

PACA LAW 101 MEMO

To: All Sellers of Fresh or Frozen Produce

From: Michael J. Keaton, Esq.

Re: Suggestions for New Invoices & Collection Practices
to Maximize Benefits under the PACA Trust

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I. THE "PAPERLESS" TRUST SYSTEM

The 1995 Amendments changed several requirements under the Perishable Agricultural Commodities Act ("PACA") but left many others the same. The main difference is obviously the creation of the so-called "paperless trust", or the ability of those shippers who hold a USDA license to have their invoices serve as the trust notice. If the supplier does not have a PACA license, the foreign or domestic supplier must preserve its trust rights the "old way" by sending a trust notice in addition to the invoice and, thus, the non-licensee cannot benefit from the Amendments in this regard. Essentially, the Amendments reflect a Congressionally approved incentive for produce companies to submit to the USDA's jurisdiction and, of course, pay the license fee.

The primary reason for removing the notice filing requirement was to save time and eliminate the USDA's expense in processing trust notices and in administrating this provision. Therefore, in cases of bankruptcy or insolvency, the USDA will no longer acknowledge receipt of trust notices or provide an opinion as to the amount qualified for trust protection, for any trust notice received after November 15, 1995. In order to ensure compliance with the regulations governing the PACA trust, each invoice must contain the following language exactly as it appears in the statute:

The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by Section 5c 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.

No language other than this will be acceptable as complying with the statutory requirements. While the issue of "substantial compliance" (ie: paraphrasing this language) has yet to be tested, the statute does quote the above language as the "approved" statement and there are several cases requiring strict compliance with the PACA for preservation of trust rights. Accordingly, there is no need to risk non-compliance when the preferred language is set forth in the statute for all to use. Additionally, this language should be prominently displayed on the front of the invoice, preferably in bold large letters. In keeping with prior practice, each invoice should include sufficient detail to identify the transaction subject to the trust including:

- names and addresses of the seller and the debtor;
- date of the transaction;
- commodity sold;
- contract terms (*i.e.*, *F.O.B.*, *consignment*, *etc.*);
- invoice price;
- the date payment is due, and;
- the amount due.

Because each invoice now serves as your trust notice, be sure to serve a copy of each invoice on the debtor within 30 days of either the payment due date or the date of receipt of notice of any check being dishonored. In the latter instance, the new invoice/trust notice should be generated and sent to the debtor within thirty (30) days of being notified of the check being dishonored.

II. PAYMENT TERM AGREEMENTS

If the payment terms are different from those specified under PACA's prompt pay regulations (*i.e.* *ten days net for an F.O.B. sale*), the agreement must be in writing, entered into prior to the transaction, and the terms must be reflected on the invoice and all other billing documents. **Merely including the term on your invoice does not satisfy this requirement.** The agreed payment terms cannot exceed 30 days from the date of acceptance of the transaction for an F.O.B. sale.

If at all practical from a business perspective, you should consider revoking all prior "terms agreements" which allow debtors to pay beyond ten (10) days. This way, you can never be caught in one of two situations that can lead to a loss of your PACA trust rights:

- 1) where an invoice reflects terms of more than 10 days and you have no written agreement to go beyond 10 days; or

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- 2) where there is an inconsistency between your documents (ie. the terms agreement says 30 days and your invoice is either silent or states terms other than 30 days - both must match exactly).

Under the USDA regulations, you can keep the "paper" saying 10 days and have oral agreements not to consider any invoice past due until the longer credit period has expired. Under the current USDA regulations, these oral agreements are unenforceable and the account debtor or, more often - the debtor's Bank, cannot rely upon such oral agreements to say the terms were anything other than the written ten (10) days. This way, we can greatly reduce the chance of an inconsistency in your documents that may destroy your trust rights. The bottom line is credit terms of 10 days greatly reduces the amount of paperwork necessary to preserve your trust rights and, thereby, significantly improves your chances of a full recovery on any outstanding account balance.

III. INVOICING PROCEDURES

Although we are pleased that obtaining trust protection may be easier with the passage of the 1995 amendments, Congress failed to address one key issue. Under the "old way", the issue of whether the debtor actually received the trust notice led to a great deal of litigation and expense. This litigation occurred when a debtor alleged it did not receive a copy of the trust notice by mail or other means and where the creditor had no proof of delivery except the live testimony of company personnel. Unfortunately, this same scenario has been occurring under the new system wherein a debtor will claim it did not receive the invoice/trust notice, and where the only proof of delivery will be live testimony regarding the business's ordinary billing practices. Although this has proven to be effective, please carefully evaluate the receivables nearing the thirty (30) day filing deadline. For these receivables, you should consider re-serving your invoice on the debtor using a method that you can prove the debtor received it. This will allow you to prove receipt through documents (ie: copy of fax confirmation or FedEx receipt) rather than through expensive live testimony about how you mailed it.

