FARMER FAVORITISM: STATUTORY PROTECTIONS FOR CREDITORS IN AGRICULTURAL BANKRUPTCY CASES

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I. INTRODUCTION

The last several years have been difficult for the agricultural industry. This is especially true in Texas, which has suffered through an historic drought.[1] Several years of adverse weather conditions and high costs of production have sown the seeds of bankruptcy filings in the industry.[2] As in any industry, a bankruptcy case involving agricultural production allows for the restructuring of debt and the modification of contractual relationships between the party filing bankruptcy (known as the "debtor") and that party's creditors.[3] Generally speaking, the federal statutes governing bankruptcy (the "Bankruptcy Code")[4] provide for a hierarchy of different classes of creditors. Creditors residing at the top of the list—such as secured creditors—are entitled to receive

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1. *See* Michael E. Young, *Continuing Texas Drought Puts Pressure on State's Water Supply*, DALLAS NEWS (Apr. 22, 2013), *available at* http://www.dallasnews.com/news/metro/20130422-continuing-texas-drought-puts-pressure-on-states-water-supply.ece (discussing the drought and quoting a climatologist comparing the current drought to "the devastating drought of the 1950s").

2. *See* Bill Franks & Nick Reister, *Harvesting a Better Understanding: Counsel Should Understand How Lending Is Different for Agriculture*, MICH. LAW. WEEKLY (Apr. 5, 2013), www.milawyersweekly.com/news/2013/04/05/harvesting-a-better-understanding-counsel-should-understand-how-lending-is-different-for-agriculture/ (noting the unique aspects of agricultural financing and warning that bankruptcy filings "may prove to be a cautionary agricultural lending tale"). The past several years have been especially difficult for dairies in particular. *See id.*; Catherine Merlo, *Fiscally Fit? Three Experts Share What Dairies Must Do to Survive*, DAIRY TODAY, Dec. 2012, at 7 (discussing the challenges facing dairies); Gosia Wozniacka, *California Dairies Strained by Feed, Milk Prices*, SAN JOSE MERCURY NEWS (Sept. 29, 2012), http://www.mercurynews.com/ ci_21661381/california-dairies-strained-by-feed-milk-prices# (reporting that, "[a]cross California, the nation's largest dairy state, dozens of dairy operators have filed for bankruptcy in recent months and many teeter on the edge of insolvency").

3. *See generally* Luis Salazar, *Too Rich for Bankruptcy: Some Pitfalls of Chapter 11 Filings by Individuals*, 9 J. BANKR. L. & PRAC. 527, 527 (July/Aug. 2000).

4. *See* 11 U.S.C. §§ 101–507 (2012).

payment of their claims prior to junior creditors—such as general unsecured creditors and equity interest holders. When the debtor is unable to pay creditors in full—which is very often the case—the classification of a claim can make the difference between a creditor getting paid or getting nothing.[5] This dynamic provides the basis for protracted disputes between the debtor and creditors, and between the creditors themselves, over how particular claims should be classified.

In agricultural industry bankruptcy cases, special interest legislation provides an additional layer of complication to the jockeying of creditors up and down the bankruptcy claim hierarchy.[6] For example, under normal circumstances, a creditor who properly perfected its security interest in collateral more than ninety days prior to the bankruptcy filing can take solace in the fact that it will be atop the creditor hierarchy, and therefore, will be able to recover on its claim in an amount not less than the value of the collateral.[7] In an agricultural industry case, the same creditor may not be entitled to similar protections if, for instance, the collateral is cash generated by the debtor from the sale of fresh produce.[8] Under the Perishable Agricultural Commodities Act (PACA), that cash may be held by the debtor in trust for the produce supplier, meaning that the produce supplier will be paid first.[9] The secured creditor will still have rights against the debtor pursuant to its security interest, but the creditor may not be paid in full if there is not enough money to pay the supplier in full first.[10] As a result, the secured creditor may lose considerable leverage that it would otherwise be able to apply in negotiations with the debtor during the bankruptcy case.[11]

This Article discusses federal and state statutes and related case law that potentially alter the typical dynamics between creditors and debtors in agricultural industry bankruptcy cases. Part One of the Article discusses bankruptcy law in general, including the identities of the principal parties in a bankruptcy case, the different chapters of bankruptcy, and the various types of claims and their priorities under the Bankruptcy Code.[12] Parts Two through Four describe and analyze trust fund statutes, PACA, the Packers and Stockyards Act (PSA),[13] and state agricultural statutes that purport to provide similar trust fund protections to claims arising from PACA and the PSA.[14] Parts Two through Four will also discuss how, in certain circumstances, those

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5. *See generally* 11 U.S.C. § 1123 (2012).
6. *See generally id.*
7. *See* Salazar, *supra* note 3, at 527–28.
8. *See* Jerald I. Ancel et al., *Cherries Packed in Brine: Pitfalls for Debtor's Counsel Under PACA*, 25 AM. BANKR. INST. J. 46, 46–48 (July/Aug. 2006).
9. 7 U.S.C. § 499a (2012).
10. *Id.*
11. *Id.*
12. *See infra* Part One.
13. 7 U.S.C. § 181 *et seq.* (2012).
14. *See infra* Parts Two–Four.

statutes allow claimants to upend the claim hierarchy and get paid first, and how courts have dealt with conflicts between the policy goals of protecting certain classes of creditors, and the policy goals of the Bankruptcy Code.[15] Part Five then discusses the Food Security Act (FSA)[16] and its effect on the bankruptcy claim hierarchy.[17] Part Five specifically addresses how secured lenders may attempt to preserve a first lien on farm products purchased in the ordinary course of business, and how failure to do so may eliminate their claims against the purchaser of the underlying collateral.[18]

II. PART ONE: BANKRUPTCY AND CLAIM CLASSIFICATION

A. Bankruptcy Basics

In the United States, bankruptcy is governed by the Bankruptcy Code, which is codified in Title 11 of the United States Code.[19] A basic understanding of bankruptcy requires familiarity with terms commonly used both in bankruptcy practice and throughout this Article. A debtor initiates a bankruptcy case by filing a petition.[20] The petition is a simple form document with only basic information relating to the debtor.[21] If the debtor is a company seeking to reorganize its debt—as opposed to liquidating its assets—by default, the debtor's management will continue to operate the business and the debtor will be known as a "debtor-in-possession."[22] The date the petition is filed is known as the "petition date."[23] The petition date is important for several reasons. First, as discussed below, claims are treated differently under the Bankruptcy Code depending on whether such claims arose before or after the petition date.[24] This distinction gives rise to the use of the terms "prepetition" and "postpetition" to distinguish between the two time periods.[25] Second, the "automatic stay" goes into effect immediately upon the filing of the petition.[26]

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15. *See infra* Parts Two–Four.
16. 7 U.S.C. § 1631 *et seq.* (2012).
17. *See infra* Part Five.
18. *See id.*
19. *See generally* 11 U.S.C. § 101 *et seq.* (2012).
20. 11 U.S.C. § 301(a) (2012) ("A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.").
21. UNITED STATES BANKRUPTCY COURT VOLUNTARY PETITION (Apr. 2013), *available at* www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Forms_Current/B_001.pdf.
22. 11 U.S.C. § 1107 (2012).
23. *See generally* 11 U.S.C. § 101.
24. *See generally* 11 U.S.C. §§ 1101–16 (2012).
25. *See id.*
26. *See* 11 U.S.C. § 362 (2012).

The automatic stay is a global injunction prohibiting creditors from taking or furthering any action to collect a prepetition debt.[27]

In addition to the debtor, several other entities are commonly found in bankruptcy cases. A debtor is also known under the Bankruptcy Code as a "trustee,"[28] in reference to the fact that debtors have fiduciary duties to all creditors. The word "trustee" can also refer to the United States Trustee, who is responsible for a number of different tasks generally associated with the supervision and administration of bankruptcy cases;[29] to a Chapter 7 trustee tasked with liquidating assets;[30] or to a party appointed to supplant the debtor-in-possession and run the business in a reorganization case.[31] Another common party in interest is the Official Committee of Unsecured Creditors, usually known simply as "the Committee."[32] The Committee is appointed by the United States Trustee and usually consists of five to seven unsecured creditors who speak for and act on behalf of all unsecured creditors.[33]

There are several different types of bankruptcy, as set forth in separate chapters of the Bankruptcy Code. A Chapter 7 case is designed for the liquidation of assets.[34] Both individuals and companies may file under Chapter 7.[35] Upon the filing of a Chapter 7 case, a trustee is appointed to take possession of, and to liquidate, all estate assets.[36] In the case of an individual, the Chapter 7 process involves the Chapter 7 trustee liquidating all non-exempt assets and paying the proceeds to creditors in order of priority under the Bankruptcy Code.[37] In individual Chapter 7 cases, the debtor ultimately receives a discharge, preventing creditors from seeking to collect on the prepetition debts.[38] In the case of a company, the Chapter 7 trustee shuts down the business immediately or soon after the petition date, and liquidates the company's assets for the benefit of creditors.[39]

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27. *Id.* § 362(a). While the automatic stay goes into effect automatically—meaning that no separate court order is required—the Bankruptcy Code provides an extensive list of exceptions to the automatic stay. *See id.* § 362(b).

28. *See, e.g.*, 11 U.S.C. § 365(a) (2012) (referring to when a "trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor").

29. *See* 28 U.S.C. § 586 (2012) (listing the responsibilities of the United States Trustee).

30. 11 U.S.C. § 704 (2012).

31. 11 U.S.C. § 1104 (2012).

32. *See* 11 U.S.C. § 1102(a) (2012).

33. *Id.*

34. *See, e.g.*, 11 U.S.C. § 704(a) (listing the trustee's duty to take control of and liquidate assets).

35. *See id.* § 704(b)(i).

36. *See id.* (listing the duties of a Chapter 7 trustee).

37. *See* 11 U.S.C. § 726 (2012).

38. 11 U.S.C. § 727 (2012). Providing individuals with a discharge, thereby relieving them of their obligation to pay prepetition debts, is sometimes known as the "fresh start" provision. *See id.* Companies are not entitled to such a discharge. *See id.*

39. *See* 11 U.S.C. § 704. Chapter 7 allows the trustee "to operate the business of [a] debtor for a limited period, if such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate." 11 U.S.C. § 721 (2012).

The reorganization chapters of the Bankruptcy Code are Chapters 9, 11, 12, and 13.[40] Each of these chapters involves the process of filing a plan with the Bankruptcy Court whereby contractual obligations between the debtor and creditors are altered, and creditors' claims are paid out over time.[41] Chapter 9 provides for reorganization of municipalities.[42] Chapter 11 cases generally involve companies, although individuals may also seek relief under Chapter 11.[43] Chapter 13 is exclusively for individuals and allows for qualified debtors to put forth a plan to pay creditors over time.[44] Finally, Chapter 12 is reserved for family farmers and family fishermen.[45] The Bankruptcy Code defines the terms "family farmer" and "family fisherman" for the purpose of determining if parties are eligible for Chapter 12 relief.[46] The terms can refer to either an individual or a company.[47] Generally speaking, for a party to qualify as a family farmer, it must have aggregate debts of less than $4,031,575, the majority of which must relate to farming activities.[48]

While this Article discusses agricultural issues in bankruptcy, a large portion of the relevant case law arises from Chapter 7 and Chapter 11 cases, rather than Chapter 12 cases.[49] Most likely, the principal reason for this is that the debt limitation in Chapter 12 results in fewer cases in which the parties have the economic incentive and wherewithal to litigate the matters covered in this Article.[50] That said, a discussion of Chapter 12 case law is included when applicable.[51] In addition, while there are a number of substantive differences between Chapter 11 and Chapter 12, the matters discussed in this Article do not implicate those differences. In other words, courts apply the claim priority issues discussed in this Article in the same manner under Chapters 7, 11, or 12.[52]

B. Types of Claims and the Absolute Priority Rule

In almost every bankruptcy case, there are insufficient non-exempt estate assets to satisfy all creditors. It follows, therefore, that the claims of some creditors will not be paid in full. Whether a creditor is paid in full, paid in pennies on the dollar, or not paid at all depends largely on what type of claim

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40. *See* 11 U.S.C. §§ 921 (2012), 1121 (2012), 1221 (2012), 1321 (2012).
41. *See* 11 U.S.C. §§ 921, 1121, 1221, 1321.
42. *See* 11 U.S.C. § 921.
43. *See* Salazar, *supra* note 3, at 527.
44. *See* 11 U.S.C. § 1322 (2012).
45. *See* 11 U.S.C. § 1221.
46. 11 U.S.C. § 101(18)–(19) (2012).
47. *Id.*
48. *See id.* § 101(18). Note that the $4,031,575 ceiling is tied to the Consumer Price Index and is adjusted every three years. *See* 11 U.S.C. § 104 (2012).
49. *See infra* Part Three, Section C and Part Four.
50. *See* 11 U.S.C. § 101(18).
51. *See infra* Part One, Section C.
52. *See infra* Part One, Section C; Part Three, Section C; and Part Four.

the creditor has. As discussed in Part One, claim payments are made according to a hierarchy of claim types established under the Bankruptcy Code.[53] Payments are applied pursuant to the "absolute priority rule," a fundamental tenet of bankruptcy law.[54] The absolute priority rule provides that all creditors holding a claim of a type higher up the claim hierarchy must be paid before any creditor holding a claim of a type lower on the hierarchy is paid anything.[55] This process is commonly referred to as the "waterfall" of claims. That is, the waterfall of payments must completely fill the coffers of senior claim holders before any payments flow down to the next lower level.[56]

At the top of the claim hierarchy are claims secured by collateral that were properly perfected as of the petition date.[57] The Bankruptcy Code provides that such claims must be paid up to the value of the collateral.[58] If, however, an alleged secured claim was not perfected on the petition date, a debtor or trustee may be able to avoid any alleged lien,[59] thus sending the creditor tumbling down the hierarchy to join unsecured creditors.

Next on the claim hierarchy are administrative expense claims.[60] These are claims generated for the administration of a bankruptcy case, such as professional fees.[61] Postpetition debts incurred by a debtor are also typically provided with administrative expense claim priority.[62] Administrative expense claims must be paid in full upon confirmation of a plan of reorganization.[63] In addition, debtors frequently pay postpetition debts in the ordinary course of business during the pendency of the case and prior to the plan process.[64] If an estate is not able to pay these types of claims, the estate is deemed administratively insolvent, and cause exists to convert a reorganization to a Chapter 7 liquidation case.[65]

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53. *See supra* Part One.

54. *See* 11 U.S.C. § 1129(b)(2) (2012).

55. *See* Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 115–16 (1939), *superseded by statute as stated in* Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 95 F.2d 1274 (5th Cir. 1991) (citing Louisville, N.A. & C. Ry. Co. v. Louisville Trust Co., 174 U.S. 552 (1899)). The absolute priority rule predates the modern Bankruptcy Code. *Id.* In *Case v. Los Angeles Lumber Products Co.*, the Supreme Court referred back to *Louisville Trust Co.* in applying the principle. More recently, the Supreme Court recognized the application of the absolute priority rule under the Bankruptcy Code. Bank of Am. Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 442 (1999).

56. *See* 11 U.S.C. § 1129(b)(2).

57. *Id.*

58. *See* 11 U.S.C. § 506(a)(1) (2012) (providing that a creditor's claim is secured up to the value of the underlying collateral); *see also* 11 U.S.C. § 1129(b)(2)(A) (discussing how secured claims must be treated in a plan of reorganization). Generally speaking, secured creditors are not entitled to full payment for the amount of their claim in excess of the collateral's value. *See* 11 U.S.C. § 506.

59. *See* 11 U.S.C. § 544(a) (2012). The ability to avoid liens is commonly referred to as the "strong arm" power. *See generally id.* (providing that a trustee may act as a lien creditor).

60. *See* 11 U.S.C. § 503(b)(2) (2012).

61. *Id.*

62. *See id.*; 11 U.S.C. § 1112 (2012).

63. *See* 11 U.S.C. § 1129(a)(9).

64. *See* 11 U.S.C. § 503.

65. *See* 11 U.S.C. § 1112(b)(4)(A).

