

The National Agricultural  
Law Center



University of Arkansas School of Law  
NatAgLaw@uark.edu ☎ (479) 575-7646

---

An Agricultural Law Research Article

**Protecting the Power of the PACA  
Trust: Contemplating the Effects of  
the Bona Fide Purchaser Defense**

by

Michelle G. Oleksa

Originally published in SAN JOAQUIN AGRICULTURAL LAW REVIEW  
8 SAN JOAQUIN AGRIC. L. REV. 173 (1998)

[www.NationalAgLawCenter.org](http://www.NationalAgLawCenter.org)

# Protecting the Power of the PACA Trust: Contemplating the Effects of the Bona Fide Purchaser Defense

## INTRODUCTION

The Perishable Agricultural Commodities Act of 1930,<sup>1</sup> known as PACA, was enacted to promote fair trading practices in the marketing of perishable agricultural commodities.<sup>2</sup> PACA was “designed primarily for the protection of the producers of perishable agricultural products - most of whom must entrust their products to a buyer . . . who may be thousands of miles away, and depend for their payment upon his business acumen and fair dealing.”<sup>3</sup> In an effort to facilitate the free flow of perishable agricultural commodities,<sup>4</sup> as well as curb unfair business practices,<sup>5</sup> Congress enacted PACA to regulate the flow of such commodities in interstate commerce as transacted by commission merchants,<sup>6</sup> dealers,<sup>7</sup> and brokers<sup>8</sup> licensed under PACA.<sup>9</sup> PACA

---

<sup>1</sup> 7 U.S.C. §§ 499a-499t (1997), Perishable Agricultural Commodities Act of 1930 [hereinafter PACA].

<sup>2</sup> *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1377 (3d Cir. 1994).

<sup>3</sup> H.R. REP. NO. 1196, 84th Cong., 1st Sess. 2 (1955), *reprinted in* 1956 U.S.C.C.A.N. 3701.

<sup>4</sup> Perishable agricultural commodities are defined in 7 U.S.C. § 499a(4)(A), (4)(B) (1997) as fresh fruits and vegetables of every kind and character, whether or not frozen or packed in ice, including cherries in brine.

<sup>5</sup> *Rothenberg v. H. Rothstein & Sons*, 183 F.2d 524, 525 (3d Cir. 1950).

<sup>6</sup> A commission merchant is defined in 7 U.S.C. § 499a(5) (1997) as “any person engaged in the business of receiving in interstate or foreign commerce any perishable agricultural commodity for sale, on commission, or for or on behalf of another.”

<sup>7</sup> A dealer is defined in 7 U.S.C. § 499a(6) (1997) as “any person engaged in the business of buying or selling in wholesale . . . any perishable agricultural commodity in interstate or foreign commerce, except . . . in respect to sales of any such commodity of his own raising, . . . for sale at retail” except when purchases of such commodities exceed \$230,000 in a calendar year, and for the canning of any such commodity except potatoes.

<sup>8</sup> A broker is defined in 7 U.S.C. § 499a(7) (1997) as “any person engaged in the business of negotiating sales and purchases of any perishable agricultural commodity

provides powerful trust provisions<sup>10</sup> in favor of unpaid sellers of produce. A statutory trust is impressed immediately upon delivery of goods to a purchaser on behalf of unpaid suppliers<sup>11</sup> and functions as a traditional trust.<sup>12</sup> However, the bona fide purchaser defense, when successfully asserted by a third-party creditor, can serve as a means of circumventing the PACA trust. If the trustee, here the purchaser of the commodities, is in breach of trust and transfers trust proceeds to a person who takes for value and without notice of the breach of trust, the latter holds the interest free of the trust and is under no liability to the beneficiary,<sup>13</sup> the unpaid seller.

