Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

[Document Number AMS–FV–09–0047]

7 CFR Part 46

Perishable Agricultural Commodities Act: Impact of Post-Default Agreements on Trust Protection Eligibility

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule.

SUMMARY: The Department of Agriculture (USDA) is proposing to amend the regulations under the Perishable Agricultural Commodities Act (PACA) in response to concerns raised by the industry that sellers may lose their status as trust creditors when they agree orally or in writing, after default on payment, to accept payments over time from financially troubled buyers. The amendment's purpose is to provide greater direction to the industry on maintaining trust protection after a buyer has made or is attempting to make partial payments.

Specifically, if there is a default in payment as defined in the reguations, the amendment would allow a seller, supplier, or agent who has met the eligibility requirements to enter into a written scheduled payment agreement for payment of the past due amount while maintaining its trust eligibility. The length of such an agreement for payment of the past due amount, while still maintaining eligibility for trust protection, could not extend beyond 180 days from the default date. In addition, the unpaid seller, supplier, or agent would be required to cease all collection of past due amounts under a written scheduled payment agreement if the buyer enters into bankruptcy or if the buyer is the respondent in a civil trust action. Any remaining unpaid amounts subject to the scheduled payment agreement would continue to qualify for trust protection.

DATES: Written or electronic comments received by August 9, 2010 will be considered prior to issuance of a final rule.

Additional Information or Comments: You may submit written or electronic comments to PACA Trust Post-Default Comments, AMS, F&V Programs, PACA Branch, 1400 Independence Avenue SW., Room 2095–S, Stop 0242, Washington, DC 20250–0242; *fax:* 202–720–8868; or *Internet: http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Phyllis L. Hall or Josephine E. Jenkins, Trade Practices Section, 202–720–6873.

SUPPLEMENTARY INFORMATION:

Background of PACA and Trust Provisions

The Perishable Agricultural Commodities Act (PACA) was enacted in 1930 to promote fair trading in the marketing of fresh and frozen fruits and vegetables in interstate and foreign commerce. It protects growers, shippers, distributors, and retailers dealing in those commodities by prohibiting unfair and fraudulent trade practices. The PACA also provides a forum to adjudicate or mediate commercial disputes. Licensees who violate the PACA may have their license suspended or revoked, and individuals determined to be responsibly connected to such licensees are restricted from employment or operating in the produce industry for a period of time.

Growing, harvesting, packing, and shipping perishables involve risk: Costs are high, capital is tied up in farmland and machinery, and returns are delayed until the crop is sold. Because of the highly perishable nature of the commodities and distance from selling markets, produce trading is fast moving and often informal. Transactions are consummated in a matter of minutes, frequently while the commodities are en route to their destination. Under such conditions, it is often difficult to check the credit rating of the buyer.

Congress examined the sufficiency of the PACA provisions fifty years after its inception and determined that prevalent financing practices in the perishable agricultural commodities industry were placing the industry in jeopardy. Particularly, Congress focused on the increase in the number of buyers who failed to pay, or were slow in paying their suppliers and the impact of such payment practices on small suppliers who could not withstand a significant loss or delay in receipt of monies owed. Congress was also troubled by the common practice of produce buyers granting liens on their inventories to their lenders, which covered all proceeds and receivables from the sales of perishable agricultural commodities, while the produce suppliers remained unpaid. This practice elevated the lenders to a secured creditor position in the case of the buyer's insolvency, while the sellers of perishable agricultural commodities remained unsecured creditors with little or no legal protection or means of recovery in a suit for damages.

Deeming this situation a "burden on commerce," Congress amended the PACA in 1984 to include a statutory trust provision, which provides increased credit security in the absence of prompt payment for perishable agricultural commodities. The 1984 amendment to the PACA states in relevant 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 payment for perishable agricultural 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 receivables 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 on commerce in perishable agricultural commodities and to protect the public interest.

(7 U.S.C. 499e(c)(1)).

Under the 1984 amendment, perishable agricultural commodities, inventories of food or other derivative products, and any receivables or proceeds from the sale of such commodities or products, are to be held in a non-segregated floating trust for the benefit of unpaid sellers. This trust is created by operation of law upon the purchase of such goods, and the produce buyer is the statutory trustee for the benefit of the produce seller. To preserve its trust benefits, the unpaid supplier, seller or agent must give the buyer written notice of intent to preserve its rights under the trust within

30 calendar days after payment was due. Alternatively, as provided in the 1995 amendments to the PACA, a PACA licensee may provide notice of intent to preserve its trust rights by including specific language as part of its ordinary and usual billing or invoice statements.