Immediately junior to administrative expense claims are priority claims.[66] Priority claims are unsecured claims that Congress has decided should be paid prior to payment of other types of unsecured claims.[67] These include certain wage claims payable to the debtor's employees, certain taxes, and claims payable for public policy reasons, such as domestic support obligations and personal injury claims arising from the debtor's intoxication.[68] Unsecured claims that do not fall into any of the defined classes of priority claims are known as "general unsecured claims."[69] Bankruptcy cases frequently involve a large number of general unsecured claims, and because general unsecured creditors are junior to nearly all other classes of claims, general unsecured claims are often paid far less than their face value.[70] Nevertheless, during the negotiations leading up to the confirmation of a plan of reorganization, it is not uncommon for senior creditors to carve out some of their recovery to allow for a distribution to unsecured creditors.[71]

Finally, at the very bottom of the claim hierarchy are holders of equity interests in the debtor.[72] Equity holders receive a distribution from the estate only in the very uncommon scenario in which all estate creditors are paid in full, plus postpetition interest.[73]

C. Postpetition Maintenance of Secured Status: Section 552 and Agricultural Collateral

Given the difference in treatment between secured claims (at the top of the claim hierarchy) and general unsecured claims (close to the bottom of the claim hierarchy), it is in the best interest of secured creditors to maintain their secured claims. A secured creditor's ability—or inability—to maintain its lien on postpetition proceeds of prepetition collateral has given rise to a diverse body of case law regarding agricultural products.[74] Section 552(a) of the Bankruptcy Code provides that "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."[75] The effect of § 552(a) is to prevent a secured creditor's floating lien in the debtor's property from attaching to property acquired by the debtor after the petition date.[76] The policy reasoning for § 552(a) is that cutting off floating

66. *See* 11 U.S.C. §§ 503, 507 (2012).
67. *See* 11 U.S.C. § 507.
68. *Id.* § 507(a).
69. *See* 11 U.S.C. §§ 506–07 (2012).
70. *See* 11 U.S.C. § 1129(b)(1) (2012).
71. *Id.*
72. 11 U.S.C. § 726(a) (2012).
73. *See id.* § 726(a); La. Indus. Coatings, Inc. v. Peruit (*In re* La. Indus. Coatings, Inc.), 31 B.R. 688, 697 (Bankr. E.D. La. 1983).
74. *See infra* note 77 and accompanying text.
75. 11 U.S.C. § 552(a) (2012).
76. *See id.*

liens "facilitates a debtor's ability to reorganize by giving the debtor assets which he acquires post-petition free of his past liabilities for use in the reorganization process."[77]

Section 552(a) is subject to a very significant exception set forth in § 552(b).[78] Section 552(b) allows a secured creditor to maintain its lien on property acquired by the debtor postpetition as long as the lien was properly perfected under state law,[79] and as long as the postpetition property is the "proceeds, product, offspring, or profits of such [prepetition] property."[80] In addition, the § 552(b) exception is itself subject to an exception.[81] The last sentence in § 552(b) provides that a bankruptcy court may deem that, based on the equities of the case, a secured creditor's lien otherwise qualified under § 552(b) shall not attach to postpetition property.[82] The bankruptcy court may make this determination only after notice and a hearing on the matter.[83]

Section 552 has given rise to various interpretations by courts. First, courts disagree on the purpose behind the § 552(b) exception.[84] Some courts interpret § 552(b) as allowing a floating lien to attach to the debtor's after-acquired property as long as the lien was properly perfected as of the petition date.[85] Other courts interpret § 552(b) much more narrowly as providing protection to a secured "creditor's interest in *particular* pre-petition goods or collateral from being terminated by the filing of a bankruptcy petition."[86] Second, as discussed below, courts disagree on when the § 552(b) equity exception should be applied.[87]

A significant body of case law focuses on whether § 552(b) allows liens on agricultural products and proceeds to survive a bankruptcy filing.[88] The agricultural products most commonly addressed—and that have given rise to various splits in the case law—are milk, livestock, and crops.[89] Among those three agricultural products, bankruptcy courts have addressed § 552(b) most

77. *In re* Lawrence, 41 B.R. 36, 37 (Bankr. D. Minn. 1984); *see also* Nanuet Nat'l Bank v. Photo Promotion Assocs., Inc. (*In re* Photo Promotion Assocs., Inc.), 61 B.R. 936, 939 (Bankr. S.D.N.Y. 1986) (noting that "the general policy reflected in 11 U.S.C. § 552(a) is to restrict the claims of prepetition secured interests to prepetition collateral and regard after-acquired property as property of the estate").

78. 11 U.S.C. § 552(b); *In re* Jackels, 55 B.R. 67, 68 (Bankr. D. Minn. 1985) ("While § 552(a) essentially terminates security interests as a general rule, there is a very large exception found in § 552(b).").

79. *See* 11 U.S.C. § 552(b); *In re* Vienna Park Props., 112 B.R. 597, 598–99 (Bankr. S.D.N.Y. 1990) (recognizing that in this context, applicable state law refers to Article 9 of the Uniform Commercial Code).

80. 11 U.S.C. § 552(b)(1).

81. *Id.*

82. *Id.*

83. *Id.*

84. *See infra* notes 85–86 and accompanying text.

85. *See* Delbridge v. Prod. Credit Ass'n & Fed. Land Bank, 104 B.R. 824, 825–26 (E.D. Mich. 1989); *In re* Triple A Feed Lots, Inc., 137 B.R. 819, 821–23 (Bankr. D. Colo. 1992).

86. *In re* Lawrence, 41 B.R. 36, 37 (Bankr. D. Minn. 1984).

87. *See infra* notes 94–96 and accompanying text.

88. *See infra* notes 91, 93 and accompanying text.

89. *See infra* notes 91, 94–97 and accompanying text.

frequently in the context of milk produced by a debtor after the petition date.[90] The majority view is that if a lender has a validly perfected floating lien on livestock and milk, then, pursuant to § 552(b), the lien attaches to milk produced by the livestock postpetition.[91] Cases adopting the majority view reason that § 552(b) allows for the preservation of the lien because the postpetition milk is a "product" of the livestock, and § 552(b)(1) specifically preserves liens on "proceeds, product, offspring, or profits" of prepetition assets.[92] In determining whether the lien was properly perfected prepetition, courts look to the Uniform Commercial Code, as adopted by the applicable state, including § 9-204(a), which provides for floating liens on after-acquired property, and § 9-102(34), which defines "farm products" to include "products" of livestock.[93] In contrast, the minority viewpoint interprets § 552(b) much more narrowly. Courts applying the minority view refuse to allow a lien on postpetition milk on the grounds that the milk is an entirely new product that came into existence after the petition date.[94]

Section 552(b) has also been interpreted in the context of whether a prepetition lien on livestock extends to livestock born after the petition date.[95] Of the relatively small number of cases addressing the issue, the majority of courts hold that livestock born postpetition are "products" or "offspring" of

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90. *See infra* notes 91–93 and accompanying text.

91. *See* Smith v. Dairymen, Inc., 790 F.2d 1107, 1111–12 (4th Cir. 1986) (identifying the cases most often cited for the proposition that § 552(b) preserves a prepetition lien on milk); Wilke Truck Service, Inc. v. Wiegmann (*In re* Wiegmann), 95 B.R. 90, 93 (Bankr. S.D. Ill. 1989); *In re* Underbakke, 60 B.R. 705, 708 (Bankr. N.D. Iowa 1986). The *Smith* case developed a three-step test for determining whether a lien attaches to postpetition milk: "(a) there must be a pre-petition security agreement, (b) the security agreement by its terms must extend to the debtor's pre-petition property and to proceeds, product, offspring, etc. of such property, and (c) applicable non-bankruptcy law, i.e., state law, must permit the security agreement to extend to such after-acquired property." *Smith*, 790 F.2d at 1111–12; *see also Wiegmann*, 95 B.R. at 92–93 (quoting the *Smith* test). Other cases have adopted this viewpoint. *See, e.g.*, *In re* Purdy, 490 B.R. 530, 539–40 (Bankr. W.D. Ky. 2013); *In re* Heilman, No. 10-10107, 2010 WL 3909167, at *1–2 (Bankr. D. S.D. Sept. 29, 2010); *In re* Veblen W. Dairy LLP, No. 10-10071, 2010 WL 2736641, at *1 (Bankr. D. S.D. July 9, 2010) (identifying the analysis as the majority view); *In re* Potter, 46 B.R. 536, 538–39 (Bankr. E.D. Tenn. 1985); United States v. Hollie (*In re* Hollie), 42 B.R. 111, 119–20 (Bankr. M.D. Ga. 1984).

92. 11 U.S.C. § 552(b)(1) (2012); *see, e.g.*, *Purdy*, 490 B.R. at 539–40.

93. *See* U.C.C. §§ 9-204(a), 9-102(a)(34) (2012); Aspen Dairy v. Bank of Am. (*In re* Aspen Dairy), Nos. BK04-41304, A04-4050, 2005 WL 2547111, at *3–*4 (Bankr. D. Neb. Feb. 14, 2005).

94. *In re* Lawrence, 41 B.R. 36, 37–38 (Bankr. D. Minn. 1984) (reasoning that "milk produced post-petition is an asset coming into existence totally after the filing and not intended to be covered by the 552(b) exception"); *see also In re* Jackels, 55 B.R. 67, 69 (Bankr. D. Minn. 1985) ("While there can be no doubt that in agricultural parlance milk is a product of a cow, that is not the meaning of the word product in the context of security interests. Rather, products is a term used to apply to security interests in such things as raw materials which are converted into inventory or other finished products . . . . "); Pigeon v. Prod. Credit Ass'n of Minot (*In re* Pigeon), 49 B.R. 657, 659–60 (Bankr. D. N.D. 1985) (reviewing the legislative history of § 552(b) and concluding the term "product" is used differently in the definition of "farm products" in the UCC; therefore, a lien on livestock and proceeds will not extend to milk produced postpetition); *In re* Serbus, 48 B.R. 5, 8 (Bankr. D. Minn. 1984) (adopting the reasoning set forth in the *Lawrence* case). *Contra* Delbridge v. Prod. Credit Ass'n & Fed. Land Bank, 104 B.R. 824, 826 n.1 (E.D. Mich. 1989) (criticizing this line of case law for, in the court's view, inappropriately characterizing a cow as a "milk-machine" that is fed after-acquired raw material (i.e., grain), thus resulting in "new" milk production).

95. *See infra* note 96 and accompanying text.

the prepetition livestock, and therefore, a properly perfected prepetition lien will continue in such livestock postpetition.[96] This line of case law seems somewhat more open to the possibility of using the § 552(b) equity exception to disallow such a postpetition lien.[97] This is in contrast to milk case law, which generally holds that it is not appropriate to use § 552(b) to disallow a postpetition lien on equitable grounds.[98]

Bankruptcy case law has also discussed § 552(b) in the context of purported liens on a debtor's crops.[99] The majority of courts have held that a prepetition lien on crops will not extend to crops planted after the petition date.[100] The issue may turn on whether the seeds were purchased postpetition, or whether they were already on hand (but unplanted) as of the petition date.[101] In addition, if the secured party's lien is on real estate (as opposed to explicitly

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96. *See In re* Sorrell, 286 B.R. 798, 811 (Bankr. D. Utah 2002) (finding that postpetition calves were not free of the lender's prepetition floating lien, but then going on to hold that the § 552(b) equity exception would allow the court to provide the debtor with "some flexibility" to sell the calves in a plan); *In re* Wobig, 73 B.R. 292, 294 (Bankr. D. Neb. 1987) (discussing the "tension" between § 552 and § 1225 such that if a family farmer debtor were never able to sell livestock offspring to fund his Chapter 12 plan, then "no 'family farmer' whose business was substantially a livestock operation would be able to obtain confirmation of a Chapter 12 plan of reorganization"). *But see In re* Big Hook Land & Cattle Co., 81 B.R. 1001, 1003–04 (Bankr. D. Mont. 1988).

97. *See Wobig*, 73 B.R. at 294; *In re* Delbridge, 61 B.R. 484, 490 (Bankr. E.D. Mich. 1986); *see also* Hollinrake v. Fed. Land Bank of Omaha (*In re* Hollinrake), 93 B.R. 183, 192 (Bankr. S.D. Iowa 1988) ("Courts are more inclined to assist the debtor through the equity exception where the creditor whose interest is being modified is oversecured."). In the *Delbridge* case, the bankruptcy court applied the § 552(b) equity exception in a case dealing with a floating lien on milk. *Delbridge*, 61 B.R. at 486–88. The bankruptcy court reasoned that the purpose of the exception is "to enable those who contribute to the production of proceeds during Chapter 11 to share jointly with pre-petition creditors secured by proceeds" and that failing to apply the exception would unfairly "let the creditor with a pre-petition lien on milk walk away with the entire cash proceeds of milk produced largely as a result of the farmer's post-petition time, labor and inputs . . . ." *Id.* at 490 (quoting United States v. Van Vactor, Francis & Martin (*In re* Crouch), 51 B.R. 331, 332 (Bankr. D. Or. 1985)) (internal quotation marks omitted). Note, however, that on appeal to the district court, the court affirmed the bankruptcy court's ultimate ruling on different grounds, but the district court specifically noted that the bankruptcy court should not have applied the equity exception on the facts at hand because the remedy of adequate protection provided the secured creditor with an adequate remedy at law. *See Delbridge*, 104 B.R. at 826.

98. *See Delbridge*, 104 B.R. at 826–27 (noting that equity exceptions are applied when there is no adequate remedy at law, and that debtors have remedies under the law in § 363 and § 506 of the Bankruptcy Code); *In re* Underbakke, 60 B.R. 705, 708–09 (Bankr. N.D. Iowa 1986) (noting that adequate protection afforded to the secured creditor provides a remedy without having to resort to the § 552(b) equity exception); *In re* Johnson, 47 B.R. 204, 207 (Bankr. W.D. Wisc. 1985) (noting that adequate protection provides for an adequate remedy at law; therefore, the application of the § 552(b) equity exception was not appropriate).

99. *See infra* note 100 and accompanying text.

100. Dettman v. Fresno-Madera Prod. Credit Ass'n (*In re* Dettman), 84 B.R. 662, 665 (B.A.P. 9th Cir. 1988); Bird v. Plains State Bank (*In re* Bird), 86 B.R. 660, 662 (D. Kan. 1988) (defining "planting"); Schieffler v. First Nat'l Bank of Wynne (*In re* Peeler), 145 B.R. 973, 975 n.2 (Bankr. E.D. Ark. 1992); Kucera v. Bank of Brainard (*In re* Kucera), 123 B.R. 852, 853–54 (Bankr. D. Neb. 1990); *In re* Olsen, 87 B.R. 148, 153 (Bankr. D. Colo. 1988); *In re* Smith, 72 B.R. 344, 348–49 (Bankr. S.D. Ohio 1987); Randall v. Bank of Viola (*In re* Randall), 58 B.R. 289, 290 (Bankr. C.D. Ill. 1986). *But see* F.D.I.C. v. Coones (*In re* Coones), 954 F.2d 596, 601 (10th Cir. 1992), *cert. granted and judgment vacated sub nom.* Coones v. F.D.I.C., 506 U.S. 802 (1992) (holding that if proceeds of prepetition crops are used to produce postpetition crops, then the prepetition lien extends postpetition).

101. *See* Thacker v. Old Nat'l Bank (*In re* Thacker), 291 B.R. 831, 832–33 (Bankr. S.D. Ill. 2003).

extending to crops), the lien may attach to the crops as "rents, issues and profits" of the real estate.[102]

D. Sidestepping the Hierarchy: Trust Fund Claims

A creditor with a properly perfected secured claim resides at the top of the claim hierarchy and is in the enviable position of being paid out of estate assets prior to other junior claim holders.[103] For this reason, secured creditors have the incentive to fight battles related to the distribution of estate assets, such as preventing a debtor from avoiding a lien or litigating the issue of whether § 552(b) preserves a lien on postpetition property. A secured creditor's position atop the claim hierarchy does not, however, guarantee that its claim will be paid first. If a claimant is able to establish that the debtor holds property in trust for its benefit, the claimant may be entitled to sidestep the claim hierarchy and be paid before secured creditors or administrative expense claimants.[104] This dynamic turns on how the Bankruptcy Code defines property of a debtor's bankruptcy estate. The Bankruptcy Code provides that, upon the filing of a bankruptcy petition, property of the estate includes every type of property interest that a debtor has or may have.[105] This term is interpreted broadly to give a debtor the maximum degree of protection over its assets in bankruptcy.[106] The claim hierarchy is tied directly to the concept of property of the estate. By design, a bankruptcy case will determine the universe of non-exempt assets comprising property of the estate and then will distribute that property to creditors up and down the creditor hierarchy, with the treatment of such creditors based on the types of claims.