The typical bona fide purchaser situation arises when a buyer of produce has resold the produce, received proceeds, and remitted payment to a lender for an existing obligation. Upon default of the debt owed to the unpaid seller, there is an attempt by the unpaid seller to force the lender, often a bank, to disgorge monies paid from the trust assets. Case law pertaining to the bona fide purchaser defense in PACA trust violation cases centers on whether the lender knew, or should have known, that the money was received in violation of the trust.<sup>14</sup> This comment explores the power of the PACA trust, analyzes

---

in interstate or foreign commerce for or on behalf of the vendor or purchaser, respectively, except . . . if such a person is an independent agent negotiating sales for and on behalf of the vendor" when the invoice value of such commodities is not in excess of \$230,000 in any calendar year.

<sup>9</sup> As stated in 7 U.S.C. § 499c(a) (1997), "no person shall at any time carry on the business of a commission merchant, dealer, or broker without a license valid and effective at such time," and any person who violates any provision shall be liable for monetary damages. Annual license fees are enumerated in 7 U.S.C. § 499c(b)(2) (1997), which states that a license fee shall equal \$550 per year, plus \$200 for each branch in excess of nine facilities, subject to an annual aggregate of \$4,000 per licensee.

<sup>10</sup> 7 U.S.C. § 499e(c)(1)-(5) (1997).

<sup>11</sup> *In re Melon Produce, Inc.* No. 88-10112, 1994 Bankr. LEXIS 520, at \*1 (D. Mass. Mar. 31, 1994); *Debruyne Produce Co. v. Richmond Produce Co.* (*In re Richmond Produce Co.*), 112 B.R. 364, 368 (Bankr. N.D. Cal. 1990); *A & J Produce Corp. v. CIT Group/Factoring, Inc.* 829 F. Supp. 651, 656 (S.D. N.Y. 1993).

<sup>12</sup> A trust is defined in RESTATEMENT (SECOND) OF TRUSTS § 2 (1959) as "a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person . . . ."

<sup>13</sup> RESTATEMENT (SECOND) OF TRUSTS § 284 (1959).

<sup>14</sup> *C.H. Robinson Co. v. B.H. Produce Co.*, 723 F. Supp. 785, 792 (N.D. Ga. 1989); *Post & Taback, Inc. v. Merrill Lynch Bus. Fin. Serv., Inc.*, 859 F. Supp. 757, 758 (S.D. N.Y. 1994); *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1380 (3rd Cir. 1993); *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F.

case law pertaining to the bona fide purchaser defense, and recommends a change in notice requirements to facilitate constructive notice and eliminate the bona fide purchaser defense.

## I. THE PURPOSE AND POWER OF THE PACA TRUST

### A. *Historical Background*

In 1984, Congress amended PACA in response to a large number of produce buyers who had received perishable agricultural goods without paying for them.<sup>15</sup> In an effort to remedy this burden, Congress enacted statutory trust provisions to benefit unpaid sellers.<sup>16</sup> These amendments provide a self-help tool to protect sellers by impressing an automatic trust on the commodities received, any derivatives therefrom, and any receivables or proceeds from the sale of the produce.<sup>17</sup>

If the produce buyer does not make full payment promptly, generally within ten days,<sup>18</sup> trust assets are preserved as a nonsegregated, "floating" trust.<sup>19</sup> Therefore, the commingling of trust assets with other assets of the buyer is contemplated as a normal incident in the establishment of a PACA trust.<sup>20</sup> The PACA beneficiary then takes priority over other creditors, whether secured or unsecured, on the buyer's assets for the full amount of the claim.<sup>21</sup> Although a produce buyer can use such assets as collateral for other creditors, the trust provisions of PACA render any such security interest agreement secondary to the PACA trust in favor of the unpaid produce seller.

---

Supp. 590, 594 (S.D. N.Y. 1995).

<sup>15</sup> *Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703, 705 (E.D. Pa. 1994).