The trust is a non-segregated "floating trust" made up of all of a buyer's commodity-related assets, under which there may be a commingling of trust assets. There is no need to identify specific trust assets through each step of the accrual and disposal process. Since commingling is contemplated, all trust assets would be subject to the claims of unpaid sellers, suppliers and agents to the extent of the amount owed them. As each supplier gives ownership, possession, or control of perishable agricultural commodities to a buyer, and preserves its trust rights, that supplier becomes a participant in the trust. Section 5(c)(2) of the PACA states in relevant part:

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

(7 U.S.C. 499e(c)(2)). Thus, trust participants remain trust beneficiaries until they have been paid in full.

Under the statute, the District Courts of the United States are vested with jurisdiction to entertain actions by trust beneficiaries to enforce payment from the trust. Thus, in the event of business failure, produce creditors may enforce their rights by suing the buyer in federal district court. It is common in this type of trust enforcement action for unpaid sellers to seek a temporary restraining order (TRO) that freezes the bank accounts of a buyer until the trust creditors are paid. Many unpaid sellers have found this a very effective tool to recover payment for produce. Often, a trust enforcement action with a TRO will be the defining moment for the future of a debtor firm. As the TRO freezes the bank accounts of the debtor, the debtor must either pay the trust creditors or attempt to operate a business without access to its bank accounts. This aggressive course of action by unpaid sellers is generally pursued when the sellers are concerned that trust assets are being dissipated.

In the event of a bankruptcy by a produce buyer, that is, the produce "debtor," the debtor's trust assets are not property of the bankruptcy estate and are not available for distribution to secured lenders and other creditors until all valid PACA trust claims have been satisfied. The trust creditors can petition the court for the turnover of the debtor's trust-related assets or alternatively request that the court oversee the liquidation of the inventory and collection of the receivables and disburse the trust proceeds to qualified PACA trust creditors.

Because of the statutory trust provision, produce creditors, including sellers outside the United States, have a far greater chance of recovering money owed them when a buyer goes out of business. However, because attorney's fees are incurred in these kinds of suits it is not always practical to pursue small claims that remain unpaid. Nonetheless, as a result of the PACA trust provisions, unpaid sellers, including those outside the United States, have recovered hundreds of millions of dollars that most likely would not otherwise have been collected.

The PACA trust provisions protect not only growers, but also other firms trading in fruits and vegetables since each buyer in the marketing chain becomes a seller in its own turn and can preserve its own trust assets accordingly. Because each creditor that buys produce can preserve trust assets for the benefit of its own suppliers, any money recovered from a buyer that goes out of business are passed back through preceding sellers until ultimately the grower also realizes the financial benefits of the trust provisions. This is particularly important in the produce industry due to the highly perishable nature of the commodities as well as the many hands such commodities customarily pass through to the end customer.

To gain trust protection under the PACA, the law offers two approaches to unpaid sellers. One option allows PACA licensees to declare at the time of sale that the produce being sold is subject to the PACA trust, providing protection in the event that payment is late or the payment instrument is not honored. This option allows PACA licensees to protect their trust rights by including the following language on invoices or other billing statements:

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

(7 U.S.C. 499(c)(4)).

The second option for a PACA licensee to preserve its trust rights, and the sole method for all non-licensed sellers, requires the seller to provide a separate, independent notice to the buyer of its intent to preserve its trust benefits. The notice must include sufficient details to indentify each transaction and be received by the buyer within 30 days after payment becomes due. Since the 1995 amendment to the PACA, the notice is not required to be filed with USDA.

Under current 7 CFR 46.46(e)(2), only transactions with payment terms of 30 days from receipt and acceptance, or less, are eligible for trust protection. Section 46.46(e)(1) of the regulations (7 CFR 46.46(e)(1)) requires that any payment terms beyond "prompt" payment as defined by the regulations, usually 10 days after receipt and acceptance in a customary purchase and sale transaction, must be expressly agreed to before entering into the transaction and reduced to writing. A copy of the agreement must be retained in the files of each party and the payment due date must be disclosed on the invoice or billing statement.