If an asset is not property of the estate, then it is not subject to distribution to the debtor's creditors.[107] For example, if Joe lets George borrow his lawnmower and George later files bankruptcy, the lawnmower does not become property of George's bankruptcy estate simply because it was in George's possession when he filed his bankruptcy petition. To that point, the Bankruptcy Code specifically recognizes that assets held by a debtor in trust are not property of a debtor's estate.[108] Certain statutes provide that funds payable to particular types of creditors are held in trust by a debtor.[109] This allows the trust fund claimants to argue that they *own* the funds that happen to be in the debtor's possession, as opposed to simply having a *claim* to the funds. Debtors and other creditors are, of course, motivated to argue that funds are not held in

102. *In re* Triple A Feed Lots, Inc., 137 B.R. 819, 822 (Bankr. D. Colo. 1992) (internal quotation marks omitted).
103. *See* 11 U.S.C. § 506(a)(1) (2012).
104. 11 U.S.C. § 507 (2012).
105. 11 U.S.C. § 541 (2012).
106. *See id.*; Burgess v. Sikes (*In re* Burgess), 438 F.3d 493, 496 (5th Cir. 2006).
107. 11 U.S.C. § 541.
108. *Id.* § 541(d).
109. *See, e.g.*, Packers and Stockyards Act, 7 U.S.C. §§ 181–229(b) (2012).

trust, and therefore are subject to distribution. The dynamic between trust funds and property of the estate underlies the intercreditor disputes involving statutes such as the PSA, PACA, and certain state statutes purporting to establish trusts for the benefit of producers of certain types of agricultural products.[110]

III. PART TWO: THE PACKERS AND STOCKYARDS ACT

The Packers and Stockyards Act is an example of a statute that creates a trust for the benefit of certain claimants.[111] The PSA was enacted in 1921 in order to provide supervision by the Secretary of Agriculture over the majority of livestock sales.[112] At the time, nearly 80% of all livestock sales occurred at large terminal markets.[113] Over the following decades, large terminal markets dissipated, and packers began purchasing livestock through country auction markets and directly from producers.[114] Those transactions generally lacked federal oversight and protection, and resulted in behavior by packers that increased the financial exposure of livestock sellers.[115]

In 1976, Congress amended the PSA in order to provide livestock sellers with expansive protections against nonpayment by meat packers.[116] As a result, livestock sellers in compliance with the PSA must now be paid in full before any other party with an interest in the packer's "inventories of, or receivables or proceeds from meat, meat food products, or livestock products" may be paid.[117] While the PSA is an expansive piece of legislation covering many issues, this section focuses on the background and history of the 1976 amendments to the PSA and how they affect livestock sellers, agricultural lenders, and the administration of livestock sellers' claims in bankruptcy.

A. History of the Packers and Stockyards Act and the 1976 Amendments

During the period prior to the enactment of the 1976 amendments to the PSA, transactions between livestock sellers, meat packers, and agricultural lenders were largely governed by the Uniform Commercial Code, as adopted in each state.[118] As a result, prior to the 1976 amendments, packers were able to "offer as security for a loan the livestock, meat, meat food products, or

110. *See id.*; Perishable Agricultural Commodities Act, 7 U.S.C. § 499(a)–(b) (2012).
111. *See* 7 U.S.C. §§ 181–229(b).
112. S. Rep. No. 94-932, at 1–2 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2267, 2270 (the "Senate Report").
113. *Id.*
114. *Id.*
115. *Id.* at 2271.
116. *See* 7 U.S.C. §§ 181–229(b), *amended by* Pub. L. No. 94-410, 90 Stat. 1249 (1976).
117. *See* 7 U.S.C. § 196(b) (2012).
118. *See, e.g.*, *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 1002–03 (M.D. Tenn. 1980).

receivables or proceeds therefrom, which [they had] not paid for."[119] In the event of bankruptcy, secured creditors with perfected liens on a packer's inventory and accounts receivables, therefore, had a security interest senior to the livestock seller.[120] Or, as the Senate Committee on Agriculture and Forestry put it in its Senate Report, "The producer, who was responsible for raising, feeding, and caring for the livestock [would be] left unpaid, while secured creditors reap[ed] the reward of [the producer's] labors."[121]

The Committee's concerns were well-founded: more than 167 meat packers collapsed between 1958 and 1975, causing enormous losses to livestock sellers.[122] By July of 1975, more than twenty-five states had enacted bonding requirements for packers in order to combat such losses.[123] In addition, nineteen states enacted prompt-payment statutes to further protect livestock sellers.[124] Even so, during 1975, livestock sellers suffered more than $20 million in losses in the American Beef Packers bankruptcy case, in which General Electric Acceptance Corporation held a security interest in American Beef Packers' inventory superior to livestock sellers' claims.[125]

The collapse of American Beef Packers and resulting satisfaction of a secured creditor at the expense of livestock sellers precipitated Congress to take action.[126] Thus, in 1976, Congress amended the PSA to "afford a measure of protection to the livestock producer" necessary to "prevent future producer tragedies, as occurred following the [American Beef Packers] bankruptcy."[127] As a result, livestock sellers in compliance with the PSA are entitled to the benefits of floating statutory trusts that prime even a secured lender's perfected first lien on a packer's "inventories of, or receivables or proceeds from meat, meat food products, or livestock products."[128] Simply put, any security interest of a lender in the assets of a qualifying packer that came into existence after the enactment of the 1976 amendments may be subordinated to a PSA trust.[129]

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119. S. Rep. No. 94-932, 1976 U.S.C.C.A.N. at 2271.
120. *See id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at 2272. As evidenced in its Senate Report, the Committee noted that because livestock is the primary source of protein in the American diet, "livestock producers occupy a position of unique national importance." *Id.* The Committee further noted that protective legislation was necessary because "[n]o individual is engaged in a riskier endeavor or one more vital to the national interest than the [livestock] producer. . . . His livestock may represent his entire year's output. If he is not paid, he faces ruin." *Id.*
127. *Id.*
128. *See* 7 U.S.C. § 196(b) (2012); *see, e.g.*, *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 1003 (M.D. Tenn. 1980).
129. 7 U.S.C. § 196(b); *see, e.g.*, *Frosty Morn Meats*, 7 B.R. at 1003.

B. Obtaining the Benefits and Protections of the PSA's Floating Statutory Trust

While the benefits of a PSA trust are extraordinary, they are available only to certain qualifying sellers. In order to obtain the benefits of a statutory trust under § 206(b) of the PSA, a claimant must prove that (1) livestock was sold; (2) the sale was in commerce; (3) the livestock was sold to a packer; (4) the sale was a cash sale; (5) the claimant has not been paid in full; (6) the packer makes more than $500,000 in annual livestock purchases; and (7) the claimant properly preserved its trust claim by providing notice of its claim to the packer and the Secretary of Agriculture within the requisite notice period.[130]

1. Did the Claimant Sell "Livestock," as Defined in the PSA?

In order to qualify for PSA trust protections, a claimant must first prove that it sold "livestock" as defined in the PSA.[131] To do so, the claimant must satisfy the following two inquiries: (1) is the claimant actually a seller entitled to PSA protection, and if so, (2) did the claimant actually sell livestock?[132] Shortly after the passage of the 1976 amendments to the PSA, parties challenged whether middlemen and brokers qualified for PSA protection or whether, given the legislative history's focus on "livestock producers," the PSA was intended to protect only the farmers and ranchers who raised livestock for sale.[133] In each case, middlemen, brokers, and other such sellers were deemed entitled to PSA protection.[134] Accordingly, any qualifying party may assert a claim under the PSA if the party sold livestock.

The term "livestock" is defined under the PSA as "cattle, sheep, swine, horses, mules or goats—whether live or dead."[135] Livestock refers to the entire

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130. 7 U.S.C. § 196(b); *see, e.g.*, First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1004 (5th Cir. 1982); Stanziale v. Rite Way Meat Packers, Inc. *(In re* CFP Liquidating Estate), 405 B.R. 694, 696 (Bankr. D. Del. 2009).

131. *See* 7 U.S.C. §§ 182(a)(4) (2012), 196.

132. *See, e.g.*, *Frosty Morn Meats*, 7 B.R. at 1020–21.

133. *Frosty Morn Meats*, 7 B.R. at 1021 (expressly ruling that middlemen and brokers were sellers entitled to PSA protection); Bast v. Orange Meat Packing Co. (*In re* G & L Packing Co.), 20 B.R. 789, 801 n.3 (Bankr. N.D.N.Y. 1982), *aff'd*, 41 B.R. 903 (N.D.N.Y 1984) (successful PSA statutory trust claims brought by middlemen and livestock auctioneers).

134. *Frosty Morn Meats*, 7 B.R. at 988; *G & L Packing Co.*, 20 B.R. at 802, 809.

135. 7 U.S.C. § 182(4). It is important to note that poultry are not included in the definition of livestock. *See id.* As a result, poultry sellers were not originally entitled to statutory trust protection under the PSA. Act of Sept. 13, 1976, Pub. L. No. 94-410 § 3(c), 90 Stat. 1249 (codified as 7 U.S.C. § 182). That issue was remedied by further amendments to the PSA in 1987, which provided separate, but substantially similar statutory trust provisions for poultry sellers. Act of Nov. 23, 1987, Pub. L. No. 100-173, § 2, 101 Stat. 918 (codified as amended 7 U.S.C. § 197 (2012)). Section 197(b) of the PSA, added by an act of Congress, approved November 23, 1987, provides statutory trust protections to sellers or growers of live poultry that sell to poultry packers, known as "live poultry dealers." *Id.* The statutory trusts provided to poultry sellers and growers are essentially identical to those provided to livestock sellers, though poultry sellers and growers must satisfy slightly different elements to obtain PSA protections. 7 U.S.C. § 197. Specifically, a claimant under § 197(b) must prove that (1) the poultry was sold; (2) the poultry was sold in commerce; (3) the poultry was

animal, as opposed to "meat," "meat food products," and "livestock products," which are otherwise defined in the PSA.[136] As one court noted, it is unlikely that, given the distinction between livestock and related byproducts under the PSA, items such as "frozen boneless beef," and beef and pork "trimmings" constitute "livestock" as required for PSA protection.[137] Thus, "if the initial sale was not of livestock as defined by [the PSA], a [PSA] trust never existed."[138]

2. Was the Sale "In Commerce" as Defined in the PSA?

Next, a PSA claimant must establish that it sold livestock in commerce.[139] The "commerce" element is arguably the easiest element for a claimant to satisfy. According to the PSA, livestock is sold in commerce if it is sent by the seller from one state to another state, or is sent with the expectation that, after purchase, the livestock will end up in another state.[140] Thus, if a seller merely *expects* that the livestock will eventually end up in another state, the sale is protected by the PSA.[141] In addition, livestock is also sold in commerce if sold for slaughter within the state so that the purchaser can distribute the products resulting from slaughter out of state.[142] As a result, a Texas rancher may sell cattle to a Texas packer "in commerce" so long as the Texas meatpacker ships products out of state.

3. Was the Livestock Sold to a "Packer" as Defined in the PSA?

A claimant must then prove that the claimant sold livestock to a packer as defined in the PSA.[143] Under the PSA, the term "packer" refers to "any person engaged in the business . . . of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or . . . of marketing meats, meat food products, or livestock products in an unmanufactured form acting as a

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sold to a live poultry dealer; (4) the poultry was sold pursuant to a cash sale or poultry growing arrangement; (5) the claimant has not been paid in full; (6) the poultry was sold to a live poultry dealer who makes more than $100,000 in annual live poultry sales or purchases; and (7) the claimant preserved its trust claim by providing notice of its claim to the live poultry dealer and the Secretary of Agriculture within the requisite notice period. *Id.*

136. *Compare* 7 U.S.C. § 182(4) (definition of "livestock"), *with id.* § 182(3) (definition of "meat food products"), *and id.* § 182(5) (definition of "livestock products").

137. *See* Stanziale v. Rite Way Meat Packers, Inc. (*In re* CFP Liquidating Estate), 405 B.R. 694, 695 (Bankr. D. Del. 2009).

138. Premier Pork L.L.C. v. Westin, Inc., No. 07-1661, 2008 WL 724352, at *8–*9 (D.N.J. Mar. 17, 2008) (acknowledging that pork bellies are not livestock, and ruling that meat food products, like pork bellies, do not entitle cash seller to the benefits of a PSA trust); *CFP Liquidating Estate*, 405 B.R. at 698 n.4.

139. *See* 7 U.S.C. § 196 (2012).

140. 7 U.S.C. § 183(b) (2012).

141. *Id.*

142. *Id.*

143. *See* 7 U.S.C. §§ 191 (2012), 196.

wholesale broker, dealer, or distributor in commerce."[144] Thus, while a middleman or auction house may not satisfy the definition of a packer, slaughterhouses, meat packers, and butchers almost certainly do.[145]

4. Was the Sale a "Cash Sale" Under the PSA?

In order to remain eligible for the protections of the PSA, a livestock seller must have participated in a cash sale.[146] Under the PSA, the term "cash sale" refers to any transaction "in which the seller does not expressly extend credit to the buyer."[147] Although the single-sentence definition of a cash sale appears quite simple, disputes over whether transactions involved extensions of credit, and therefore precluded the protection of the PSA, are not uncommon.[148]

It is important to note that a cash sale does not necessarily involve a due-on-sale transaction pursuant to which a seller is provided cash payment at the time livestock is delivered.[149] In fact, the PSA recognizes that a packer is not obligated to deliver payment to the seller until just prior to the close of the business day after possession of livestock transfers to the packer (known as the "prompt payment provision").[150] Thus, under the prompt payment provision, a packer who buys livestock on Monday morning does not have to remit payment until close of business on Tuesday.

Packers have, on a number of occasions, sought to avoid cash sales by engaging in activities that disregard or repeatedly violate the prompt payment provision of the PSA.[151] When doing so, packers often cite frequent payment extensions or patterns of acceptances of late payments to prove that sellers

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144. Stanziale v. Rite Way Meat Packers, Inc. (*In re* CFP Liquidating Estate), 405 B.R. 694, 697 (Bankr. D. Del. 2009) (quoting 7 U.S.C. § 191) (internal quotation marks omitted).

145. *Id.* In cases involving poultry, a claimant must have sold to a "live poultry dealer." 7 U.S.C. § 197(b) (2012). A live poultry dealer is an entity "engaged in the business of obtaining live poultry by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter by another . . . ." 7 U.S.C. § 182(10) (2012). This definition has led to surprising results for sellers of certain poultry and poultry products who presumed a PSA claim against purchasers. *See, e.g.*, Three "S" Farms, Inc. v. Plymouth Capital Ltd. (*In re* Chi-Mar Foods, Inc.), 207 B.R. 594, 596 (Bankr. N.D. Ill. 1997). In the *Chi-Mar Foods* case, Three "S" Farms purchased live chickens from growers, slaughtered the chickens, and sold the dead chickens to Chi-Mar Foods, which eventually filed bankruptcy. *Id.* at 595. Three "S" Farms then asserted PSA trust claims against the debtor for unpaid bills related to the debtor's purchase of dead chickens. *Id.* The court ruled that PSA trusts only arose from the sale of live poultry. *Id.* at 597. As a result, Three "S" Farms, which purchased live chickens to slaughter and resell, was not the "live poultry dealer" subject to PSA trust claims from its chicken sellers. *Id.* at 595, 597. Three "S" Farms' PSA claims against Chi-Mar Foods were denied. *Id.* at 597.

146. 7 U.S.C. § 196.

147. *Id.* § 196(c).

148. *See, e.g.*, First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1004–06 (5th Cir. 1982); *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 997–98 (M.D. Tenn. 1980); Bast v. Orange Meat Packing Co. (*In re* G & L Packing Co.), 20 B.R. 789, 807 (Bankr. N.D.N.Y. 1982), *aff'd*, 41 B.R. 903 (N.D.N.Y. 1984).

149. *See* 7 U.S.C. § 228(b) (2012).