<sup>16</sup> *Id.*

<sup>17</sup> Regulations under the Perishable Agricultural Commodities Act; Addition of Provisions to Effect a Statutory Trust, 49 Fed. Reg. 45,735 (1984) (codified at 7 C.F.R. § 46).

<sup>18</sup> Full payment promptly is defined in 7 C.F.R. § 46.2(3)(aa) (1997) as making payment without committing a violation of the Act. This section requires payment, in most cases, within ten days of receiving the produce. Although parties are allowed to extend the time by written agreement, when payment terms extend beyond thirty days, the seller is not entitled to the trust provisions.

<sup>19</sup> 7 C.F.R. § 46.46(b) (1997).

<sup>20</sup> *Id.*

<sup>21</sup> *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D. N.Y. 1993).

### B. Ramifications When the Debtor Company Files Bankruptcy

The concept of the floating trust under PACA functions as a powerful means of recovery for an unpaid seller facing a produce buyer in bankruptcy. Conceptually, the trust creates a tier of claims that "float above" the priority ladder.<sup>22</sup> Section 541 of the Bankruptcy Code states that property in which the debtor holds only legal title, and not an equitable interest, is not considered part of the bankruptcy estate.<sup>23</sup> The corpus<sup>24</sup> of a secured PACA trust is an equitable interest, and thus not a part of the debtor's bankruptcy estate subject to distribution.<sup>25</sup>

One commentator, speaking in the bankruptcy context, referred to the PACA trust as the product of diligent lobbyists who worked to create priority treatment for unpaid sellers of produce at the expense of all others.<sup>26</sup> But Congress made clear that its focus was on the larger picture:

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 protect the public interest.<sup>27</sup>

Shortly after the trust provisions went into effect, the court in *In re Fresh Approach, Inc.* articulated the underlying policy of the PACA trust:

It must be remembered that PACA was not enacted to protect those in Debtor's shoes, but rather to prevent the chaos and disruption in the flow

---

<sup>22</sup> Kay Standridge Kress, *Last in Line: What Unsecured Creditors Need to Know About the Perishable Agricultural Commodities Act*, AM. BANKR. INST. J., Nov. 1995, at 1.

<sup>23</sup> 11 U.S.C. § 541(d) (1997).

<sup>24</sup> Corpus is defined in BLACK'S LAW DICTIONARY 343 (6th ed. 1990) as the main body or principal of a trust.

<sup>25</sup> *East Coast Potato Distrib. v. Grant (In re Super Spud, Inc.)*, 77 B.R. 930, 931 (Bankr. M.D. Fla. 1987); see also *In re Fresh Approach, Inc.*, 51 B.R. 412, 419 (Bankr. N.D. Tex. 1985).

<sup>26</sup> John D. Penn, *Suggestion for the National Bankruptcy Review Commission and Congress: Eliminating Special Interest (or Special Purpose) Provisions*, 4 AM. BANKR. INST. L. REV. 541 (1996).

<sup>27</sup> 7 U.S.C. § 499e(c)(1) (1997).

of perishable agricultural commodities sure to result from an industry-wide proliferation of unpaid obligations. While in isolation this may seem a harsh course to follow, in the macroeconomic sense PACA serves to ensure continuity of payment and therefore survival of the industry. Congress has plainly decided it would be less disastrous to risk the liquidation of a single purchaser than to threaten the entire production chain with insolvency.<sup>28</sup>

Congress' concern with disruption of interstate commerce justifies priority payment to PACA trust beneficiaries over all creditors, secured and unsecured.<sup>29</sup>

### C. Personal Liability

The essence of the PACA trust is the creation of a fiduciary duty in the produce buyer as trustee, to control the trust assets for the produce seller, as beneficiary. When an individual is in a position to control the trust assets, but fails to preserve them properly, that person has breached the fiduciary duty and will be held personally liable in tort.<sup>30</sup> Personal liability in this context should be distinguished from the use of alter-ego doctrine or the principle of piercing the corporate veil.<sup>31</sup> Generally, the corporate veil may be pierced to hold liable an individual who disregards the corporate form by committing a fraud, or advancing his or her personal interests rather than those of the corporation.<sup>32</sup> Personal liability under PACA, by contrast, requires only that trust assets be used for some purpose other than repayment to the seller.<sup>33</sup> Such abuse will be considered a breach of fiduciary duty even if the proceeds from the sale of the produce were used for legitimate business expenditures, such as payment of rent or payroll.<sup>34</sup>