In a perfect world, from a trust claim enforcement perspective, each and every invoice would be sent to the debtor in a way that we have a document which serves as the "proof of delivery." We can greatly reduce your legal fees in any trust enforcement action by having more unambiguous documentation to support the claim and less live testimony about who sent what and when. When the documents "speak for themselves", the debtor's counsel either gives in right away or we obtain a summary judgment at a fraction of the cost of a contested court battle or a full-blown trial. The trick in this regard is to not nullify the 1995 Amendments by replacing one paperwork-intensive administrative burden with another.

If, in the opinion of your credit personnel, the buyer's credit standing is questionable, or if they have misgivings about receiving payment, they should re-send each invoice to the debtor via fax, and keep a copy of the transmission record and the cover sheet as a proof of service on the debtor. The fax cover should clearly indicate the contents of the transmission by including language like: "**Attached are copies of unpaid invoices approaching 30 days past due for which we hereby preserve our rights under the PACA trust**". While it would be nice to have written proof of delivery and receipt on each late invoice, you need to decide how much follow-up can be done without needlessly increasing the office work load. In particular, we strongly advise a fax follow-up on questionable accounts (ie: customers who have recently changed ownership, those currently experiencing downward fluctuations in their credit ratings, those who have factored or assigned their accounts receivable, etc.).

IV. INTEREST AND ATTORNEYS' FEES

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While the primary concern is to make sure your trust claims are properly preserved, another issue to consider is the amount which can be claimed under the trust and any reparation actions. The USDA and many courts are allowing interest and collection costs, including attorneys' fees, to be recovered from the Debtor as part of your trust claim - but only if this provision is made a part of the transaction itself. Also, it will help to reduce the chances of a damage dispute arising if you limit the time for such claims. Along these lines, please consider including the following provisions on the face of your new invoices:

- ***Interest shall accrue on any past-due account balance at the rate of 1.5% per month (18% per annum).***
- ***Buyer agrees to pay all costs of collection, including attorneys' fees.***
- No claims for credits or adjustments can be considered unless the problem is reported in writing to Seller within eight (8) hours of receipt of the product along with the written USDA inspection results.

** The first two (2) provisions recently allowed ***Keaton & Associates, P.C.*** to win a favorable decision for our grower/shipper client, thereby allowing it to recover its attorneys' fees and interest from the debtor ***in addition to*** the invoice costs of the produce. This ***landmark ruling*** from the 9th Circuit Court of Appeals in California is entitled ***Middle Mountain Land & Produce, Inc. v. Sound Commodities***, 307 F.3d 1220 (9th Cir. 2002). In that ruling (a copy is enclosed), the Appeals Court stated "Congress wrote the statute broadly to include not only the value of commodities sold but also the expenses in connection with the sale of [Produce] when it drafted the statute. It did not limit the claim to [Produce] alone... A fair reading of the statute brings contractually due attorneys' fees and interest within the scope of the statute's protection of 'full payment owing in connection with the [produce] transaction.'" As you might expect, this was a ***huge win for the supply side of this industry*** and confirmed a position this firm has taken in every case, without exception. Many PACA lawyers will advise you to put these provisions on your invoices, then not ask for these "extras" in Court. In fact, some of these other lawyers actually spend their clients' money fighting ***against*** PACA coverage of interest and collection costs. If you put this language on your invoices, our firm will always fight to get your entire claim paid, not just a portion of it.

V. OTHER KEY CHANGES TO THE PACA

- In order to proceed under the Shortened Rules of Procedure, a USDA reparation complaint may now seek up to \$30,000.00 rather than the previous \$15,000.00 limit. Thus, all complaints for \$30,000.00 or less will be decided without an oral hearing.
- The filing fees of \$60.00 and \$300.00 for informal and formal complaints, respectively, are now permanent requirements.
- In a reparation action, the complainant will automatically be awarded the \$300.00 filing fee as

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damages if it prevails.

- The new amendments include a change in the unfair practices section to allow payment of collateral fees and expenses including promotional allowances, rebates, etc. However, the payments must be disclosed on invoices, etc. in order to comply with the PACA full disclosure requirements.

VI. COLLECTION STRATEGY & TRUST CLAIM ENFORCEMENT

In selecting the best way to proceed against a past due account, ask yourself one question - why is this account not paying? The answer to this question will determine whether you should go with a USDA complaint or act to privately enforce your PACA trust rights. The challenge here is to know when to use each method so you don't end up having to pay for both to get your money out of the Debtor.

A) USDA COMPLAINT

If the Debtor is not paying because he has plenty of money but believes none of it is yours, then by all means, your regional USDA office is the place to go. An informal or formal complaint is cheap and is usually a very effective way of getting a delinquent buyer to pay you, if that buyer is still concerned with its credit rating or license standing. However, the only satisfaction this procedure has to offer is the entry of a reparation award in your favor. This piece of paper tells the Debtor - "pay this amount within 30 days or your license will be suspended." If the Debtor does not pay, the USDA has no other way to force him to pay you. Accordingly, this is a relatively passive action which only works if two essential factors are present - (1) the Debtor actually has all of the money he owes you in readily-available cash, and (2) he really cares if his license is suspended. By the time most Debtors are past due to a valued supplier, there is not enough cash to go around to pay all suppliers and some unpaid creditors (like you) need to be shorted or flat-out ignored for the Debtor to make ends meet.