Over the past few years, several federal courts have invalidated the trust rights of unpaid creditors because these creditors agreed in writing, and in some cases, by oral agreement, after default on payment, to accept payments over time from financially troubled buyers. In general, these courts have invalidated the seller's previously perfected trust rights because the agreements were deemed to extend payment terms beyond 30 days.[1]

Many within the industry and the USDA Fruit and Vegetable Industry Advisory Committee have urged the Secretary to amend the PACA regulations to address the impact of post-default agreements on eligibility for trust protection. They have voiced concern that the uncertainty created by court decisions and the silence of the

[1] *See, Paris Foods Corp.* v. *Foresite Foods, Inc.,* No. 1:05–cv–610–WSD, 2007 WL 568841 (N.D. Ga. Feb. 20, 2007); *Bocchi Americas Assoc.* v. *Commerce Fresh Mktg., Inc.,* No. Civ. A. H0402411, 2005 WL 3164240 (S.D. Tex. Nov. 28, 2005); *American Banana Co.* v. *Republic Nat. Bank of N.Y.,* 362 F.3d 33 (2nd Cir. 2004); *Patterson Frozen Foods, Inc.* v. *Crown Foods, Int'l,* 307 F.3d 666, 667 (7th Cir. 2002); *Greg Orchards Produce, Inc.* v. *P. Roncone J.,* 180 F.3d 888, 892 (7th Cir. 1999); *Idahoan Fresh* v. *Advantage Produce, Inc.,* 157 F.3d 197, 205 (3d Cir. 1998); *In re Lombardo Fruit and Produce Co.,* 12 F.3d 806, 809 (8th Cir. 1993); and *Hull* v. *Hauser's Foods, Inc.,* 924 F.2d 777, 781–82 (8th Cir. 1991).

PACA regulations on this matter introduce risk, cost, and unnecessary litigation to the marketing chain.

The court decisions at issue have held that any post-default agreement, whether oral or written, that extends the buyer's obligation to pay the seller's invoices beyond 30 days after receipt and acceptance of the produce abrogates the produce seller's PACA trust rights. These decisions have held that (1) when a seller enters into the post-default agreement, the agreement modifies any valid payment agreement entered into prior to the transaction and therefore voids the trust protection,[2] and (2) post-default agreements that allow for installment payments exceeding 30 days from receipt of produce violate the PACA prompt-pay provisions.[3]

It is our interpretation of the statute and regulations that post-default agreements are not an extension of the 30-day maximum time period for pre-transaction agreements that would result in a waiver of the seller's trust rights; post-default payment agreements are an attempt to collect a debt. The Secretary has long recognized a significant difference between the relative positions of buyers and sellers before a transaction, versus their positions after a buyer defaults on payment. The Secretary has observed that "produce sellers are not in an equal bargaining position with produce purchasers who are in possession of the produce seller's perishable agricultural commodities."[4] After a buyer has defaulted on payment, the seller is at the buyer's mercy. Any agreement reached after default is not an arm's length transaction. The trust is intended to provide protection to the unpaid seller whose bargaining position has changed for the worse after delivering its produce to a buyer. We do not believe that a seller's perfected trust rights should be lost because the seller enters into a payment arrangement, in an attempt to collect a debt, after the buyer has violated the PACA's prompt payment requirement.

When a buyer defaults on payment for produce, it has committed a violation of section 2(4) of the PACA (7 U.S.C. 499b(4)). The defaulting buyer's license is then subject to suspension or revocation, or the buyer may be assessed a civil penalty for its violations of the PACA. Allowing a seller who has perfected its trust rights to enter into a post-default payment agreement with the defaulting buyer does not negate the buyer's violations of the Act. The trust is a means to protect the seller's right to payment for produce, not to enforce the prompt payment provisions of the Act. The Secretary can still initiate an enforcement action against the buyer to seek the appropriate sanction for violation of the Act without regard to any post-default agreement entered into between the unpaid seller and the buyer in default.

Many of the court decisions at issue have been based on an interpretation of § 46.46(e) of the regulations (7 CFR 46.46(e)). Section 46.46(e)(1) (7 CFR 46.46(e)(1)) requires that parties who elect to use different times for payment must reduce their agreement to writing before entering into the transaction. Current § 46.46(e)(2) (7 CFR 46.46(e)(2)) states that the maximum time for payment for a shipment to which a seller can agree and still qualify for coverage under the trust is 30 days after receipt and acceptance of the commodities. It is our interpretation that § 46.46(e)(2), like (e)(1) of the regulations (7 CFR 46.46(e)(1) and(e)(2)), addresses pre-transaction agreements only.