150. *Id.*

151. *See infra* notes 153–60.

extended credit and had no expectation of prompt payment as required by statute.[152] Courts generally disregard such arguments and interpret the provisions of the PSA for the benefit of livestock sellers.[153] In fact, courts have even invalidated written extensions of credit in order to establish cash sales where the written extensions of credit were obtained by duping livestock sellers.[154]

One frequently cited case, *In re Gotham*, is particularly informative as to how courts analyze cash and credit sales and remains one of the most cited cases addressing PSA issues.[155] In *Gotham*, the Fifth Circuit analyzed the PSA to determine whether a seller's repeated acceptance of late payments constituted an express extension of credit under the PSA.[156] First, the court analyzed what might constitute an express extension of credit required to avoid a cash sale.[157] The court determined that while the definition of a cash sale did not indicate what was necessary for an express extension of credit, § 409(b) of the PSA provided an appropriate explanation.[158] In pertinent part, § 409(b) advises that "the parties to the purchase and sale of livestock may expressly agree in writing, before such purchase or sale, to effect payment in a manner other than that required in subsection (a) of this section."[159] The court in *Gotham* acknowledged that obtaining such a written agreement prior to sale would weigh in favor of a credit sale.[160]

Even so, simply obtaining a written extension of credit is not necessarily sufficient to avoid a cash sale.[161] According to the *Gotham* court's interpretation of § 409(b) of the PSA, the purchaser must also obtain a written acknowledgement from the seller pursuant to which the seller acknowledges that it is entering into a written agreement for the sale of livestock on credit, and that it will no longer be entitled to the benefits of the trust provisions of the PSA.[162] To remain effective, the seller must retain a copy of the

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152. *See infra* notes 153–59.

153. *See infra* notes 154–59 and accompanying text.

154. *See, e.g.*, *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 1016–19 (M.D. Tenn. 1980). The court in *Frosty Morn Meats*, a truly seminal case addressing PSA issues, reasoned that under § 192 of the PSA, engaging in any unfair or deceptive practice or device is unlawful. *Id.* at 1016. Frosty Morn Meats used blanket waivers, misleading language, and other deceptive tools to trick sellers into waiving their PSA trust claims. *Id.* at 997. The court invalidated those agreements and the language therein on the grounds of fraud, misrepresentation, and unfair trade practices. *Id.* at 997–98. As a result, the livestock sellers who previously executed those misleading documents were granted cash-seller status, and allowed to pursue PSA trust claims. *Id.*

155. First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1004 (5th Cir. 1982).

156. *Id.*

157. *Id.* at 1005.

158. 7 U.S.C. § 228b(b) (2012); *Gotham Provision Co.*, 669 F.2d at 1005–08.

159. 7 U.S.C. § 228b(b).

160. *Gotham Provision Co.*, 669 F.2d at 1005.

161. *Id.* at 1005–06.

162. *Id.* at 1007.

acknowledgement and must provide a copy to the seller.[163] A form acknowledgement may be found in § 201.200 of the Code of Federal Regulations, and expressly states, in pertinent part:

> (a) No packer whose average annual purchases of livestock exceed $500,000 shall purchase livestock on credit, and no dealer or market agency acting as an agent for such a packer shall purchase livestock on credit, unless: (1) Before purchasing such livestock the packer obtains from the seller a written acknowledgment as follows:
>
> On this date I am entering into a written agreement for the sale of livestock on credit to ______, a packer, and I understand that in doing so I will have no rights under the trust provisions of section 206 of the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 196, Pub. L. 94-410), with respect to any such credit sale.[164]

Accordingly, a packer seeking to enter into a credit transaction may not hide the ball in order to preclude unknowing sellers from the benefits of the PSA.[165] Instead, any agreement to effectuate a credit sale must contain the above-referenced waiver and acknowledgement, and must contain language that clearly establishes it is the "express intention of the parties to enter into a credit arrangement."[166]

5. Was the Livestock Seller Paid in Full?

To retain a valid PSA trust fund claim, a cash seller must establish that it has not been paid in full.[167] The issue is slightly more complex than it may appear. Under the PSA, a claimant has only a limited time to preserve its claim with applicable notice.[168] Even so, a claimant may be forced to wait a considerable period before receiving payment. During that time, interest could arguably accrue, thereby increasing the claimant's PSA claim. A number of

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163. *Id.* at 1006–07.

164. 9 C.F.R. § 201.200 (2013).

165. Bast v. Orange Meat Packing Co. (*In re* G & L Packing Co.), 20 B.R. 789, 808 (Bankr. N.D.N.Y. 1982), *aff'd*, 41 B.R. 903 (N.D.N.Y. 1984). For example, submitting an invoice to a seller with the term "charge" and payment terms in excess of the prompt payment provision will not result in a credit sale. *Id.* Likewise, more devious efforts to avoid cash sales are also likely to be disregarded in favor of livestock sellers. *Id.* In *Frosty Morn Meats*, a packer sought to avoid cash sales by forcing sellers to execute extensions of credit under the guise that the extensions of credit were required for PSA trust protections. *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 997–98 (M.D. Tenn. 1980). The court invalidated the extensions of credit as the product of fraud and misrepresentations by the packer. *Id.*

166. Kunkel v. Sprague Nat'l Bank, 128 F.3d 636, 646 (8th Cir. 1997) (applying the PSA to a state law issue and expressly acknowledging that transactions are cash-sale transactions under the PSA "unless there is an express agreement extending credit from the seller to the buyer"); *Gotham Provision Co.*, 669 F.2d at 1007–08; *In re* Coop de Consumidores del Noroeste, 464 B.R. 525, 537 (Bankr. D.P.R. 2012); *G & L Packing Co.*, 20 B.R. at 808 (holding that "[a] writing that does not conform to the regulations of 9 C.F.R. § 201.200 does not waive the trust provisions").

167. *See G & L Packing Co.*, 20 B.R. at 808.

168. 7 U.S.C. § 196(b) (2012).

courts addressing the PSA and PACA, which contain many similarities, have ruled that claimants may not be paid in full until they receive the original agreed purchase price, plus pre-judgment interest.[169] It remains unclear whether a PSA claimant is entitled to an award of attorneys' fees incurred by enforcing its claim.[170]

6. *Does the Packer Make More Than $500,000 in Annual Purchases?*

The PSA is intended to protect livestock sellers engaged in the sale of livestock in interstate commerce.[171] The PSA is not necessarily intended to protect sellers engaged in individual or wholly intrastate transactions.[172] Accordingly, a PSA claimant must show that the purchaser against whom recovery is sought maintained annual livestock purchases of not less than $500,000.[173] A seller of poultry must only establish that a live poultry dealer, as defined in the PSA, maintained annual live poultry purchases of not less than $100,000.[174]

7. *Did the Claimant Preserve Its Trust Claim by Submitting Notice?*

Pursuant to § 206(b) of the PSA, a claimant will obtain the benefits of the PSA trust so long as it satisfied the six elements addressed above.[175] That said, a claimant's failure to provide notice of its right to trust funds may be fatal to its claim.[176] As stated in § 206(b):

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169. *G & L Packing Co.*, 41 B.R. at 915–16 (ruling on appeal that the bankruptcy court did not abuse its discretion by granting PSA claimants interest in addition to their claims); Pa. Agric. Coop. v. Ezra Martin Co., 495 F. Supp. 565, 565 (M.D. Penn. 1980) (holding full payment included principal and interest); *see also In re* W.L. Bradley Co., 78 B.R. 92, 93–95 (Bankr. E.D. Penn. 1987) (involving a PACA claim, but including an analysis of PSA case law). The bankruptcy court noted that while PACA and the PSA are silent as to a claimant's entitlement to interest, the court would use its equitable powers to grant interest in order to promote the prompt payment required by statute. *W.L. Bradley Co.*, 78 B.R. at 93–95. The court refused to pay attorneys' fees, though, because under the American Rule, attorneys' fees may be awarded in limited and inapplicable situations. *Id.*

170. *G & L Packing Co.*, 20 B.R. at 810 (granting interest, but denying the request for attorneys' fees). *Compare W.L. Bradley Co.*, 78 B.R. at 95 (PACA case citing the American Rule for refusal to grant attorneys' fees), *with* Houston Avocado Co. v. Monterey House, Inc. (*In re* Monterey House, Inc.), 71 B.R. 244, 248 (Bankr. S.D. Tex. 1986) (PACA case citing the unpublished decision in *In re* Great Am. Veal, Inc., Case No. 82-1029 (Bankr. D.N.J. Oct. 28, 1982), and allowing, without explanation, an award of attorneys' fees to the trust claimant).

171. Packers & Stockyards Act of 1921, Pub. L. No. 94-410, 1976 U.S.C.C.A.N. (90 Stat. 1249) 2267, 2271–72.

172. *See* 7 U.S.C. § 183 (2012).

173. *See* 7 U.S.C. § 196(b).

174. 7 U.S.C. § 197(b) (2012).

175. *See supra* note 136.

176. Monfort, Inc. v. Kunkel (*In re* Morken), 182 B.R. 1007, 1018 (Bankr. D. Minn. 1995) (citing First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1013 (5th Cir. 1982); Liberty Mut. Ins. Co. v. Bankers Trust Co., 758 F. Supp. 890, 893 (S.D.N.Y. 1991), *rev'd sub nom.* Liberty Mut. Ins. Co. v. Rotchers Pork Packers, Inc., 969 F.2d 1384 (2d Cir. 1992); Bast v. Orange Meat Packing Co. (*In re* G & L Packing Co.), 20 B.R. 789, 906 (Bank. N.D.N.Y. 1982), *aff'd*, 41 B.R. 903

> [T]he unpaid seller shall lose the benefit of such trust if, in the event that a payment instrument has not been received, within thirty days of the final date for making a payment under section [409], or within fifteen business days after the seller has received notice that the payment instrument promptly presented for payment has been dishonored, the seller has not preserved his trust under this subsection. The trust shall be preserved by giving written notice to the packer and by filing such notice with the Secretary.[177]

Thus, in order to preserve a trust claim, a claimant must file a claim with the Secretary of Agriculture and provide written notice to the packer subject to the claim not later than (1) thirty days after payment was due under the prompt payment provision of the PSA; or (2) fifteen business days from the date the claimant obtained notice that the packer's check bounced.[178] A claimant cannot preserve its PSA claim by simply informing a packer and the Secretary of Agriculture that it intends to pursue PSA claims.[179] Even evidence of actual notice is insufficient to preserve a claim if a claimant did not provide notice pursuant to the specific provisions of the PSA.[180] Accordingly, claimants must file notice with the Secretary of Agriculture, and must provide packers with written notice of claims.[181]

C. The Power of PSA Trust Claims in Bankruptcy

If a claimant satisfies all of the above elements, it is entitled to the considerable benefits of a PSA trust claim. It is important to note that the creation of a PSA trust claim is distinguishable from the creation of a statutory lien. Pursuant to § 544(a) of the Bankruptcy Code, a bankruptcy trustee may use its "strong arm powers" to invalidate certain liens arising or perfected after the commencement of a bankruptcy case.[182] As courts have pointed out, the PSA "does not create a statutory lien invalid against the trustee in bankruptcy. Rather, [the PSA] provides for a statutory trust fund . . . ."[183] The creation of a trust fund, as opposed to a lien, insulates PSA claimants from payment pursuant to the bankruptcy claim hierarchy, and ensures first payment even at the

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(N.D.N.Y. 1984)). The court in *Morken* noted that, "[t]o preserve its rights under [the PSA], an unpaid seller must give written notice to both the debtor packer and the Secretary of Agriculture within the specified time limits. . . . The critical fact here is that, regardless of any [other] concerns, the defendants' claims pursuant to 7 U.S.C. § 196(b) will always fail because of their noncompliance with its notice requirements." *Morken*, 182 B.R. at 1018.

177. 7 U.S.C. § 196(b).

178. *Id.*

179. *See id.*

180. *Gotham Provision Co.*, 669 F.2d at 1013.

181. *Id.*

182. 11 U.S.C. § 544(a) (2012).

183. *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 1005 (M.D. Tenn. 1980); *see, e.g.*, Stanziale v. Rite Way Meat Packers, Inc. (*In re* CFP Liquidating Estate), 405 B.R. 694, 697 (Bankr. D. Del. 2009); First Interstate Bank of Cal. v. Great Am. Veal, Inc. (*In re* Great Am. Veal, Inc.), 59 B.R. 27, 33 (Bankr. D.N.J. 1985).

expense of lenders holding secured first liens on bankrupt packers' livestock, inventory, receivables, and proceeds from meat, meat food products, and livestock products.

1. PSA Trust Assets Do Not Become Property of a Bankrupt Packer's Estate

A PSA claimant is entitled to the benefits of a trust that encompasses "[a]ll livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom" until the claimant is paid in full.[184] As noted above, the creation of a statutory trust, as opposed to a lien, precludes trust assets from becoming assets of a bankruptcy estate.[185] As a result, essentially all of the proceeds from livestock purchased by a packer pursuant to cash sales must be set aside from the packer's bankruptcy estate and are not subject to any liens that may preempt payment to PSA claimants.[186]

The *In re Frosty Morn Meats* case, decided by the District Court for the Middle District of Tennessee, provides an example of the power of a PSA trust fund claim in a bankruptcy case.[187] Packer Frosty Morn Meats obtained financing for its operations from Citibank.[188] In order to secure the indebtedness, Citibank was granted a first-lien security interest in inventory, accounts receivable, and the proceeds thereof.[189] At or near the time Frosty Morn Meats filed bankruptcy, 3,471 cash sellers brought PSA claims totaling approximately $2.3 million.[190] In order to ensure payment of PSA trust claims, the bankruptcy court approved an agreement to escrow nearly $2.74 million of receipts for the payment of all PSA claims.[191] Citibank objected and argued that its first lien on all inventory, accounts receivables, and the proceeds thereof primed PSA claims.[192]

The *Frosty Morn Meats* court rejected Citibank's argument and ruled that PSA trust funds were not property of the bankruptcy estate.[193] As a result, the funds were not subject to Citibank's lien against the debtor's assets.[194] Moreover, because the trust fund assets were excluded from the estate, they were not subject to any other liens or distributions to the debtor's creditors.[195]

184. 7 U.S.C. § 196(b).
185. *Frosty Morn Meats*, 7 B.R. at 1005–06.
186. *Id.* at 1005.
187. *Id.* at 992–99.
188. *Id.* at 993.
189. *See id.*
190. *See id.* at 1000.
191. *Id.* at 1012.
192. *Id.* at 995–98.
193. *Id.* at 1007.
194. *See id.* at 1006–07.
195. *See id.*

The PSA claimants, therefore, were entitled to receive full payment of their claims despite Citibank's perfected first lien.[196]

2. PSA Trust Payments Are Not Subject to Avoidance Actions

The exclusion of PSA trust assets from a packer's bankruptcy estate has additional meaningful benefits, including defense against avoidance actions. Under §§ 544, 545, 547, 548, and 549 of the Bankruptcy Code, a bankruptcy trustee is entitled to avoid certain "transfer[s] of an interest of the debtor in property."[197] Because § 541 of the Bankruptcy Code excludes funds held in trust for the benefit of others from a debtor's estate, the delivery of PSA trust funds to a PSA claimant cannot be a transfer of an interest of the debtor in property.[198]

3. Obtaining Payment from Commingled Assets

PSA trusts only extend to "livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom . . . ."[199] PSA trusts do not extend to assets purchased or derived from credit sales.[200] As noted by the court in *Frosty Morn Meats*, Congress anticipated the purchase of livestock through credit sales and that such funds would not be available to PSA trust claimants.[201] Thus, PSA trusts extend only to the portion of a packer's assets arising from cash sales, while the remainder constitutes property of the packer's estate.[202] If a bankrupt packer appropriately accounted for all cash sale assets

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196. *See id.*

197. 11 U.S.C. §§ 544(b)(1) (2012), 545 (2012), 547–48 (2012), 549 (2012).

198. *See* Stanziale v. Rite Way Meat Packers, Inc. (*In re* CFP Liquidating Estate), 405 B.R. 694, 697 (Bankr. D. Del. 2009). In *CFP Liquidating Estate*, the bankruptcy trustee sought to avoid transfers made to five prepetition creditors within ninety days of the petition date. *Id.* at 695–96. Each of the creditors asserted a PSA claim against the debtor, and argued that the transfers constituted the payment of PSA trust assets, and so were not transfers of an interest of the debtor in property under § 547 of the Bankruptcy Code. *Id.* The court in *CFP Liquidating Estate* agreed with the creditors' reasoning, and held that, "[p]ursuant to 11 U.S.C. § 547, a preference action can only be maintained against a transfer of interest in the property in a debtor's estate. Accordingly, if [PSA] trusts exist as to the Defendants, the Trustee's preference actions as to assets in those trusts must fail." *Id.* at 697. Despite the court's reasoning, the creditors' defenses were called into question because they had not sold livestock to the debtor as required for the creation of a PSA trust. *Id.* As a result, the court refused to grant the creditors' motions to dismiss the trustee's avoidance actions, despite agreeing with the creditors' legal arguments as they related to PSA trust claims and defenses to avoidance actions. *Id.* PSA claimants are, therefore, able to retain their PSA payments despite the fact that a packer's other creditors may face avoidance actions following the receipt of payments. *See id.*

199. 7 U.S.C. § 196(b) (2012).