In addition, for an individual to be held personally liable under PACA, he or she must be deemed "responsibly connected"<sup>35</sup> to the

---

<sup>28</sup> *In re Fresh Approach, Inc.*, 51 B.R. 412, 420 (Bankr. N.D. Tex. 1985).

<sup>29</sup> *East Coast Potato Distrib. v. Grant (In re Super Spud, Inc.)*, 77 B.R. 930, 931 (Bankr. M.D. Fla. 1987).

<sup>30</sup> *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D. N.Y. 1993); *contra Farm-Wey Produce, Inc. v. Wayne L. Bowman Co.*, No. 1:96-cv-397 and 1:96-cv-513, 1997 U.S. Dist. LEXIS 11760 (E.D. Tenn. June 26, 1997).

<sup>31</sup> *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D. N.Y. 1993); *A & J Produce Corp. v. CIT Group/Factoring, Inc.*, 829 F. Supp. 651, 656 (S.D. N.Y. 1993).

<sup>32</sup> *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D. N.Y. 1993).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> 7 U.S.C. § 499a(b)(4)(B)(9) (1997).

purchasing corporation or other business entity. This designation applies to one who is affiliated as an owner, partner, officer, director, or, in the case of a corporation, shareholder owning more than ten percent of the outstanding stock of a corporation.<sup>36</sup> When a responsibly connected individual causes a dissipation<sup>37</sup> of trust assets, he or she may be held personally liable for that breach of fiduciary duty. The court in *Shepard v. K.B. Fruit & Vegetable, Inc.* held that PACA liability attaches first to the corporation that has sold produce without remitting the proceeds due to the beneficiary, and then if corporate assets are insufficient, others may be held secondarily liable if they had a role in causing the corporate trustee to commit the breach of trust.<sup>38</sup> A significant result of this second tier of liability is that an unpaid seller may bring an action in state court against a corporation on a contract theory, and if a judgment is not satisfied, next pursue individual defendants in federal court on the PACA trust theory.<sup>39</sup> Notably, once a person is deemed responsibly connected, he or she is strictly barred from being employed by any PACA licensee when there is an unpaid reparation award issued within two years of the proposed employment.<sup>40</sup>

#### D. Personal Liability Juxtaposed With Personal Bankruptcy

When a responsibly connected individual dissipates PACA trust assets and then files for personal bankruptcy, any debts owed to trust beneficiaries are generally non-dischargeable.<sup>41</sup> The foundation for the non-dischargeable nature of a PACA debt is found in the Bankruptcy Code: An individual debtor is not discharged from any debt incurred

---

<sup>36</sup> 7 C.F.R. § 46.2(ff) (1997).

<sup>37</sup> Dissipation is defined in 7 C.F.R. § 46.46(2) (1997) as any act or failure to act that could result in the diversion of trust assets or prejudice or impair the ability of unpaid suppliers, sellers, or agents to recover money owed in connection with produce transactions.

<sup>38</sup> *Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703, 706 (E.D. Pa. 1994).

<sup>39</sup> *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 282 (9th Cir. 1997).

<sup>40</sup> 7 U.S.C. § 499h (b)(3) (1997). See also *Farley and Calfee, Inc. v. U.S. Dept. of Agric.*, 941 F.2d 964, 968 (9th Cir. 1991) (upholding the strict employment bar as consistent with legislative history to prevent circumvention of PACA).