This interpretation of our regulations is consistent with the Secretary's unwillingness to impute a waiver of trust rights as illustrated in the policies established by the Secretary and upheld by the courts in the context of the trust provisions of the Packers and Stockyards Act (7 U.S.C. 181 *et seq.*), after which the PACA trust provisions are largely modeled.[5] In the context of the PACA trust, the right to make a claim against the trust are vested in the seller, supplier, or agent who has met the eligibility requirements of paragraphs (e)(1) and (2) of § 46.46 (7 CFR 46.46(e)(1) and (2)). The seller, supplier, or agent remains a beneficiary of the PACA trust until the debt owed is paid in full. An agreement to pay the antecedent debt in installments is not considered payment in full. Thus, we do not believe that a post-default payment agreement should constitute a waiver of a seller's previously perfected trust rights.

Post-default agreements are often the result of a reasonable effort by an unpaid seller, supplier, or agent to recover at least some of the debt owed to it without incurring the risks and expense of protracted litigation. Such agreements should be viewed as a useful tool for recovery of unpaid debts, allowing for cure of a temporary payment delay as can occur in the produce industry due to the perishable nature of the product being bought and sold as well as the often fast-paced and short-term fluctuations in market price due to weather, pests, transportation, and seasonality of supply and demand.

While the potential benefits of post-default agreements are real, we believe such agreements should be subject to regulatory requirements. To ensure that the post-default payment arrangement does not extend beyond a reasonable period, the maximum length of an agreement to accept scheduled payments on the past due amount and maintain eligibility for trust protection could not extend beyond 180 days from the default date. We believe that one hundred eighty days is a reasonable time period during which a firm experiencing minor financial troubles can work out delinquent accounts with its suppliers. Such an arrangement lessens the financial problems that often beset an unpaid produce seller whose market, by its nature, precludes taking the normal steps to secure credit sales. If a seller who has met the requirements of paragraphs (e)(1) and (2) of § 46.46 (7 CFR 46.46)(e)(1) and (2)), is not allowed to enter into a post-default agreement and still maintain its trust protection, the seller is penalized. In such circumstances, the produce debtor is permitted to use the seller for financing and at the same time avoid the impact of the statutory trust. Post-default agreements that allow payments to be made within 180 days following the default on the original payment due date pose no significant risk to the produce industry, but they may allow buyers and sellers more flexibility. Post-default payment agreements can be a practical approach to getting outstanding debts paid without jeopardizing the seller's trust rights, thereby serving to protect the interests of the supplier, buyer, and the fruit and vegetable industry.

In order to maintain trust eligibility, the post-default payment agreement should be in writing. A written agreement, rather than a verbal agreement or course of dealing claim, would constitute a valid post-default agreement. Parties to a written agreement would have material evidence to prove the actual terms of the agreement should litigation become necessary.

When a produce debtor files bankruptcy or if a trust action is filed against the produce debtor, all unpaid sellers of produce should be treated equally. Therefore, an unpaid seller who has entered into a post-default payment agreement must stop accepting payments from the debtor once a

[2] *See American Banana Co.,* 362 F.3d at 33; *Patterson Frozen Foods,* 307 F.3d at 669.

[3] *American Banana Co.,* 362 F.3d at 46.

[4] *See In re: Scamcorp, Inc.,* 57 Agric. Dec. 527, 563 (1998).

[5] *See, e.g., In re Gotham Provision Co., Inc.,* 669 F.2d 1000, 1007 (5th Cir. 1982).

bankruptcy or trust action is filed. Any amount still due under the payment agreement would be subject to the trust.

Section 46.46(e)(1) and (2) of the regulations (7 CFR 46.46(e)(1) and (2)) speak only to the effect of a pre-transaction agreement on the ability of a seller, supplier, or agent to qualify for trust protection. Neither the statute nor current regulation address post-default agreements, nor do they specify any maximum payment terms for post-default agreements. The issuance of a regulation clarifying that post-default agreements do not waive trust rights is within the Secretary's delegated authority (7 U.S.C. 499o), and would be consistent with PACA's purpose and legislative history. Failure to do so may harm interstate commerce in produce that the PACA was enacted to protect. Therefore, we propose to amend PACA regulations as described below.

We propose to amend 7 CFR 46.46(e)(2) by adding the words "prior to the transaction". This change would clarify that the 30-day maximum time period for payment for a shipment to which a seller can agree and still qualify for coverage under the trust relates back to paragraph (e)(1) which refers to pre-transaction agreements.

