11th Cir. 1997).

to whether the bank received principal loan payments in the ordinary course of business and was without notice of the debtor's breach of trust. This case was heard after the district court entered judgment for the suppliers. A Bank had extended a revolving line of credit for \$200,000 to GMS, for its use in its produce purchasing and reselling business. GMS secured the loan with its accounts receivable. GMS customers made all of their payments on GMS's accounts receivable, including those on which the bank had not advanced credit, directly into a lock box. These checks were thereafter deposited by the bank into GMS's checking account on a daily basis. The Bank then debited from GMS's account the amounts advanced as principal loan payments. GMS paid the interest owed directly to the Bank each month. Although the determination of this case remains to be seen, it is clear that the court will once again involve itself in an extensive factual inquiry. Again, it is doubtful that Congress ever intended for such a factual inquiry to be undertaken by the judiciary in determining who has the superior right to payments. Throughout the years the law of PACA has developed substantially in order to provide lenders with broader protection than was once afforded to them in their dealings with purchasers in the agricultural industry.

III. DISCUSSION

Congress' intent was clear when it enacted PACA. The purpose of PACA was to encourage fair trading practices in the marketing of perishable commodities by suppressing unfair and fraudulent business practices in the marketing of fruits and vegetables in interstate and foreign commerce.¹⁰⁶ Additionally, when enacting the 1984 amendment, Congress was expressly concerned with an increase in hidden security agreements whereby a lender's interest would prevail over the PACA trust beneficiary.¹⁰⁷

Many commission merchants, dealers or brokers in the normal course of their business transactions, operate on bank loans secured by the inventories, proceeds or assigned receivable from sales of perishable agricultural commodities, giving the lenders a secured position in the case of insolvency...This legislation would provide a remedy by impressing a trust in favor of the unpaid seller or supplier on the inventories of commodities and products derived therefrom and on the proceeds of sale of such commodities and products in the hands of the commission merchant, dealer or broker...The Committee believes that the statutory trust requirements will not be a burden

¹⁰⁶ House Report No. 98-543, 98th Congress, 1st Session 4,5 (1983), U.S. Code Cong. & Admin.News 1984, 406 (House Report).

¹⁰⁷ House Report No. 98-543, 98th Congress, 1st Session 4,5 (1983), U.S. Code Cong. & Admin.News 1984, 408 (House Report).

to the lending institutions. They will be known to and considered by prospective lenders in extending credit. The assurance the trust provision gives that raw products will be paid for promptly and that there is a monitoring system provided under the Act will protect the interests of the borrower, the money lender and the fruit and vegetable industry.¹⁰⁸

Thus, PACA 1984 amendment's purpose was to increase the legal protection for unpaid shippers and growers by enacting the non-segregated floating trust on all PACA property. However, after reading the most recent decisions that concern lenders who transact with trustees of the PACA trust, it seems that our judicial system often offers a contrary view. In effect the judiciary is circumventing the intent of Congress by engaging in the bona fide purchaser defense that is available under common law trust principles. In the 1988 case of *Lyng v. Frydman*,¹⁰⁹ the court specifically held that the defense of bona fide purchaser was inapplicable in cases involving the PACA trust. However, since the 1989 *C.H. Robinson* decision,¹¹⁰ many courts are now entertaining litigation between trust beneficiaries who claim that the trustee's lenders received trust assets in breach of trust and the lenders who defend the claim by arguing that they are bona fide purchasers for value without notice of the breach of trust. As a result, there has been an increase in litigation between such parties where the PACA trust beneficiary must not only bring suit against the trustee of the trust but also against a lender who receives trust assets in breach of the trust.

In looking at the Bankruptcy' court's "fresh-start" philosophy it is easier to understand their reluctance in enforcing the trumping effect of the PACA statute over their debtors. As noted by the United States Bankruptcy Court for the Eastern District of Pennsylvania:

There is a federal statute which gives PACA trust creditors a priority over all other creditors. The PACA trust is extremely potent in its ability to affect distribution in bankruptcy. It effectively provides its beneficiaries with a claim status that trumps that of all other creditors. The wisdom behind such prophylactic statutes, which can be likened to the "special interest" provisions in the Code, can be questioned. Every special-interest protection not only undermines the rights of general unsecured creditors, but also the concept of a unitary, self-contained Bankruptcy Code. We can appreciate that producers of perishable agricultural commodities can be financially devastated by a buyer's bankruptcy case. However, bankruptcies are often devastat-

¹⁰⁸ *Id.* at 407.