<sup>41</sup> *Strube Celery & Vegetable Co. v. Zois (In re Zois)*, 201 B.R. 501, 507 (Bankr. N.D. Ill. 1996); see also *Quaif v. Johnson* 4 F.3d 950, 955 (11th Cir. 1993); *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473, 475 (Bankr. D. Md. 1995); *Nuchief Sales, Inc. v. Harper (In re Maddox Harper)*, 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993); *Tom Lange, Inc. v. Stout (In re Stout)*, 123 B.R. 412, 415 (Bankr. W.D. Okla. 1990); but see *Six L's Packing Co. v. Arter*, No. 88-1998, 1991 U.S. Dist. LEXIS 407 at \*17 (E.D. Pa. Jan.16, 1991).

for defalcation<sup>42</sup> while acting in a fiduciary capacity.<sup>43</sup> Significantly, the court in *Nuchief Sales, Inc. v. Harper* held that defalcation within the bankruptcy context encompasses the misappropriation of trust funds held in any fiduciary capacity and the failure to properly account for such funds.<sup>44</sup> The court concluded:

[Defendants] had a fiduciary duty to hold the produce received from plaintiffs and any accounts receivable or proceeds derived from their sale in trust for the plaintiffs. Because neither the produce, the accounts receivable, nor the proceeds of produce are now available to satisfy the plaintiffs' unpaid claims, and because there has been a failure to properly account for the funds, [defendant] is guilty of defalcation . . . . [T]he defendant's defalcation is non-dischargeable.<sup>45</sup>

Thus, defalcation does not require intent to defraud.

## II. THE BONA FIDE PURCHASER DEFENSE

### A. *Elements of the Bona Fide Purchaser Defense*

A lender who has received trust funds from a produce buyer, and who is then sued by the unpaid seller upon an allegation of receiving such funds in violation of the PACA trust, may assert the bona fide purchaser defense. To successfully argue such a defense, and thus be able to keep the funds, the lender must prove the funds were for value and received without notice of the breach of trust.<sup>46</sup> As to the for value element, the general rule is that if the trustee transfers produce or other trust property in consideration of the extinguishment of a pre-existing debt, the transfer is not for value.<sup>47</sup> For instance, a lender who accepted produce as payment of a debt could not assert the bona fide purchaser defense. However, the transfer is for value if the trustee transfers money in consideration of extinguishing an existent debt.<sup>48</sup> It has been well-established in PACA trust litigation that payment of money to a lender from the produce buyer, for an already owed debt,

---

<sup>42</sup> Defalcation is defined in BLACK'S LAW DICTIONARY 343 (6th ed. 1990) as follows: "For purposes of the Bankruptcy Code, . . . defalcation . . . is failure to meet an obligation, misappropriation of trust funds or money held in any fiduciary capacity, and failure to properly account for such funds."

<sup>43</sup> 11 U.S.C. § 523(a)(4) (1997).

<sup>44</sup> *Nuchief Sales, Inc. v. Harper* (*In re Maddox Harper*), 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993).

<sup>45</sup> *Id.*

<sup>46</sup> RESTATEMENT (SECOND) OF TRUSTS § 284 (1959).

<sup>47</sup> RESTATEMENT (SECOND) OF TRUSTS § 304 (1959).

<sup>48</sup> *Id.*

is considered for value.<sup>49</sup>

However, there is conflicting case law interpreting the meaning of knowledge of a breach of trust by the lender. As is detailed below, the focus of the inquiry is whether or not to impute knowledge. Similar factual contexts have led to widely varying results. The foundational premise of the following cases presumes a transfer of money to the lender for value and in breach of the PACA trust.