200. *Id.*

201. *Frosty Morn Meats*, 7 B.R. at 1009.

202. *But see* First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1011 n.13 (5th Cir. 1982) (ruling that essentially all commingled assets are subject to a trust claim, thereby disregarding the tracing obligation, but acknowledging without ruling on the decision in *Frosty Morn*

and all credit sale assets, it would be possible to determine what could be used to satisfy PSA trust fund claims, and what could be used to satisfy creditors of the estate.[203]

Frequently, however, cash sale assets are comingled with credit sale assets.[204] As a result, considerable confusion arises as to what assets are subject to estate creditors' claims, and what assets must be escrowed for payment of the trust claims. Typically, if cash and credit sale assets are commingled, PSA claimants are entitled to satisfaction from all of a packer's commingled assets, unless the packer or its estate representative can successfully trace and isolate all cash sale assets.[205]

For example, in the *Gotham* bankruptcy case, a dispute arose between the first lien holder and PSA trust claimants regarding whether PSA trust claimants were entitled to commingled cash and credit sale assets.[206] The first lien holder argued that the PSA claimants were obligated to "trace the particular accounts receivable derived from the sale of their livestock . . . in order to recover."[207] In an effort to resolve the dispute, the Secretary of Agriculture issued an amicus curiae brief and argued that Congress did not intend to obligate PSA claimants to spend potentially considerable funds in order to trace their accounts receivable.[208]

The bankruptcy court and Fifth Circuit agreed with the Secretary of Agriculture and found that because PSA trusts are made up of a floating pool of all cash sale assets, no individual claimant has an obligation to trace its accounts receivable to proceeds from the specific livestock it sold to the packer.[209] The court in *Gotham* further noted that:

> [D]ue to the nature of the meat packing business where, once slaughtered, animal carcasses are quickly cut into meat products and commingled, it is a practical impossibility to identify which receivables correspond to which seller's livestock, whether that seller be an unpaid cash seller, a paid cash seller, or a credit seller.[210]

Accordingly, because it would be nearly impossible to trace specific assets once meat products are commingled, the Fifth Circuit ruled that, when trust funds are commingled with assets derived from credit sales, "a lien on the

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Meats that credit sale assets should be excluded from trust assets if successfully traced by the party disputing the PSA claim).

203. *See Frosty Morn Meats*, 7 B.R. at 1010.

204. *See, e.g.*, *Gotham Provision Co.*, 669 F.2d at 1010–11; *Frosty Morn Meats*, 7 B.R. at 1010.

205. *See Frosty Morn Meats*, 7 B.R. at 1013 (holding that PSA claimants would be paid from commingled cash and credit sale assets unless objecting party successfully traced and excluded credit sale assets from PSA escrow accounts).

206. *See Gotham Provision Co.*, 669 F.2d at 1010.

207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.* at 1011.

entire commingled fund exists for the benefit of the beneficiaries of the trust, and those who receive a transfer of assets from the commingled fund with actual or constructive notice of the trust are subject to the lien."[211] Therefore, in order to prove a right to payment under the PSA, a claimant need only prove the balance owed and the existence of a floating pool of commingled inventories of livestock products, accounts receivables, and proceeds derived from cash and credit sales.[212] An objecting party may defeat a PSA claim against comingled assets, but must first successfully audit, trace, and identify commingled credit sale assets to exclude them from the floating trust.[213]

It is important to recall that a PSA claim grants the PSA claimant a trust fund claim against a packer's cash sale assets.[214] The statutory trust created by the PSA excludes those funds from the packer's estate until all PSA claims are paid in full.[215] As a result, creditors may not obtain or lay claim to PSA trust assets until all PSA claims are satisfied.[216] Because commingling subjects all commingled assets to the PSA trust, but for successful tracing by an objecting party, no creditor of a packer's estate may be paid from commingled funds subject to a PSA trust claim until all such claims are paid in full.[217] Thus, if any PSA claims remain unpaid, PSA claimants have a right to reclaim commingled assets paid to third parties, or set off by third parties against other debts.[218]

IV. PART THREE: THE PERISHABLE AGRICULTURAL COMMODITIES ACT

A. Legislative History and Purpose of PACA

PACA, which was first enacted in 1930, is another federal statute that, in a manner very similar to the PSA, creates a floating trust in favor of a particular

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211. *Id.* Note that the court in *Gotham* refers to the creation of a lien against all commingled funds. *Id.* As the court in *Gotham* repeatedly noted, the PSA does not create a statutory lien, but a floating trust. *Id.* The lien referred to by the Fifth Circuit presumably described a first right to payment from credit sale assets commingled with cash sale trust fund assets. *Id.*

212. *Id.*

213. *In re* Frosty Morn Meats, Inc., 7 B.R. 988, 1013 (M.D. Tenn. 1980).

214. *Id.* at 1001.

215. *Id.*

216. *Id.*

217. *See id.*

218. *See, e.g.*, First State Bank of Miami v. Gotham Provision Co. (*In re* Gotham Provision Co.), 669 F.2d 1000, 1003–04, 1010–11 (5th Cir. 1982) (holding that the bank that received more than $300,000 in accounts receivable from a bankrupt debtor prior to repayment of all PSA claims was required to disgorge payments received until PSA claimants were satisfied in full); *see also* Weichman Pig Co. v. Jack-Rich, Inc. (*In re* Jack-Rich, Inc.), 176 B.R. 476, 481–82 (Bankr. C.D. Ill. 1994) (requiring the bank that set off the account containing cash-sale proceeds subject to a PSA trust to disgorge all such funds for the benefit of PSA trust fund claimants); Bast v. Orange Meat Packing Co. (*In re* G & L Packing Co.), 20 B.R. 789, 802–10 (Bankr. N.D.N.Y. 1982), *aff'd*, 41 B.R. 903 (N.D.N.Y. 1984) (piercing the corporate veil of a bankrupt debtor and packer affiliate, holding both to be a unified entity for the slaughtering, packing, and processing of meat, and enabling PSA trust claimants to pursue assets of a non-bankrupt affiliate for the satisfaction of PSA trust claims).

producer.[219] In the case of PACA, the protected parties are producers of perishable fruits and vegetables.[220] The statute arose from Depression-era concerns that producers of perishable commodities had "little or no way to protect themselves from catastrophic loss when the buyer got into financial difficulties."[221] The vulnerability of such producers was contrasted with that of secured lenders, who are protected by liens.[222] As originally enacted, PACA merely imposed an obligation that buyers of perishable commodities make "full payment promptly," and imposed penalties for non-payment, including damages and revocation of the buyer's agricultural license.[223]

Congress subsequently determined that the statutory prompt payment requirement provided commodity producers with insufficient protection.[224] As a result, PACA was amended in 1984 to require buyers of perishable commodities to hold payments "in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment . . . has been received by such unpaid suppliers, sellers, or agents."[225] By design, the PACA floating trust is similar in form and application to the PSA floating trust.[226] In fact, case law has described the PSA as a legislative

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219. *See* 7 U.S.C. § 499 (2012).

220. *Id.*

221. *In re* Superior Tomato-Avocado, Ltd., 481 B.R. 866, 869 (Bankr. W.D. Tex. 2012); *see also* Hull Co. v. Hauser's Foods, Inc., 924 F.2d 777, 780 (8th Cir. 1991) (quoting Chidsey v. Geurin, 443 F.2d 584, 587 (6th Cir. 1971)) (stating that "[t]he original PACA enactments served 'to provide a particular remedy to small farmers and growers who were vulnerable to the sharp practices of financially irresponsible and unscrupulous brokers in perishable commodities'" (quoting *Chidsey*, 443 F.2d at 587)).

222. *Superior Tomato-Avocado, Ltd.*, 481 B.R. at 869 (stating that "[l]enders, by contrast, can protect themselves with liens").

223. *See Hull Co.*, 924 F.2d at 780 (discussing PACA prior to the 1984 amendments); *see also In re* Borek, 260 B.R. 886, 888–90 (Bankr. S.D. Fla. 2001) (discussing PACA prior to the 1984 amendments).

224. H.R. Rep. No. 98-543, at 2–3 (1983), *reprinted in* 1984 U.S.C.C.A.N. 405, 405–06. The House Report addressing the legislation that ultimately became the 1984 PACA amendments stated that the purpose of the amendments was to "increase the legal protection for unpaid sellers and suppliers of perishable agricultural commodities until full payment of sums due have been received by them." *Id.* The basis for providing additional protection was a finding by Congress that "in recent years, there has been a substantial increase in instances where commission merchants, dealers or brokers have failed to pay for perishable agricultural commodities received by them or have been slow in making payment therefor." *Id.* at 406; *see* Endico Potatoes, Inc. v. CIT Group/Factoring, Inc., 67 F.3d 1063, 1067 (2d Cir. 1995), *superseded by rule as stated in* Fleming Cos. v. U.S. Dep't of Agric., 322 F. Supp. 2d 744 (E.D. Tex. 2004); Tom Lange Co. v. Lombardo Fruit & Produce Co. (*In re* Lombardo Fruit & Produce Co.), 12 F.3d 806, 808–09 (8th Cir. 1993); JSG Trading Corp. v. Tray-Wrap, Inc., 917 F.2d 75, 77 (2d Cir. 1990); *see also* Quality Food Prods., Inc. v. Bolanos (*In re* Bolanos), 475 B.R. 641, 647 (Bankr. N.D. Ill. 2012) (discussing Congress's rationale for the 1984 PACA amendments by noting that, prior to the amendments, "[d]ue to a large number of defaults by the purchasers, and the sellers' status as unsecured creditors, the sellers recover, if at all, only after banks and other lenders who have obtained security interests in the defaulting purchaser's inventories, proceeds and receivables").

225. 7 U.S.C. § 499e(c)(2) (2012).

226. H.R. Rep. No. 98-543, at 2–3 (1983), *reprinted in* 1984 U.S.C.C.A.N. 405, 405–07 (stating that the PACA amendments incorporate provisions "similar to those of the Packers and Stockyards act" and noting that the payment problems affecting perishable commodity producers "are similar to the ones faced by the livestock industry in 1976 when an amendment very similar to this was added to the Packers and Stockyards act").

ancestor of PACA.[227] As such, early decisions on the amended version of PACA relied upon PSA case law to interpret the interaction between PACA and the Bankruptcy Code.[228] In addition, while PSA case law continues to provide helpful guidance on the application of the PACA floating trust, an independent body of PACA case law has also developed to address certain bankruptcy-related issues.[229]

B. Requirements for the Establishment of the PACA Trust

The creation and preservation of a PACA trust requires a showing that (1) particular types of perishable commodities were shipped; (2) the purchaser falls within one of the specific classes of purchasers; and (3) the supplier delivered a particularized written notice of intent to preserve the PACA trust.[230] If a party is able to demonstrate that any of these elements have not been met, then no floating trust is created and the normal bankruptcy claim hierarchy rules will apply.[231] Courts generally agree that the party seeking to disprove the trust has the burden to demonstrate that PACA does not apply.[232]

1. Qualifying Commodities

PACA applies to "[f]resh fruits and fresh vegetables of every kind and character," "whether or not frozen or packed in ice."[233] PACA does not cover fruits and vegetables if they "have been manufactured into articles of food of a different kind or character."[234] Generally speaking, this means that only "[u]nprocessed or very minimally processed fruits and vegetables" will

227. *Superior Tomato-Avocado, Ltd.*, 481 B.R. at 872; *In re* Fresh Approach, Inc., 51 B.R. 412, 419–20 (Bankr. N.D. Tex. 1985).

228. *Fresh Approach*, 51 B.R. at 419 (stating that "[b]ecause of the youth of the PACA amendments, there is a dearth of caselaw regarding the interplay of PACA and the Bankruptcy Code. Consequently, this Court has often found itself sailing hitherto uncharted waters, and has relied frequently upon analogies drawn to similar rights and circumstances involving other statutes and doctrines," including the PSA).

229. *See generally Superior Tomato-Avocado, Ltd.*, 481 B.R. 866 (discussing PACA trusts); *Fresh Approach*, 51 B.R. 412 (discussing PACA trusts).

230. *See* 7 U.S.C. § 499(c) (2012).

231. *Id.*

232. *See* Troy Vitrano Co. v. Nat'l Produce Co., 815 F. Supp. 23, 24–25 (D. D.C. 1993); Gullo Produce Co. v. A.C. Jordan Produce Co., 751 F. Supp. 64, 68 (W.D. Pa. 1990); *In re* Churchfield, 277 B.R. 769, 773 (Bankr. E.D. Cal. 2002); *Fresh Approach*, 51 B.R. at 422. *But see* Callaway Produce Co. v. Bear Kodiak Produce, Inc. (*In re* Bear Kodiak Produce, Inc.), 283 B.R. 577, 585 & n.10 (Bankr. D. Ariz. 2002) (stating that it was "unclear" whether the bank arguing against the establishment of a PACA trust bore the burden of disproving the trust elements).

233. 7 U.S.C. § 499a(b)(4)(A).

234. 7 C.F.R. § 46.2(u) (2010). This regulation lists various processes that do not change the character of a fruit or vegetable including "chopping, color adding, curing, . . . refrigerating, shredding, . . . waxing, adding of sugar or other sweetening agents[,] . . . or comparable methods of preparation." *Id.*

qualify.[235] Thus, for example, potatoes are covered by PACA, but french fries are not.[236]

2. *Qualifying Purchasers*

PACA applies if a purchaser of qualified fresh fruits or vegetables falls within the statutory definition of a "commission merchant," a "dealer," or a "broker."[237] A commission merchant is defined 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."[238] A dealer is defined as an entity in the business of buying or selling, in interstate or foreign commerce,[239] fresh fruits and vegetables in "wholesale or jobbing quantities" and of a cost value greater than $230,000 in any calendar year.[240] The statute leaves the determination of what constitutes "wholesale or jobbing quantities" to the Secretary of Agriculture.[241] This determination is set forth in the Code of Federal Regulations, which provides that wholesale or jobbing quantities are "aggregate quantities of all types of produce totaling one ton (2,000 pounds) or more in weight in any day shipped, received, or contracted to be shipped or received."[242] The "any day" requirement has been interpreted to mean that once the quantity requirement is met on a particular day, all future shipments are subject to PACA, regardless of weight.[243] In addition, a broker is defined as an entity negotiating purchases and sales for or on behalf of a qualified vendor or purchaser.[244] PACA further requires dealers and brokers to obtain licenses from the Secretary of Agriculture.[245]

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235. *In re* Long John Silver's Rests., Inc., 230 B.R. 29, 33 (Bankr. D. Del. 1999), *superseded by rule as stated in* Fleming Cos. v. US. Dep't of Agric., 322 F. Supp. 2d 744 (E.D. Tex. 2004) (quoting A&J Produce Corp. v. CIT Group/Factoring, Inc., 829 F. Supp. 651, 658 (S.D.N.Y. 1993), *aff'd in part*, *rev'd in part*, Endico Potatoes, Inc. v. CIT Group/Factoring, Inc., 67 F.3d 1063 (2d Cir. 1995)).

236. *Id.*

237. *See* 7 U.S.C. § 4996 (2012).

238. 7 U.S.C. § 499a(b)(5).

239. *See* Bank of L.A. v. Official PACA Creditors' Comm. (*In re* Southland + Keystone), 132 B.R. 632, 640 (B.A.P. 9th Cir. 1991) (interpreting 7 U.S.C. § 499a(b)(8)). Interstate commerce is defined very broadly and generally will not require the produce to actually cross state lines. *Id.*

240. 7 U.S.C. § 499a(b)(6).

241. *Id.*

242. 7 C.F.R. § 46.2(x) (2013). Generally speaking, restaurants will be considered PACA dealers if the quantity and value elements are met. *See* Demma Fruit Co. v. Old Fashioned Enters., Inc. (*In re* Old Fashioned Enters., Inc.), 236 F.3d 422, 426 (8th Cir. 2001).