¹⁰⁹ *See supra* n 18.

¹¹⁰ *C.H. Robinson Company v. B.H. Produce Company, Inc.*, 723 F.Supp. 785 (N.D. Ga. 1989).

ing to a debtor's unpaid creditors. They may be devastating to a secured or unsecured creditor of a produce dealer as well. However, only producers and a few types of other creditors are entitled to a favored treatment. The impact of the PACA amendments have therefore been appropriately described as "Draconian" and has been subjected to strict construction against producers.¹¹¹

Although the ideal behind the bankruptcy laws is not new, Congress has nevertheless seen fit, notwithstanding the "fresh-start" philosophy to enact and broaden the protections afforded by PACA. As stated by another district court:

It must be remembered that PACA was not enacted to protect those in the debtor's shoes, but rather to prevent the chaos and disruption in the flow of perishable agricultural commodities sure to result from an industry wide proliferation of unpaid obligations. While in isolation it may seem a harsh course to follow, in the macroeconomics sense PACA serves to ensure continuity of payment and therefore survival of the industry.¹¹²

Bankruptcy courts are not, however, the only ones entertaining the bona fide purchaser defense. It seems that at present all the courts which are involved with PACA cases construe *C.H. Robinson* as the correct statement of the law. These courts address the fact that "Congress, in creating a statutory trust, must have intended that it operate in accordance with generally settled principles of trust law."¹¹³ However, what these courts fail to consider is that Congress made no such intent one way or the other. In effect, it seems that the judiciary is usurping the role of Congress through the precedent that it has established and has presently become a part of PACA law.

Some possible reasons behind the district courts' engaging in the bona fide purchaser analysis may be that they believe 1) that such "special legislation" is archaic and outdated; 2) deregulation of the industry is a preferred alternative, i.e. laissez faire; or 3) perhaps it may be that they think that such a protection is required in order to promote the market economy.

¹¹¹ *In re Hindle & Co. Inc.*, 149 BR 775, 785(Bankr. E.D.Pa 1993).

¹¹² *In re Country Club Market, Inc.*, 175 B.R. 1005, 1008 (Bankr. D. Minn. 1994).

¹¹³ *Sheppard v. KB Fruit & Vegetable, Inc.*, 1993 WL 21008 (E.D.Pa. 1993) (citing *C.H. Robinson Co. v. Trust Company Bank, N.A.* 952 F.2d 1311 (11th Cir. 1992)).

A. *Whether Or Not The PACA Statute Is Archaic And Outdated*

For over 65 years the PACA legislation has been a part of our agricultural industry. It was enacted at a time when our economy was severely depressed and such "special legislation" was warranted.¹¹⁴ However, on November 15, 1995, the question of whether or not the PACA statute is outdated and should be repealed was specifically answered when the PACA Reform measure H.R. 1103, previously known as "Pombo-Boehner compromise" became law. The most notable change made under this legislation was the phasing out of license fees over three years in order to relieve the financial burden on retailers. However, PACA's original and most important considerations that dealt with unfair trade practices and the 1984 statutory trust placed on certain assets was not repealed.¹¹⁵ Initially, PACA was enacted to deal with problems in the market economy as a result of brokers and purchasers failure to pay farmers for produce received. This multi-billion dollar fresh fruit industry is still particularly susceptible to unfair and fraudulent practices in the marketing of such commodities, in view of the high perishability of fresh fruits and vegetables.¹¹⁶ The importance for a farmer to know that the integrity of the market is available to him when he is selling his or her production in an era of volatile markets cannot be undermined. This is especially true for an industry of farmers who have long been so protected and are in reliance of PACA's statutory trust of which they are the beneficiaries. Thus, if Congress had intended to lessen the burden placed on lenders under PACA, wouldn't it have done so just three years ago when it was reformed?

B. *Whether Deregulation Of The Industry Is A Preferred Alternative*

Deregulation of an industry is always a viable option. The United States is a capitalist society. When markets function well, the economy is promoted. PACA was enacted at a time when the agriculture industry had taken a big hit. Agriculture had been seriously depressed since 1921, as the great expansion

¹¹⁴ As stated by one judge, the wisdom behind such "special interest" legislation can be questioned. *Id. citing* Hindle, 149 B.R. at 785. The PACA trust provisions are grounded in a rather remarkable Congressional determination that garden-variety secured transactions common in almost every area of the market place constitutes a burden on interstate commerce and is a contrary to public policy. *Id.* at 537.