In such circumstances, the Debtor views the potential loss of his license as secondary to keeping food on the table and a roof over his head. The delays inherent in this process also provide the unscrupulous or truly desperate Debtors with ample time to hide the company's assets from what he knows will be the next step - a large creditor or his Bank deciding enough is enough and pulling the plug for good. From there, the Debtor's choices are to run and hide or file a bankruptcy petition. Once this happens, PACA will tell you there is nothing more they can do and that you are free to enforce your reparation award in federal court to recover the amounts to which they determined you are properly entitled. The problem is, by the time you get this far, the Debtor has likely burned through whatever cash he had, and sold or hidden whatever other assets he had, back on the date you first started the PACA action. Now you are faced with an uphill battle to recover these dissipated trust assets, if you can even find them.

B) PRIVATE ENFORCEMENT OF PACA TRUST RIGHTS

On the other hand, if the debtor is not paying timely because there is simply not enough money to go around at the end of the month, the earlier you move against him the better. The other way of saying this is - why close the barn door after the horses have left? In most instances, the lack of payment is due to the Debtor's insolvency and he begins to throw money (your money) at the wheel that squeaks the loudest. When the reason for the non-payment is insolvency, a PACA reparation order simply becomes another piece of paper telling the

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Debtor he owes you X amount of money. Your invoice already does that, but the Debtor is still not paying you.

In cases of non-payment because of insolvency, the Debtor generally has some money - just not enough to go around. He will continue to pay the landlord, because he can lock him out. He will continue to pay his labor, because they will not work for long without a check. He will continue to pay the Bank on any loans because they can foreclose on all his assets and, invariably, he will continue to pay himself and his other "insiders" a full salary. The only way to stop this leakage or "dissipation" of the PACA trust assets to non-trust creditors, which the law requires to wait in line behind you, is to enforce your trust rights in court. While initially more expensive than going to the USDA and filing a PACA complaint, the results are much more satisfying. You have the right to obtain a Court Order freezing the Debtor's accounts and all other assets until he pays you - ahead of all other creditors - including his landlord, the utility company and even his secured creditors or Bank.

By moving quickly, you can close the barn doors before the horses are gone. Upon entry of this Court Order, called a Temporary Restraining Order or "TRO", the Debtor's bank accounts are all frozen and every check the Debtor has on the way to someone other than you will bounce because the money in that account is frozen. By striking while the Debtor still has some cash and uncollected receivables, this action has the uncanny ability to capture the Debtor's immediate and undivided attention. He suddenly becomes very interested in taking your telephone calls and in reaching a prompt resolution of your unpaid balance so he can get his accounts unfrozen. In addition, with some slight modifications to your invoices, the costs of this private enforcement action can be added to your PACA trust claim so the Debtor is forced to reimburse you for all the legal expenses. See Section IV above.

VII. CONCLUSION

This information should assist you in determining how best to implement the new procedures allowed under the 1995 Amendments to the PACA and better protect your hard-fought produce receivables. To further assist you, we have enclosed a copy of both a sample payment term agreement and a sample revocation of existing agreements. In the event you decide terms of more than 10 days are a business necessity, be sure you have a written payment term agreement in the file for every customer. For obvious reasons, a counter-signed agreement is the best, but the key is to stay consistent. Having some signed and others not signed will only invite some cagey debtor's lawyer or shifty bank's lawyer to argue there was no "meeting of the minds" and thus, no agreement as to the 10+ day terms, thereby possibly disqualifying your trust claim..

At a minimum, these fact disputes will give a judge reason to pause and likely direct the parties to fully research and brief the issues on both sides. While the Debtor's attorneys and even other firms that handle a little bit of many types of cases may require extensive research to "get up to speed", we are always ready to go. Because our firm spends 100% of its time enforcing PACA trust claims for creditors only, we are always up to date on the most recent case law the Judge may need to decide an issue and have most likely already briefed and argued those issues in numerous other cases. In many situations, we are also able to identify a potential problem with sales documentation before it becomes a litigation problem, like when the Debtor or the competing creditors are seeking to disqualify your PACA trust claim.

Should you have any questions regarding these recommendations, or if you have any specific questions on an issue relating to credit or collections, please do not hesitate to call. We would be happy to help at no

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charge for an initial consultation. Please free to call us at 800/535-9949, fax us a note at 847/934-6508 or simply send me an e-mail at keaton@pacatrust.com. We will be happy to lay out your options at no cost. We look forward to be being able to help you.