243. Indianapolis Fruit Co. v. Locavore Food Distribs., Inc., No. 10-14070, 2011 WL 4373976, at *3 (E.D. Mich. Sept. 20, 2011).

244. 7 U.S.C. § 499a(b)(7).

245. 7 U.S.C. § 499c (2012). The PACA discussion in this Article generally assumes that the debtor is the purchaser of the perishable commodities and that the creditors are fighting over the effect of the PACA trust fund on funds held by such a debtor. *See supra* Part Three, Section A. Note also, however, that the PACA licensing requirements can cause significant issues for a debtor when the debtor is the supplier of the commodities because 7 U.S.C. § 499d(a) could be interpreted to provide that the license would be terminated upon a plan of reorganization. *See also* Ancel et al., *supra* note 8, at 47–48 (discussing the possible termination of a license under 7 U.S.C. § 499d(a)).

3. Notice Requirements

The final element for the establishment of a PACA trust is that an entity selling perishable fruits and vegetables must provide certain types of written notice to the purchasing party.[246] Notice may be provided either by (1) the supplier sending the purchaser a notice of intent to preserve the PACA trust (the "notice of intent method"), or (2) the supplier including particular language on invoices sent to the purchaser (the "invoice method").[247] The notice of intent method requires that, within thirty calendar days after payment for the perishable commodities is due, the supplier must send the purchaser a written notice of intent to preserve the PACA trust.[248] This notice must include specific information related to the identity of the parties, the date of the applicable transaction, and the agreed-upon payment terms.[249] The invoice method, which is available only to PACA licensees, requires the supplier to include the following language on invoices sent by the supplier to the purchaser:

> 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.[250]

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246. 7 U.S.C. § 499e(c)(3) (2012).

247. *Id.* §499e(3)–(4).

248. *Id.* § 499e(c)(3).

249. *Id.* The notice:

> must include the statement that it is a notice of intent to preserve trust benefits and must include information which establishes for each shipment: (i) The names and addresses of the trust beneficiary, seller-supplier, commission merchant, or agent and the debtor, as applicable, (ii) the date of the transaction, commodity, invoice price, and terms of payment (if appropriate), (iii) the date of receipt of notice that a payment instrument has been dishonored (if appropriate), and (iv) the amount past due and unpaid.

7 C.F.R. § 46.46(f) (2013). Prior to being amended in 1995, 7 U.S.C. § 499e(c)(3) also required the supplier to file the notice with the Secretary of Agriculture. 7 U.S.C. § 499e (2012). Such a filing is not required in the amended version, although some post-1995 case law continues to state that notifying the Secretary is required. *See, e.g.*, *In re* Yarnell's Ice Cream Co., 469 B.R. 823, 827 (Bankr. E.D. Ark. 2012) ("The seller [can comply with the notice requirement by sending] the buyer and the Secretary of Agriculture a written notice of intent to preserve trust benefits . . . .").

250. 7 U.S.C. § 499e(c)(4) (internal quotation marks omitted). Section 499e(c)(4) sets forth the requirements for a "licensee" to take advantage of the invoice method. *Id.* The fact that the notice of intent method in § 499e(c)(3) does not use the term "licensee" has led some to conclude that, notwithstanding the requirements in 7 U.S.C. § 499c, a supplier is not required to be licensed for the establishment of a PACA trust fund. *Id.* Rather, licensing conveys an advantage because it allows the supplier to use the invoice method, while non-licensees are limited to the more onerous notice of intent method. *See In re* Superior Tomato-Avocado, Ltd., 481 B.R. 866, 869 n.3 (Bankr. W.D. Tex. 2012); *see also* Enoch Packing Co. v. Emerich & Fike (*In re* Enoch Packing Co.), 386 Fed. Appx. 611, 613 (9th Cir. 2010) ("As an entity not licensed under PACA, the Floreses' sole method of preserving their trust benefits was to give notice pursuant

Under the invoice method, the supplier is not required to specify the payment terms on the face of the invoice as long as the agreed-upon payment terms meet the "prompt payment" definition under PACA.[251] Namely, the purchaser must make payment within the sooner of (1) ten days following the sale with respect to each shipment, or (2) twenty days from acceptance of the perishable commodities.[252] If the parties agree upon alternative payment terms, the parties must expressly agree to the terms in writing, and must list the terms on the face of the invoice.[253] The PACA trust will not be preserved if the payment terms are over thirty days.[254]

C. PACA and Bankruptcy

In the context of bankruptcy, the PACA trust leads to the same policy friction between preservation of a trust fund and the equitable treatment of a debtor's creditors that was discussed above with respect to the PSA trust. That said, a distinct body of bankruptcy practice and case law involving PACA has developed. As to bankruptcy practice, it is not uncommon in larger bankruptcy cases involving PACA claims for the bankruptcy court to approve of procedures for PACA claimants to make their claims in a specified format and prior to a specified PACA claims bar date.[255] It is generally accepted that if a PACA claimant does not comply with such procedures, it cannot take advantage of the PACA trust fund, even if the claimant otherwise complied with the statutory PACA elements.[256]

As to bankruptcy case law, a number of bankruptcy courts have analyzed the most fundamental PACA issue: whether the statutory elements have been met and, therefore, whether a PACA trust was established or maintained. A significant split in bankruptcy case law has developed on the issue of whether or not strict compliance with the statutory notice requirements is necessary for the creation of the trust.[257] This split in the case law is illustrated through the analysis of two recent cases on either side of the issue. The first case, *In re Superior Tomato-Avocado, Ltd.*,[258] involved Superior Tomato-Avocado, Ltd. (Superior), an entity that purchased produce and supplied it to grocery stores.

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to § 499e(c)(3)."); Anic, Inc. v. Chipwich, Inc. (*In re* Chipwich, Inc.), 165 B.R. 135, 139 (Bankr. S.D.N.Y. 1994) ("Therefore, even though Chipwich did not possess a PACA license, the Plaintiffs could have protected themselves as trust beneficiaries by serving and filing trust notices naming Chipwich.").

251. 7 C.F.R. § 46.46(3)(ii) (2013).

252. *Id.* (requiring invoices to specify terms of payment if the terms differ from the prompt payment requirements set out in 7 C.F.R. § 46.2(z)(2)).

253. *Id.*

254. 7 C.F.R. § 46.46(e)(2) (2013).

255. *See, e.g.*, VLM Food Trading Int'l, Inc. v. Ill. Trading Co., No. 12 C 8154, 2013 WL 3506392, at *3 (N.D. Ill. July 11, 2013) ("The function of a PACA claims procedure is not merely to identify creditors—it is also to provide notice and deadlines to unpaid creditors who seek to recover funds.").

256. *Id.* at *2–*3.

257. *In re* Superior Tomato-Avocado, Ltd., 481 B.R. 866, 870 (Bankr. W.D. Tex. 2012).

258. *Id.* at 867.

Superior filed Chapter 11 bankruptcy and one of its produce suppliers, A&A Concepts, LLC (A&A), asserted a PACA trust fund claim in Superior's bankruptcy case.[259] A&A sought to preserve the PACA trust via the notice of intent method.[260] To that end, A&A sent Superior a "generic statement of account" consisting of approximately one hundred invoices with a cover page stating "NOTICE OF INTENT TO PRESERVE PACA TRUST BENEFITS."[261] Superior's counsel asserted, and the court agreed, that A&A's notice did not strictly comply with the notice of intent method set forth in § 466e(c)(3).[262] The issue before the bankruptcy court was whether substantial compliance with the notice requirement was sufficient to establish the trust.[263]

The court began its analysis by surveying case law on both sides of the issue.[264] The court concluded that both "[t]he weight of authority as well as the current trend in the case law both tip in favor of substantial compliance."[265] The reasoning behind the case law allowing substantial compliance, according to the *Superior Tomato-Avocado* court, was that liberal construction of PACA should be permitted, given the legislative history demonstrating that the statute was enacted to protect produce sellers.[266] The court also took note of case law determining that PACA is not in opposition to the policies of the Bankruptcy Code because the legislative history of the Code demonstrates that statutory trust funds were never intended to be included as property of the estate.[267]

The court then turned to analyzing the various arguments relied upon by courts adopting the minority view.[268] The first argument raised by such courts is that the favoritism inherent in PACA "stand[s] in direct opposition to the fundamental functions of the Bankruptcy Code, which is to assure a *pro rata* distribution with a minimum of special priorities for otherwise similarly entitled creditors."[269] The *Superior Tomato-Avocado* court disagreed with this analysis

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259. *Id.* at 868.

260. *Id.* at 869. According to the court, as a non-licensee, A&A was not permitted to use the invoice method. *Id.* at 869 n.3.

261. *Id.* at 869 (internal quotation marks omitted).

262. 7 U.S.C. § 499e(c)(3) (2012). Foregoing references to § 499e refer to 11 U.S.C. § 499e. *See* 11 U.S.C. § 499e.

263. *Superior Tomato-Avocado, Ltd.*, 481 B.R. at 869–70.

264. *Id.* at 870–73.

265. *Id.* at 870 (citing Hull Co. v. Hauser's Foods, Inc., 924 F.2d 777, 782–83 (8th Cir. 1991); Food Authority, Inc. v. Sweet & Savory Fine Foods, Inc., No. 10-CV-1738 (JS)(WDW), 2011 WL 477714 (E.D.N.Y. Feb. 4, 2011); Atlantic Coast Produce, Inc. v. McDonald Farms, Inc., No. Civ.A.5:04 CV 00015, 2005 WL 1785137 (W.D. Va. July 21, 2005); Tom Lange Co. v. Lombardo Fruit & Produce Co. (*In re* Lombardo Fruit & Produce Co.), 107 B.R. 654 (Bankr. E.D. Mo. 1989), *aff'd in part*, *rev'd in part*, 12 F.3d 806 (8th Cir. 1993); Dubin v. Carlton Fruit Co. (*In re* Carlton Fruit Co.), 84 B.R. 810 (Bankr. M.D. Fla. 1988); *In re* W.L. Bradley Co., 75 B.R. 505, 511–12 (Bankr. E.D. Pa. 1987)).

266. *Id.* at 871.

267. *Id.* at 871 n.4.

268. *Id.* at 871–73.

269. *Id.* at 871 (citing Bowlin & Son, Inc. v. San Joaquin Food Serv., Inc. (*In re* San Joaquin Food Serv., Inc.), 958 F.2d 938 (9th Cir. 1992); Anic, Inc. v. Chipwich, Inc. (*In re* Chipwich, Inc.), 165 B.R. 135 (Bankr. S.D.N.Y. 1994); Blair Merriam Fresh Fruit & Produce Co. v. Clark (*In re* D.K.M.B., Inc.), 95 B.R. 774 (Bankr. D. Colo. 1989)).

for two reasons.[270] First, as noted above, the Bankruptcy Code recognizes that trust funds are not property of the estate.[271] Second, the tenets of statutory construction favor PACA over the Bankruptcy Code.[272] Specifically, "PACA provides for a special remedy for a specific class of creditors . . . ."[273] Therefore, PACA is a more specific statute than the Bankruptcy Code, and specific statutes should govern over general ones.[274] In addition, whereas PACA was first enacted in 1930, the relevant amendments addressing notice were enacted in 1984 and 1995.[275] Therefore, because the Bankruptcy Code was enacted in 1978, PACA is the more recent statute, and "as the later statute, should take precedence in the event of a conflict."[276] As such, the *Superior Tomato-Avocado* court ruled in favor of A&A because its substantial compliance with PACA was sufficient to establish the trust.[277]

The case *In re Ebro Foods, Inc.* provides an example of the other side of the debate.[278] While the *Superior Tomato-Avocado* case dealt with the notice of intent method, the *Ebro Foods* case dealt with the invoice method.[279] In *Ebro Foods*, G and G Peppers, LLC (G&G) was a licensed PACA dealer and supplied produce to food manufacturer Ebro Foods, Inc. (Ebro).[280] The transactions at issue began with three purchase orders Ebro sent to G&G.[281] The purchase orders provided that payment would be "[n]et 30 days."[282] In addition, at Ebro's request, G&G acknowledged receipt of the purchase orders by faxing signed copies back to Ebro.[283] G&G thereafter sent Ebro the amount of produce set forth in the purchase orders, along with invoices setting forth a total amount due of $42,920.[284] The invoices included the verbatim PACA notice language required by § 499e(c)(4).[285] However, the invoices also included a box setting forth payment terms as "PACA 'terms.'"[286]

Ebro failed to pay the $42,920 and G&G exercised its right under PACA to file an administrative complaint against Ebro with the United States

270. *Superior Tomato-Avocado, Ltd.*, 481 B.R. at 872–73.
271. *Id.* at 872; *supra* note 198 and accompanying text.
272. *Superior Tomato-Avocado, Ltd.*, 481 B.R. at 872.
273. *Id.*
274. *See id.* (citing Bulova Watch Co. v. United States, 365 U.S. 753, 758 (1961); Overton Distribs., Inc. v. Heritage Bank, 340 F.3d 361, 365 (6th Cir. 2003)).
275. *Id.* at 872–73.
276. *Id.* at 873.
277. *Id.*
278. G & G Peppers, LLC v. Ebro Foods, Inc. (*In re* Ebro Foods, Inc.), 424 B.R. 420 (Bankr. N.D. Ill. 2010), *aff'd in part, rev'd in part*, 449 B.R. 759 (N.D. Ill. 2011).
279. *Compare Superior Tomato-Avocado, Ltd.*, 481 B.R. 866, *with Ebro Foods*, *Inc.*, 424 B.R. 420.
280. *Ebro Foods*, *Inc.*, 424 B.R. at 423.
281. *Id.*
282. *Id.*
283. *Id.*
284. *Id.*
285. *Id.*
286. *Id.* (internal quotation marks omitted).

Department of Agriculture (USDA).[287] The USDA ruled in G&G's favor, and G&G thereafter sought to enforce the ruling in federal district court.[288] The court stayed that proceeding when Ebro filed bankruptcy.[289] G&G then filed an adversary proceeding seeking the turnover of the $42,920 on the grounds that Ebro held it in trust under PACA.[290] The bankruptcy court parsed through the invoice method notice requirements to determine whether G&G complied with the statute.[291] The court acknowledged that G&G set forth the correct language under § 499e(c)(4).[292] The issue in the case, however, turned on G&G's statement "that the payment terms were "PACA 'terms.'"[293] As noted above, the default payment terms under PACA require the purchaser to pay within ten days after sale of the produce.[294] The invoice method requires the language in § 499e(c)(4), but also refers back to § 499e(c)(3), which provides:

> When the parties expressly agree to a payment time period different from that established by the Secretary, a copy of any such agreement shall be filed in the records of each party to the transaction and the terms of payment shall be disclosed on invoices, accountings, and other documents relating to the transaction.[295]

The *Ebro Foods* court noted that the purchase orders, which were signed by G&G, set forth thirty-day payment terms, while the invoices set forth PACA terms, presumably referring to the default ten-day terms.[296] The court thus held that G&G and Ebro had "expressly" agreed to a different payment method and that G&G failed to comply with the invoice method because these different terms were not set forth on the invoices.[297] The court refused to accept G&G's arguments that it had "largely complied" with the invoice method and cited to case law requiring strict compliance.[298] The court stated that strict compliance

287. *Id.*
288. *Id.*
289. *Id.*
290. *Id.* at 423–24.
291. *Id.* at 428–30.
292. *See id.* at 423.
293. *See id*. (internal quotation marks omitted).
294. 7 C.F.R. § 46.2(z)(2) (2010).
295. 7 U.S.C. § 499e(c)(3) (2012).
296. *Ebro Foods*, *Inc.*, 424 B.R. at 423.
297. *Id.* at 426, 430.
298. *Id.* (citing Bocchi Ams. Assocs., Inc. v. Commerce Fresh Mktg., Inc., 515 F.3d 383 (5th Cir. 2008); Am. Banana Co. v. Republic Nat'l Bank of N.Y., N.A., 362 F.3d 33 (2d Cir. 2004); Patterson Frozen Foods, Inc. v. Crown Foods Int'l, Inc., 307 F.3d 666 (7th Cir. 2002), *superseded by statute as stated in* C.H. Robinson Worldwide, Inc. v. Auster Acquisitions, LLC, No. 11 C 105, 2011 WL 3159155 (N.D. Ill. 2011); Bowlin & Son, Inc. v. San Joaquin Food Serv., Inc. (*In re* San Joaquin Food Serv., Inc.), 958 F.2d 938 (9th Cir. 1992)); *see also In re* Yarnell's Ice Cream Co., 469 B.R. 823 (Bankr. E.D. Ark. 2012) (holding that the PACA trust was not created when the supplier left out a sentence in the 7 U.S.C. § 499e(c)(3) language). Note that, while the *Superior Tomato-Avocado* court took the position that the substantial compliance line of case law is the majority view, more cases cited by the *Ebro Foods* court in support of its strict compliance

is necessary because of the "special nature of the PACA trust provisions."[299] G&G thereafter appealed to the district court.[300] The district court affirmed the bankruptcy court's PACA ruling.[301]

The intersection between PACA and bankruptcy law is not limited to matters related to notice. In fact, bankruptcy courts have addressed a number of PACA issues. These include whether the trust fund created by PACA imposes a fiduciary relationship between the debtor and the produce supplier, such that the breach of the trust would create grounds for denying the debtor's bankruptcy discharge.[302] Another issue that has come up in bankruptcy cases is whether a director or officer of a bankrupt debtor incurs personal liability by failing to put into place mechanisms for preserving PACA trust funds.[303] Courts have also analyzed whether contractual attorneys' fees and interest should be included when a party asserts a PACA trust fund claim in a bankruptcy case.[304] Ultimately, however, whether the PACA trust fund is created or maintained will be the most important issue in any bankruptcy case involving PACA. To put it another way, there will not be any cause to address other issues if a PACA trust was neither created nor thereafter preserved.