¹¹⁵ "By stripping away critically needed safeguards on business practices, repeal of PACA would severely burden fruit and vegetable buyers and sellers, especially the smaller ones, by dismantling their dispute resolution forum." As stated by Lon Hatamiya, administrator of the Agricultural Marketing Service, in testimony before the House Subcommittee on Risk Management and Specialty Crops. *Supermarket News*, Vol.45, No 13.

¹¹⁶ *Payment for Agricultural Commodity Producers*, *Agricultural Law Journal* at 253.

of production during the war had turned quickly into overproduction and falling prices, thus the relief afforded by the PACA was in great demand. Faced with the market failure, the government's regulation of PACA can be looked at as an attempt by the government to promote competition in the industry that was badly hurt. However, by entertaining the bona fide purchaser analysis the courts are in effect saying that the PACA regulation has failed and deregulation may be a better option. In other words, PACA shippers/growers have comparable bargaining positions to secured lenders and thus should fend for themselves without government intervention. As discussed below this too is an unfeasible ideal as the market economy is better served through the continuing effect of the PACA legislation.

C. *Whether Such Protection Is Required In Order To Promote The Market Economy*

Producers and shippers of perishable commodities are, for the most part, small size businesses. The process of growing, harvesting, packing and shipping perishables is a real gamble; costs are high, capital is tied up in farm land and machinery, and returns are delayed until the crop is sold. If the grower-shipper cannot realize any returns on the sale of crop when due, he may not be able to survive...Additionally, sellers of perishable agricultural commodities are often located thousands of miles away from their customers. Sales transactions must be made quickly or they are not made at all. Many sales are consummated while the commodities are en route to a particular destination. Under such conditions, it is often difficult to make credit checks, conditional sales agreements, and take other traditional safeguards.¹¹⁷

Without the benefit provided by PACA's statutory trust the industry itself might self-destruct. When farmers and sellers do not get paid by the produce buyers/brokers they have no means to keep future production in place. At the same time, these brokers owe money to a lender who provided them with capital to keep their own business in place. These lenders know about the federal statute that is in place, and they know the risk they face when a farmer/seller does not get paid. Thus, they should bear the loss of non-payment as it is their business to supply risk-capital. Additionally, they have the means before paying out loans to inquire if the broker is creditworthy and responsible. The assurance of payment to a produce seller is an integral and necessary step in the preservation of the market economy.

¹¹⁷ *Id.*

IV. CONCLUSION

The PACA statute has been around for over 65 years. As originally enacted PACA's goal was to protect small farmers/unpaid sellers from the "sharp practices" of buyers who delay or fail to pay sellers.¹¹⁸ By its 1984 amendment, additional protection was provided to unpaid sellers and suppliers of perishable goods by imposing a statutory trust on the proceeds of sale. Sellers have used these provisions to seek recovery of any asset subject to the trust, including those assets which have been conveyed by the buyer to third party payees.¹¹⁹ Thus, a secured creditor who has farm products as collateral may find that its security interest is subordinate to a federal statutory trust in favor of unpaid produce suppliers and sellers.¹²⁰ However, today our judicial system when presented a PACA claim by a trust beneficiary has engaged itself in the "bona fide purchaser" analysis in order to protect lenders who deal with the PACA trustee's from having to disgorge payments they have received in breach of the trust. In entertaining this defense the courts make mention that "it must have been the intent of Congress" that such an interpretation be followed, yet, the PACA statute or its legislative history makes no mention of any such intent. Thus, our judiciary is in effect circumventing the intent of Congress by engaging in the bona fide purchaser analysis. Instead of worrying about what Congress' intent must have been when enacting PACA, the court should leave that determination itself to Congress which enacted the statute and is better suited to make that determination.

¹¹⁸ Duane M. Geck, *The Perishable Agricultural Commodities Act that Trumps Creditors Claims and Interests*, 21 CAL. BANKR. J. 231 (1993).

¹¹⁹ John M. Himmelberg and Mitchell H. Stabbe, *The 1984 PACA Amendments After Six Years: Producing Sellers' Trust and Lenders' Disgust*, 43 ARK. L. REV. 523, (1990).

¹²⁰ Geck, *supra* n. 118.