We also propose to add a new paragraph (e)(3) to 7 CFR 46.46. The new paragraph would provide that in circumstances of a default in payment as defined in § 46.46(a)(3), a seller, supplier, or agent who has met the eligibility requirements of § 46.46 paragraphs (e)(1) and (2) could agree in writing to a schedule for payment of the past due amount and still remain eligible under the trust. The post-default payment agreement could not extend beyond 180 days from the default date. New paragraph (e)(3) would require a seller, supplier or agent who enters into a post-default payment agreement to stop accepting payments under the agreement if the buyer declares bankruptcy or if a temporary restraining order is issued by a district court in a trust action. The remaining outstanding debt would qualify for trust protection. Current 7 CFR 46.46(e)(3) and (4) would be redesignated as (e)(4) and (5).

Executive Orders 12866 and 12988

This proposed rule has been determined to be not significant for the purposes of Executive Order 12866, and therefore, has not been reviewed by the Office of Management and Budget. This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform, and is not intended to have retroactive effect. This proposed rule will not preempt any State or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule. There are no administrative procedures that must be exhausted prior to any judicial challenge to the provisions of this proposed rule.

Effects on Small Businesses

Pursuant to requirements set forth in the Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), USDA has considered the economic impact of this proposed rule on small entities. The purpose of the RFA is to fit regulatory actions to the scale of businesses subject to such actions in order that small businesses will not be unduly or disproportionately burdened. The Small Business Administration (SBA) has defined small agricultural service firms (13 CFR 121.601) as those whose annual receipts are less than $7,000,000. There are approximately 14,400 firms licensed under the PACA, a majority of which could be classified as small entities.

The proposed regulations would clarify that a trust beneficiary who has perfected its trust rights does not forfeit those rights by entering into a post-default agreement to accept partial or installment payments on the amount due. This language would provide companies of all sizes with clear regulatory guidance on this matter, thereby reducing the time and expense associated with litigating matters involving post-default agreements and trust right preservation under the PACA. Therefore, we believe that this proposed rule will not have a significant economic impact on a substantial number of small entities.

Paperwork Reduction Act

In accordance with OMB regulations (5 CFR part 1320) that implement the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35), the information collection and recordkeeping requirements that are covered by this proposed rule are currently approved under OMB number 0581–0031.

E-Government Act Compliance

AMS is committed to complying with the E-Government Act, which requires Government agencies in general to provide the public the option of submitting information or transacting business electronically to the maximum extent possible. Forms are available on our PACA Web site at *http://www.ams.usda.gov/paca* and can be printed, completed, and faxed. Currently, forms are transmitted by fax machine and postal delivery.

List of Subjects in 7 CFR Part 46

Definitions, Accounts and records, Duties of licensees, Statutory trust.

For the reasons set forth in the preamble, AMS proposes to amend 7 CFR part 46 as follows:

PART 46—[AMENDED]

1. The authority citation for part 46 continues to read as follows:

Authority: 7 U.S.C. 499a–499t.

2. In § 46.46, paragraph (e)(2) is revised, paragraphs (e)(3) and (4) are redesignated as paragraphs (e)(4) and (5), and a new paragraph (e)(3) is added as follows:

§ 46.46 Statutory trust

* * * * *

(e) * * *

(2) The maximum time for payment for a shipment to which a seller, supplier, or agent can agree, prior to the transaction, and still be eligible for benefits under the trust is 30 days after receipt and acceptance of the commodities as defined in § 46.2(dd) and paragraph (a)(1) of this section.

(3) If there is a default in payment as defined in § 46.46(a)(3), the seller, supplier, or agent who has met the eligibility requirements of paragraphs (e)(1) and (2) of this section will not forfeit eligibility under the trust by agreeing in writing to a schedule for payment of the past due amount. The maximum time for payment of a past due amount to which a seller, supplier, or agent can agree, after a default, and still be eligible for benefits under the trust is 180 days from the default date, that is, the original payment due date of the transaction. The seller, supplier, or agent must cease all collections of past due amounts under a scheduled payment agreement if the buyer enters into bankruptcy or if the buyer is ordered to hold its inventory, accounts receivable, and proceeds intact until a determination of trust interest in a civil action. The remaining unpaid amount under the scheduled payment agreement will continue to qualify for trust protection.

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Dated: June 2, 2010.

David R. Shipman,

Acting Administrator, Agricultural Marketing.

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