V. PART FOUR: STATE TRUST FUND LAW

Legislation creating trust funds in favor of agricultural producers is not limited to federal law. A number of state legislatures have enacted laws imposing trusts similar to those created by the PSA and PACA.[305] Those

ruling indicate more support at the circuit court level. *See In re* Superior Tomato-Avocado, Ltd., 481 B.R. 866, 870 (Bankr. W.D. Tex. 2012).

299. *Ebro Foods*, *Inc.*, 424 B.R. at 427. The court did not elaborate on what makes a PACA trust fund any different or more "special" than other trusts created under state or federal law. *Id.*

300. G & G Peppers, LLC v. Ebro Foods, Inc. (*In re* Ebro Foods, Inc.), 449 B.R. 759, 761 (N.D. Ill. 2011).

301. *Id.* at 767.

302. *See, e.g.*, Quality Food Prods., Inc. v. Bolanos (*In re* Bolanos), 475 B.R. 641 (Bankr. N.D. Ill. 2012); KGB Int'l, Inc. v. Watford (*In re* Watford), 374 B.R. 184 (Bankr. M.D.N.C. 2007); *see also* Michael D. Sousa, *Are You Your Vendor's Keeper? The Perishable Agricultural Commodities Act and § 523(a)(4) of the Code*, 15 J. BANKR. L. & PRAC. 6 Art. 3 (Dec. 2006).

303. *See, e.g.*, Golman-Hayden Co. v. Fresh Source Produce, Inc., 217 F.3d 348 (5th Cir. 2000); *Watford*, 374 B.R. 184; *see also* Nichole Leonard, *The Unsuspecting Fiduciary: The Curious Case of PACA and Personal Liability*, 25 AM. BANKR. INST. J. 32 (2006).

304. *See* Country Best, M&M v. Christopher Ranch, LLC, 361 F.3d 629, 632 (11th Cir. 2004) (concluding also that Congress did not intend such limitations); Middle Mountain Land & Produce Inc. v. Sound Commodities Inc., 307 F.3d 1220, 1224 (9th Cir. 2002) (reversing the bankruptcy court's decision disallowing attorneys' fees and concluding that "[t]here is no evidence that Congress intended to exclude contractual rights to attorneys' fees and interest as outside the scope of a PACA claim"). *Contra* Nobles-Collier, Inc. v. Hunts Point Tomato Co., Nos. 02 Civ. 4128 (LMM), 02 Civ. 5287 (LMM), 2004 WL 102756, at *2 (S.D.N.Y. Jan. 22, 2004) (concluding that PACA does not provide for either attorney's fees or interest); Dimare Homestead, Inc. v. Fair (*In re* Fair), 134 B.R. 672, 676 (Bankr. M.D. Fla. 1991) (holding that suppliers were not entitled to attorneys' fees because such fees were not expressly provided for in the PACA statute).

305. *See, e.g.*, NY AGRIC. & MKTS. LAW ch. 69, art. 20 (2013); TEX. AGRIC. CODE ANN. § 103.002 (2009).

statutes are important because, while the Bankruptcy Code is federal law, the Supreme Court has made it clear that property interests, such as whether or not an asset is held in trust, continue to be governed by state law during a bankruptcy case.[306] Therefore, a debtor operating in multiple states is potentially presented with a patchwork quilt of state laws governing when producers of certain agricultural commodities are entitled to be paid.

This section will analyze the trust fund legislation enacted by one particular state that protects producers' payment interests in relation to one particular agricultural commodity.[307] Specifically, it will focus on the protection provided by Texas law to milk producers. Chapter 181 of the Texas Agricultural Code (Chapter 181) is entitled "Payment for Raw Milk."[308] Section 181.002 requires a milk processor to "hold in trust all payments received from the sale of milk for the benefit of the dairy farmer from whom the milk was purchased until the dairy farmer has received full payment of the purchase price for the milk."[309] Chapter 181 defines both "milk processor" and "dairy farmer" broadly,[310] thus ensuring that a wide swath of milk-related producers and purchasers are covered. In addition, dairy farmers selling milk through a cooperative association are expressly covered under Chapter 181.[311]

Chapter 181 provides dairy farmers with even greater protection by requiring milk processors to establish an escrow account for the benefit of the dairy farmer.[312] Upon a dairy farmer's demand, a milk processor must create such an escrow account and,

> on receipt of a payment from the sale of milk or dairy products, deposit into the account a sum of money determined by multiplying the total amount of all payments received by the milk processor from the sale of milk or dairy products by the fraction determined by dividing the total quantity of milk purchased by the milk processor for sale as milk or dairy products into the quantity of milk sold by the dairy farmer to the milk processor. The milk

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306. Butner v. United States, 440 U.S. 48, 56 (1979).

307. While a comprehensive state-by-state analysis of trust fund legislation is outside the scope of this Article, this small sampling of state law should stand as a warning to producers, purchasers, and secured lenders that it is worth the time to investigate state trust fund legislation in jurisdictions where the parties do business.

308. AGRIC. ch. 181.

309. AGRIC. § 181.002(a).

310. AGRIC. § 181.001(3). "'Milk processor' means a person who operates a milk, milk products, or frozen desserts processing plant that is located in Texas." *Id.* "'Dairy farmer' means a farmer engaged in the business of producing milk for sale to milk processors directly or through a cooperative association of which the dairy farmer is a member." *Id.* § 181.001(2).

311. AGRIC. § 181.0015. "When a dairy farmer sells or markets milk through a cooperative association of which the dairy farmer is a member, the cooperative association is considered a dairy farmer for purposes of this chapter." *Id.* "'Cooperative association' means any group in which farmers act together in the market preparation, processing, or marketing of farm products or any association organized under Chapter 52 of this code." AGRIC. § 181.001(1).

312. AGRIC. § 181.002(c).

> processor shall continue to make payments into the escrow account until the dairy farmer has received full payment of the purchase price for the milk.[313]

Chapter 181 also specifies the damages that a dairy farmer is entitled to if the milk processor fails to pay for the milk, including the milk purchase price, "interest on the purchase price at the highest legal rate, from the date possession is transferred until the date payment is made in accordance with [Chapter 181]," and attorneys' fees.[314]

By any measure, Chapter 181 provides an extraordinary level of payment protection to dairy farmers and cooperatives. It follows that other creditors and debtors would have the incentive to litigate the applicability of the statute and the scope of this protection. Surprisingly, however, with the exception of *Lone Star Milk Producers, Inc. v. Litzler*, no court at the state or federal level has analyzed the protections provided by Chapter 181.[315] *Lone Star* involved the Chapter 7 bankruptcy case of ice cream manufacturer Americana Foods Limited Partnership (Americana).[316] Lone Star Milk Producers, Inc. (Lone Star) was a cooperative association that supplied raw milk to Americana.[317] As of the petition date, Americana owed Lone Star $585,593.10 for milk delivered by Lone Star to Americana (the Milk Funds).[318] JPMorgan Chase Bank, N.A. (JPMorgan) held a lien on substantially all of Americana's assets.[319] Lone Star filed an adversary proceeding complaint against Americana and JPMorgan seeking recovery of the Milk Funds on the grounds that they were held by Americana in trust for Lone Star pursuant to Chapter 181.[320]

JPMorgan opposed the relief and argued that, among other things, Chapter 181 did not create an express trust and that state law cannot "rewrite the priorities established in the Bankruptcy Code [by] impermissibly put[ting] 'dairy farmers' ahead of other creditors."[321] The bankruptcy court noted the general rule that property held in trust is not property of the estate.[322] But the court went on to state that "the ability of a state to create trusts excluding property from bankruptcy estates is clearly not without limitation. For instance, states may not create laws that are solely meant to manipulate bankruptcy

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313. *Id.* Chapter 181 also specifies that the escrow account must be an interest bearing account "with a financial institution located in [Texas] the deposits of which are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation." *Id.* § 181.002(d).

314. AGRIC. § 181.005(2).

315. Lone Star Milk Producers, Inc. v. Litzler, 370 B.R. 671 (Bankr. N.D. Tex. 2007). Note that co-author Jason Binford was co-counsel in the representation of Lone Star Milk Producers, Inc. in the adversary proceeding leading to this reported decision. *Id.* at 673.

316. *Id.* at 674.

317. *Id.*

318. *Id.*

319. *Id.* at 679. JPMorgan's collateral "included, among other things, all inventory, farm products and receivables, which extended to all proceeds, products, rents and proceeds thereof." *Id.*

320. *Id.* at 674.

321. *Id.* at 676.

322. *See id.*

priorities."[323] To that point, the court went on to formulate the following rule: "[A] state may create a statute that imposes a trust excluding property from a bankruptcy estate as long as the statute also has valid non-bankruptcy applications and the trust attaches prior to the petition date."[324]

The court thereafter concluded that Chapter 181 created an express trust and otherwise met the test for a valid trust.[325] As such, the milk funds were never property of Americana's bankruptcy estate, JPMorgan's lien never attached to such funds, and the Chapter 7 trustee was required to pay the milk funds to Lone Star, plus interest and attorneys' fees.[326] The court also held that recovery to Lone Star was not predicated on Lone Star's ability to "identify which products contained the specific raw milk that [Lone Star] sold to [Americana]."[327] In other words, Lone Star was not required to trace the milk funds.[328]

Other states have also enacted statutes purporting to create trust funds for the benefit of producers of other types of agricultural commodities.[329] Whether these statutes create express trusts and otherwise meet the state law test set forth in *Lone Star* remains undetermined. Nevertheless, while there is little case law guidance, the difference between a trust fund created under state law and a trust fund created under federal law is a crucial distinction. The limited ability of state law to trump the bankruptcy claim hierarchy would seem a natural point of attack when a producer cites to a state trust fund statute. On the other hand, from the perspective of producers, if statutory protection is available in a particular state, and if a producer is able to show that the statute was not designed to trump bankruptcy priorities, state trust fund statutes may provide means to being paid in full, plus interest and attorneys' fees. In the context of being owed money by a debtor, that is the absolute best any creditor can hope for.

VI. PART FIVE: THE FOOD SECURITY ACT

The above discussion of federal and state legislation focuses on how the creation of statutory trusts can extract assets from a bankruptcy estate that could otherwise pay secured creditors, and how unsecured trust fund claimants may obtain full payment of their claims regardless of the bankruptcy claim

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323. *Id.* (citing Haber Oil Co. v. Swinehart, 12 F.3d 426, 435 (5th Cir. 1994)).
324. *Id.* at 677.
325. *Id.* at 678.
326. *Id.* at 679.
327. *Id.* at 680 (likening Chapter 181 to the PACA trust, which also does not require tracing).
328. *Id.*
329. *See, e.g.*, CAL. FOOD & AGRIC. CODE § 56701 (2013) (creating a trust fund in favor of producers of farm products); MINN. STAT. ANN. § 27.138 (2001) (creating a trust fund in favor of producers of produce and products of produce); MISS. CODE ANN. § 75-31-505 (2013) (requiring a milk processor to hold payments in trust); N.Y. AGRIC. & MKTS. LAW § 250-a (2005); *cf.* S.D. CODIFIED LAWS § 40-20-10.1 (2013) (requiring proceeds from the sale of livestock to be held in trust if the livestock were shipped to an open market without authorization).

hierarchy. This section focuses on the Food Security Act (FSA), which does not involve the creation of a statutory trust. Instead, the FSA dramatically affects the creditor claim hierarchy by stripping a secured creditor's liens from farm products purchased in the ordinary course of business unless extraordinary measures are taken by the secured creditor to preserve those liens.[330]

A. Federal Preemption and the History of the Food Security Act

In December 1985, Ronald Reagan signed into law the Food Security Act of 1985 (FSA).[331] The purpose of § 1324 of the FSA, entitled "Protection for Purchasers of Farm Products," was to eliminate the farm products exception, which Congress viewed as an impediment to interstate commerce.[332] The farm products exception arose out of § 9-307(1) of the Uniform Commercial Code, now incorporated in § 9-320(a), and provides that "a buyer in the ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence."[333] As a result of the farm products exception, buyers of farm products faced the potential for double liability following a purchase.[334] For example, "a seller . . . could take sale proceeds and fail to repay a secured creditor, and the creditor could then seek payment from the buyer who took the goods subject to the undisclosed and practically undiscoverable security interest."[335] Even if the buyer knew of the security interest, the buyer likely had "no reasonable means to ensure that the seller [used] the sales proceeds to repay the lender."[336]

330. *See* 7 U.S.C. § 1631 (2012). The following example highlights the potential chaos to the claims hierarchy caused by the FSA: Lender finances Borrower's farming operations. Borrower grants Lender a first lien on all crops. Borrower informs Lender of intent to sell crops to Purchaser. Lender provides notice of lien to Purchaser. Purchaser buys crops for resale and delivers payment to Borrower. Borrower fails to pay Lender. Shortly thereafter, the price of crops plummets, and Purchaser files bankruptcy. If Lender provided proper notice and the Purchaser retained the crops, the Lender retains a secured claim in the crops during Purchaser's bankruptcy case. If Lender provided proper notice and Purchaser resold or otherwise disposed of the crops prior to bankruptcy, Lender has an unsecured claim against Purchaser for conversion. If the Lender's notice was inadequate, Lender has *no claim* in Purchaser's bankruptcy case, and must seek recovery from Borrower. *Id.*

331. Presidential Statement on Signing the Food Security Act of 1985 into Law, 21 WEEKLY COMP. PRES. DOC. 1528 (Dec. 23, 1985).

332. 7 U.S.C. § 1631. Section 1324 of the FSA is codified at 7 U.S.C. § 1631. *Id.* Further references to sections of the FSA will utilize the statutory location to eliminate potential confusion. *See id.* § 1631(a)–(b) (2012); McDonald v. Ocilla Cotton Warehouse, Inc. (*In re* McDonald), 224 B.R. 862, 866 (Bankr. S.D. Ga. 1998).

333. U.C.C. § 9-320(a) (2012) (formerly incorporated in § 9-307(1) (1978)) (applicable at time of enactment of the FSA).

334. Farm Credit Servs. of Mid Am. v. Rudy, Inc., No. C-3-93-271, 1995 WL 1622801, at *3 (S.D. Ohio Mar. 8, 1995).

335. *Id.*

336. 7 U.S.C. § 1631(a)(1).