### *B. Case Law Interpretation Of Knowledge Of Breach Of Trust*

#### 1. Courts Declining To Impute Knowledge

A duty of inquiry on the part of a lender has been the benchmark in several decisions as a determinant of knowledge of breach of the PACA trust by a lender.<sup>50</sup> The duty of inquiry as it relates to general trust theory is defined as follows:

A third person has notice of a breach of trust not only when he knows of the breach, but also when he 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 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.<sup>51</sup>

The court in *Consumer Produce Co., Inc. v. Volante Wholesale Produce* found that, in the PACA context, "a duty of inquiry arises when a third party transferee has knowledge that a produce purchaser/trustee is not paying suppliers or is in financial difficulty."<sup>52</sup> In that case, the lender was held to have constructive knowledge of the PACA trust, and was also aware that the debtor was a produce wholesaler whose principal business was the purchase and resale of produce on credit.<sup>53</sup>

---

<sup>49</sup> *Chiquita Brands, Inc. v. Micbruce, Inc.*, 800 F. Supp. 1521, 1525 (N.D. Ohio 1992); *Larry Sheppard v. K.B. Fruit & Vegetable, Inc.*, No. 91-6624, 1993 U.S. Dist. LEXIS 1933, at \*6 (E.D. Pa. Jan. 12, 1993); *C.H. Robinson Co. v. Trust Co. Bank*, 952 F.2d 1311, 1313 (11th Cir. 1992); *But see A & J Produce Corp. v. CIT Group Factoring, Inc.*, 829 F. Supp. 651, 656 (S.D. N.Y. 1993) (holding transfers of trust property such as accounts receivable are not for value).

<sup>50</sup> *Battle v. Fresh Preps Distrib., Inc.*, 873 F. Supp. 1062, 1067 (E.D. Mich. 1995); *Consumers Produce Co. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1383 (3d Cir. 1994); *C.H. Robinson Co. v. B.H. Produce, Inc.*, 723 F. Supp. 785, 792 (N.D. Ga. 1989).

<sup>51</sup> RESTATEMENT (SECOND) OF TRUSTS § 297 cmt. a (1959).

<sup>52</sup> *Consumers Produce Co. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1383 (3d Cir. 1994).

<sup>53</sup> *Id.*

However, the debtor failed to advise the lender of its financial difficulties and the resulting nonpayment of its suppliers.<sup>54</sup> Thus, the court concluded the duty of inquiry never arose and did not require disgorgement of the funds paid in violation of the PACA trust.<sup>55</sup>

The court in *C.H. Robinson Company v. Trust Company Bank* similarly premised its finding of bona fide purchaser status of a lender based upon the distinction between knowledge of the PACA trust versus knowledge of breach of trust.<sup>56</sup> The *Robinson* court reasoned that, in the bankruptcy context, lenders have constructive knowledge of the priority status of unpaid trust beneficiaries "in much the same way that a second mortgagee is charged with constructive knowledge of a properly recorded first mortgage even if the second mortgagee lacked actual knowledge of the prior mortgage."<sup>57</sup> Yet the court distinguished the constructive knowledge requirement as it relates to the bona fide purchaser defense, invoking the duty to inquire as the measuring standard.<sup>58</sup> In requiring this higher standard, the court stated that, in the absence of specific instructions to the contrary, Congress must have intended PACA to operate according to traditional trust principles and "strict liability" of lenders would transcend such notions.<sup>59</sup>

The bona fide purchaser defense was also successfully asserted in *C.H. Robinson Company v. B.H. Produce Company, Inc.*<sup>60</sup> The court, relying on "ordinary" trust principles, found it was insufficient to impute knowledge of a trust where the only showing is that money could be the proceeds of the sale of trust property.<sup>61</sup> Knowledge of the breach of trust would be properly imputed only if "from facts known to the bank about the affairs of its customers there is a *high probability* that all or part of the funds must have come from the proceeds of the sales of property in which a trust was perfected."<sup>62</sup>

---

<sup>54</sup> *Id.* at 1384.

<sup>55</sup> *Id.* at 1385; *see also* *Battle v. Fresh Preps Distrib., Inc.*, 873 F. Supp. 1062, 1068 (E.D. Mich. 1995) (finding no breach of the duty of inquiry when debtor failed to respond to requests by the lender to provide financial information).

<sup>56</sup> *C.H. Robinson Co. v. Trust Co. Bank*, 952 F.2d 1311, 1314 (11th Cir. 1992).

<sup>57</sup> *Id.* at 1315.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 1316.

<sup>60</sup> *C.H. Robinson Co. v. B.H. Produce Co.*, 723 F. Supp. 785, 798 (N.D. Ga. 1989).

<sup>61</sup> *Id.* at 793.

<sup>62</sup> *Id.* (emphasis added).

## 2. Case Law Imputing Knowledge

Although factually applying similar criteria as the courts above, namely actual or constructive knowledge of breach of the PACA trust, some courts have imputed knowledge based on factors other than a strictly construed duty of inquiry by the third-party creditor. In *In re Richmond Produce Co., Inc.*, the defendant bank asserted ignorance of the PACA trust as a defense.<sup>63</sup> The court emphasized that the bank knew the debtor was engaged in the sale of perishable agricultural commodities and knew the monies received resulted from the sale of such commodities.<sup>64</sup> The court concluded that the bank was not a bona fide purchaser and must refund the monies received to the unpaid seller:

[T]he only factual defense advanced by the Bank is its ignorance of the existence of PACA. It is clear, however, that the statutory scheme would be defeated if mere ignorance of the existence of PACA were sufficient to defeat the trust rights of the claimants protected thereunder, and the court holds that this is not a valid defense.<sup>65</sup>

If the standards of *In re Richmond Produce Co., Inc.* were applied to the cases above when bona fide purchaser status was successfully asserted, it is apparent the results would have been different. All lenders would have been found to know that the debtor dealt in perishable goods and the funds received represented proceeds from those goods. Such knowledge would have prohibited the assertion of the bona fide purchaser defense.

The court in *E. Armata, Inc. v. Platinum Funding Corp.* imputed knowledge upon similar findings.<sup>66</sup> The court reasoned that because the PACA trust was created by federal statute, the defendant had constructive knowledge of the trust.<sup>67</sup> Moreover, the defendant knew the underlying transactions of the debtor involved the food industry, specifically perishable agricultural commodities.<sup>68</sup> That information was sufficient to put defendant on notice that a breach of trust could have occurred,<sup>69</sup> and thus the bona fide purchaser defense failed.

---

<sup>63</sup> *Debruyne Produce Co. v. Richmond Produce Co. (In re Richmond Produce Co.)* 112 B.R. 364, 376 (Bankr. N.D. Cal. 1990).

<sup>64</sup> *Id.* at 378.

<sup>65</sup> *Id.*

<sup>66</sup> *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F. Supp. 590, 594 (S.D. N.Y. 1995).

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

## III. RECOMMENDATIONS

The provisions of the PACA trust afford the unpaid seller a powerful means of recovery to ensure the public of a constant supply of perishable agricultural commodities. When a produce buyer fails to use proceeds to pay the seller, it is highly likely that such a buyer, often on the brink of insolvency, will also owe lenders for past debts. Failure to impute constructive knowledge of the breach of a statutory trust such as PACA, when such lenders have received funds at the expense of the seller, circumvents the foundational basis of prioritizing the unpaid seller above all others. The PACA trust provisions are silent in reference to third-party creditors of the produce purchaser. However, legislative history reveals that Congress contemplated the impact of PACA upon lenders:

The Committee believes that the statutory trust requirements will not be a burden 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 for under the Act will protect the interests of the borrower, the money lender, and the fruit and vegetable industry. Prompt payment should generate trade confidence and new business which yields increased cash and receivables, the prime security factors to the money lender.<sup>70</sup>

Although the plain language and legislative intent of PACA would support an implication that the bona fide purchaser defense should be inapplicable, many courts, as noted above, have allowed the successful assertion of the defense. There is, however, a means that would guarantee the imputation of knowledge to the lender and effectively eliminate the bona fide purchaser defense: a public registry.

To contemplate the creation of a public registry, it is useful to note the historical development of how notice of breach of the PACA trust was achieved by the unpaid seller. When PACA was amended in 1984 to include the trust provisions,<sup>71</sup> the seller had to take specific steps for trust protection: "The unpaid supplier, seller, or agent shall lose the benefits of such trust unless such person has given written notice of intent to preserve the benefits of the trust to the commission merchant, dealer, or broker and has filed such notice with the Secretary . . . ."<sup>72</sup> The annual licensing fees funded the cost incurred by the

---

<sup>70</sup> H.R. REP. NO. 543, 98th Cong., 1st Sess. 3 (1983) (emphasis added), *reprinted in* 1984 U.S.C.C.A.N. 405, 407.

<sup>71</sup> 7 U.S.C. § 499e(c) (1997).

<sup>72</sup> 7 U.S.C. § 499e(c)(3), *amended by* 7 U.S.C. § 499e(c)(3) and (c)(4) (1997).

Department of Agriculture for processing suppliers' notices to the Secretary of Agriculture.<sup>73</sup> In 1995, PACA was again amended to reflect new options for notice requirements. The unpaid seller has the choice of either giving the purchaser written notice of intent to preserve the benefits of the PACA trust,<sup>74</sup> or including the following statement on the invoice:

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.<sup>75</sup>

Notice to the Department of Agriculture and the resultant administrative expense was, therefore, completely eliminated.

The infrastructure needed to process notice remains in place. There is a national administrative office, as well as a number of regional offices around the country.<sup>76</sup> Moreover, the United States Department of Agriculture has a web page on the Internet.<sup>77</sup> Current notice options as to the debtor should remain intact, while notice to the PACA regional offices upon default by the produce buyer should be reinstated. As long as the unpaid produce seller properly filed notice with PACA in accordance with statutorily set time limits, the seller would be protected under the PACA trust. However, such notice should be a matter of public record. The public should be able to access all notices of default filed at regional PACA offices, as well as have the ability to view the notices of default by way of the Internet. Although such a system would require additional funds to maintain, it is likely that licensees would be willing to pay a slightly increased yearly fee to safeguard their protection under the PACA trust.

#### CONCLUSION

The PACA trust provisions effectively prioritize the unpaid seller of produce under most circumstances, ensuring the continued availability

---

<sup>73</sup> H.R. REP. NO. 543, 98th Cong., 1st Sess. 3(1983), *reprinted in* 1984 U.S.C.C.A.N. 405, 417-418.

<sup>74</sup> 7 U.S.C. § 499e(c)(3) (1997).

<sup>75</sup> 7 U.S.C. § 499e(c)(4) (1997).

<sup>76</sup> The national administrative office is located at the following address: National Administrative Office, Fruit & Vegetable Division, AMS, U.S. Department of Agriculture, P.O. Box 96456, Room 2095 S, Washington, D.C., 20090-6456.

<sup>77</sup> <[Http://www.USDA.gov](http://www.USDA.gov)>.

of perishable commodities across the country. However, the bona fide purchaser defense erodes the function of the PACA trust by allowing third-party creditors to retain monies paid in violation of the trust.

Implementation of a public registry is analogous to the use of deed recordation and financing statement filings in real and personal property security transactions. Thus, just as recorded notice functions in real property, and Article Nine of the Uniform Commercial Code<sup>78</sup> functions in personal property, a public registry means that all will be deemed by law to have constructive notice. The complete elimination of the bona fide purchaser defense is an integral aspect of such a system: No one could ever take money in violation of the trust without imputed knowledge. The public registry is a viable, economical way to prohibit the assertion of the bona fide purchaser defense, strengthening the power of the PACA trust.

MICHELLE G. OLEKSA

---

<sup>78</sup> U.C.C. § 9-401 (1996).