By the passage of the FSA, Congress statutorily abrogated the widely accepted farm products exception.[337] The new general rule established by the FSA provides that farm product purchasers take farm products free and clear of liens, even if the security interest is properly perfected pursuant to state law, and the buyer is aware of the security interest.[338] The general rule is not without certain exceptions. Lenders may still preserve and enforce their security interests against purchasers in certain situations, described in more detail below.[339]

It is important to note that the FSA does not serve as a means of perfecting a security interest in farm products. As noted in the FSA's legislative history, "the bill [Food Security Act] would not preempt the basic state-law rules on the creation, *perfection*, or priority of security interests."[340] Thus, in order to ensure the initial perfection of a security interest, a lender must comply with appropriate state law provisions.[341] For example, in the *Julien Co.* bankruptcy case, a lender sought to enforce its once-perfected security interest in farm products against a buyer.[342] The lender failed to comply with lien perfection statutes in states where the crops securing the lender's loan were delivered.[343] As a result, the lender lost its perfected security interest in the crops.[344] Parties seeking to retain perfected interests in farm products must not only comply with the terms of the FSA, but also with state law lien perfection statutes. Moreover, while strict compliance with the FSA may enable a lender to retain its security interest in farm products, failure to properly perfect and continue to perfect a security interest under state laws may result in a loss of lien priority.[345]

B. Application of the FSA: Retaining and Avoiding Liens on Farm Products

As provided in the FSA, a "buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest."[346] The FSA

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337. Tallahatchie Cnty. Bank v. Marlow (*In re* Julien Co.), 141 B.R. 384, 388–89 (Bankr. W.D. Tenn. 1992).

338. AG Servs. of Am., Inc. v. United Grain, Inc., 75 F. Supp. 2d 1037, 1042 (D. Neb. 1999).

339. *Id.*

340. Mercantile Bank of Springfield v. Joplin Reg'l Stockyards, Inc., 870 F. Supp. 278, 282 (W.D. Mo. 1994) (noting that the drafters of the FSA intended for state law to control the creation, perfection, and priority of security interests, and citing Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 338 (D. Neb. 1990)); *Julien Co.*, 141 B.R. at 389 (quoting H.R. Rep. No. 271, at 110 (1985), *reprinted in* 1985 U.S.C.C.A.N. 1214) (internal quotation marks omitted).

341. *Julien Co.*, 141 B.R. at 389–90.

342. *Id.* at 387.

343. *Id.*

344. *Id.* at 390.

345. *See id.* at 390–91.

346. 7 U.S.C. § 1631(d) (2012).

provides two exceptions to the general rule pursuant to which a lender may continue to enforce its secured claim after purchase.[347] First, a lender may "preserve its security interest by providing notice of that interest directly to the buyer."[348] Second, a lender may preserve its lien "by filing notice of that interest with a central filing system in states wherein such a central filing system exists."[349]

1. Preservation of Lien by Direct Notice of a Security Interest

In order for a lender to preserve its lien through the notice provisions of the FSA, a lender must provide written notice of its lien to a purchaser within one year before the date of the sale of farm products.[350] To provide timely notice though, a lender must first discover who that purchaser might be.[351] Section 1631(h)(1) of the FSA authorizes lenders to include provisions in their security agreements obligating borrowers to provide notice of any potential purchasers, selling agents, or commission merchants that may partake in the sale of the lender's collateral.[352] Such provisions further require borrowers to update lenders of any previously undisclosed buyer at least seven days prior to sale.[353] Failure to comply with the § 1631(h) notice provision is punishable by a statutory fine in the amount of $5,000, unless proceeds from the sale are delivered to the lender within ten days.[354]

Once a lender has identified a purchaser, it must provide the purchaser with written notice of its liens in order to preserve its security interest in the farm products subject to sale.[355] Pursuant to the FSA, the lender's written notice must include the following information:

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347. Farm Credit Servs. of Mid Am. v. Rudy, Inc., No. C-3-93-271, 1995 WL 1622801, at *4 (S.D. Ohio Mar. 8, 1995).

348. *Id.*

349. *Id.*

350. *See* 7 U.S.C. § 1631(e)(1)(A). The phrase "1 year before the sale" has given rise to a number of disputes regarding the timeliness of notice. *See id.* Courts addressing the issue have looked to the definition of "sale" in the applicable state's commercial code and have compared it with the text of the FSA. *See, e.g.*, *In re* Hatfield 7 Dairy, Inc., 425 B.R. 444, 454 (Bankr. S.D. Ohio 2010); McDonald v. Ocilla Cotton Warehouse, Inc. (*In re* McDonald), 224 B.R. 862, 869 (Bankr. S.D. Ga. 1998). In *Hatfield 7 Dairy*, the court noted that the FSA only applies in situations in which a "buyer" actually "buys" a farm product. *Hatfield 7 Dairy*, 425 B.R. at 454. State law applicable in *Hatfield 7 Dairy* delineated between "buys" and "contracts to buy." *Id.* (internal quotation marks omitted). Since the FSA did not include the phrase "contracts to buy," the court determined that an actual sale must occur for the FSA to apply. *Id.* (internal quotation marks omitted). The court then noted the UCC provisions define a "sale" as the passage of title from the seller to the buyer for a price. *Id.*

351. *See* 7 U.S.C. § 1631(e)(1)(A).

352. *Id.* § 1631(h)(1).

353. *Id.* § 1631(h)(2)(A).

354. *Id.* § 1631(h)(3).

355. *Id.* § 1631(e). This assumes that the lender and collateral are located in a state that does not utilize a central filing system, which would give rise to alternative means of preserving the lender's security interest. *See id.*

i. "the name and address of the secured party";[356]
ii. "the name and address of the person indebted to the secured party";[357]
iii. "the social security number, or other approved unique identifier, of the debtor or, in the case of a debtor doing business other than as an individual, the Internal Revenue Service taxpayer identification number, or other approved unique identifier, of such debtor";[358]
iv. "a description of the farm products subject to the security interest created by the debtor, including the amount of such products where applicable, crop year, and the name of each county or parish in which the farm products are produced or located";[359] and
v. "any payment obligations imposed on the buyer by the secured party as conditions for waiver or release of the security interest."[360]

The lender's written notice of liens must strictly satisfy each and every statutory notice requirement in order to preserve the lender's security interest in the farm products subject to sale.[361] As one court noted, "[t]he weight of authority is that anything less than complete and precise compliance with the notice provisions of § 1631(e)(1) is insufficient."[362]

In the case of *In re Printz*, an agricultural lender provided the debtor-farmer with financing for the farmer's annual crop production.[363] The lender properly perfected its liens on each of the farmer's crops.[364] The farmer provided notice to the lender of its intent to sell its crops to a grain elevator.[365] Seeking to comply with the FSA, the lender sent four letters that provided the potential purchaser with notice of the lender's perfected liens.[366] The grain elevator eventually purchased the farmer's crops and argued that it purchased

356. *Id.* § 1631(e)(1)(A)(i)(1).
357. *Id.* § 1631(e)(1)(A)(i)(2).
358. *Id.* § 1631(e)(1)(A)(i)(3).
359. *Id.* § 1631(e)(1)(A)(i)(4).
360. *Id.* § 1631(e)(1)(a)(v).
361. Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co., 371 F.3d 450, 454 (8th Cir. 2004). The Eighth Circuit explained that the FSA's purpose and text support strict compliance with the direct notice provisions. *Id.* Congress adopted the FSA to protect farm product purchasers, not lenders. *Id.* Strict compliance with the notice provisions will leave little doubt whether a purchaser may take free and clear or may be bound to the lender's lien. *Id.* Strict compliance eliminates any guesswork as to potential liability. *Id.* Moreover, the FSA does contain other provisions that allow for substantial compliance. *Id.* Since the direct notice provisions do not include such language, Congress must not have intended to allow mere substantial compliance. *Id.* As a result, a party seeking to retain its lien through direct notice must strictly adhere to the notice requirements found therein. *See id.* Recent decisions are consistent with *Farm Fresh Catfish*. *See, e.g.*, CNH Capital Am. LLC v. Trainor Grain & Supply Co. (*In re* Printz), 478 B.R. 876, 883 (Bankr. C.D. Ill. 2012); State Bank of Cherry v. CGB Enters., 984 N.E.2d 449, 469 (Ill. 2013).
362. *Printz*, 478 B.R. at 883 (citing *Farm Fresh Catfish*, 371 F.3d at 454).
363. *Id.* at 878.
364. *Id.* at 879.
365. *Id.*
366. *Id.*

those crops free and clear of all liens because the lender's notice letters failed to comply with the express statutory requirements of the FSA.[367]

The court in *Printz* acknowledged that the lender did, in fact, have a properly perfected security interest in the farmer's crops prior to the sale.[368] The court also acknowledged that the letters delivered to the purchaser by the lender provided the purchaser with actual knowledge of the lender's liens.[369] The notice letters, however, failed to provide the farmer's social security number and failed to properly describe the crops.[370] The court ruled that, even though the purchaser had actual knowledge of the lender's liens, and received written notice of those liens, the lender's failure to strictly comply with the statutory notice requirements of the FSA was fatal to the lender's continuing security interest in the crops.[371] Thus, lenders seeking to ensure the preservation of their liens pursuant to the written notice provisions of the FSA must take extra care to ensure complete and precise compliance with the statutory requirements found therein.

The Eighth Circuit similarly ruled that strict compliance with the direct notice provisions of the FSA is necessary to preserve a lender's security interest in farm products.[372] In *Farm Credit Midsouth, PCA v. Farm Fresh Catfish*, the lender provided financing to the borrower for the purchase and operation of a catfish farm.[373] The borrower obtained a security interest in all catfish and catfish fingerlings and perfected its security interest pursuant to applicable state law.[374] Thereafter, the borrower notified the lender that it intended to sell products to Farm Fresh Catfish Company (Farm Fresh).[375] The lender then delivered a pair of letters to Farm Fresh detailing the lender's security interest and providing payment obligations for the release and waiver of the lender's lien.[376] In return, Farm Fresh issued checks payable to the borrower and lender, thereby ensuring delivery of payment to the lender and the release of the lender's security interest in the purchased products.[377]

At some point during the relationship, Farm Fresh stopped making checks payable to both the borrower and lender as required in the lender's notice letters.[378] The borrower then cashed nearly $700,000 in checks, but failed to remit those payments to the lender.[379] The lender then sued Farm Fresh for the

367. *Id.* at 879, 882.
368. *Id.* at 883.
369. *Id.* at 887.
370. *Id.* at 883.
371. *Id.*
372. Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co., 371 F.3d 450, 453–54 (8th Cir. 2004).
373. *Id.* at 451–52.
374. *Id*. at 452.
375. *Id.*
376. *Id.*
377. *Id.*
378. *Id.* ("Although Farm Fresh usually paid with checks payable to [borrower] and [lender], on these forty-four catfish purchases, the Farm Fresh checks listed only [the borrower] as payee.").
379. *Id.*

conversion of its collateral under the assumption that it had retained its lien on the catfish by substantially complying with the FSA's direct notice provisions.[380] Farm Fresh argued that it was not liable for conversion because it purchased catfish free and clear of liens, and noted that the lender's notice letters failed to strictly comply with the direct notice requirements of the FSA.[381]

The court in *Farm Fresh Catfish* agreed with Farm Fresh and ruled that strict compliance with the requirements of the direct notice provisions of the FSA was necessary.[382] In support of its ruling, the court pointed out one major difference between the language of the direct notice provisions and the central filing system provisions.[383] In order to preserve liens under the central filing system provisions of the FSA, described in detail below, a lender must file an effective financing statement that contains the same notice information required in a direct notice letter.[384] Unlike a direct notice letter, the notice provided in an effective financing statement is sufficient if it "substantially complies . . . even though it contains minor errors that are not seriously misleading."[385] The substantial compliance language is nowhere to be found in the direct notice provisions of the FSA.[386] Accordingly, the court ruled that direct notice requires strict compliance, while notice through a state's central filing system requires only substantial compliance.[387]

2. *Preserving Security Interests Pursuant to the Central Filing System*

Under the FSA, states are authorized to create central filing systems, in cooperation with the Secretary of Agriculture, that provide lenders with an additional mechanism through which to preserve security interests in farm products.[388] The establishment of a central filing system requires the Secretary of State for a particular state to receive and compile information regarding security interests on farm products submitted by lenders in the form of effective financing statements.[389] The compilation of effective financing statements is then formed into a master list and circulated regularly to all registrants of the central filing system.[390] Effective financing statements are similar to financing

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380. *Id.* at 451.
381. *Id.*
382. *Id.* at 453–54.
383. *Id.* at 453 (noting that § 1631(c)(4)(H) allows for substantial compliance with the notice requirements, so long as any errors or omissions are not seriously misleading, while § 1631(e)(1)(A) contains no such provision).
384. *Id.*
385. 7 U.S.C. § 1631(c)(4)(H) (2012).
386. *Farm Fresh Catfish*, 371 F.3d at 453.
387. *Id.* at 454.
388. *See* 7 U.S.C. § 1631(c)(2); *see generally* 9 C.F.R. § 205.203 (2012) (discussing where an effective financing statement may be filed).
389. 7 U.S.C. § 1631(c)(2)(A)–(C).
390. *Id.* § 1631(c)(2)(D)–(E).

statements governed by state law, but generally require additional information and execution by both the lender and borrower.[391] Effective financing statements do not, however, affect state law lien perfection requirements.[392] Accordingly, lenders seeking to preserve their interests in states with a central filing system should file a state financing statement, as well as a federal effective financing statement, in order to potentially preserve their security interests in farm products. Currently though, only nineteen states utilize central filing systems under the FSA.[393] As a result, the central filing system method of lien preservation is frequently unavailable to lenders.

In a state that has established a central filing system, a lender may preserve its lien on farm products if "(A) the buyer has failed to register with the Secretary of State of such State prior to the purchase of farm products; and (B) the secured party has filed an effective financing statement or notice that covers the farm products being sold."[394] Thus, if a lender chooses not to provide a potential purchaser with direct notice of its liens, it must comply with the central filing system provisions of the FSA to have any hope of preserving its liens.[395] To do so, the lender must file an effective financing statement with the central filing system.[396] An effective financing statement requires a lender to comply with the same notice requirements listed in the direct notice provisions.[397] Unlike the direct notice provisions, though, substantial

391. AG Servs. of Am., Inc. v. United Grain, Inc., 75 F. Supp. 2d 1037, 1044 (D. Neb. 1999) (quoting 7 U.S.C. § 1631(c)(4)).

392. *Id.*

393. *Clear Title (Central Filing Systems)*, U. S. DEPARTMENT OF AGRICULTURE, GRAIN INSPECTION, PACKERS & STOCKYARDS ADMIN., http://www.gipsa.usda.gov/Lawsandregs/clear title.html (last visited July 21, 2013). Those states include Alabama, Colorado, Idaho, Louisiana, Maine, Minnesota, Mississippi, Montana, Nebraska, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Utah, Vermont, West Virginia, and Wyoming. *Id.* No state that continues to utilize an effective financing statement has been certified within the last twenty years. *Id.*

394. 7 U.S.C. § 1631(e)(2)(A)–(B). In the alternative, a lender's security interest shall be preserved if the buyer has registered and receives notice of the lender's security interest, but does not secure a waiver or release of the lender's security interest on account of buyer's failure to perform any payment obligation found therein. *Id.* This default lien preservation is consistent in both the direct notice and central filing provisions of the FSA. *Compare id.* (stating that when there is a central filing system, the buyer takes a security interest if it receives written notice from the Secretary of State that the product is subject to an effective financing statement and the buyer does not have a waiver of the security interest for failure to comply with payment requirements), *with id.* § 1631(e)(1)(A)(v) (stating that a buyer may take a security interest if it received, within one year before the sale, written notice of the payment obligations that condition the waiver of security interest). If a buyer fails to satisfy the payment obligation necessary to release the lender's security interest, the buyer has voluntarily taken an affirmative action necessary to preserve the lien under the FSA. *Id.* § 1631(d). In such situations, the lender's lien will continue, and the lender may sue the buyer for conversion. *See* Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co., 371 F.3d 450, 452 (8th Cir. 2004) (stating that though unsuccessful for lack of strict compliance with written notice requirements, lender brought a conversion suit against purchaser for failing to comply with payment obligations found in letter providing notice of lender's security interest in farm products).

395. *See* 7 U.S.C. § 1631(e).

396. *Id.* § 1631(e)(2); 9 C.F.R. § 205.202 (2012) (entitled "Effective financing statement") (providing additional direction regarding procedures for filing an effective financing statement.).

397. 7 U.S.C. § 1631(e)(2).

compliance with the notice requirements is sufficient so long as the notice is not seriously misleading.[398] An effective financing statement must also be executed by the borrower and filed by the lender with a state's central filing system.[399] Once filed, the state's Secretary of State is obligated to produce and regularly circulate an updated master list of security interests in farm products to registered buyers, thereby placing all such registered buyers on notice.[400]

If a buyer of farm products in a state with a central filing system does not register for regular notice, it will typically purchase farm products subject to liens and may be held liable for conversion if it later sells or otherwise disposes of the farm products.[401] Buyers who purchase farm products from multiple states must be especially aware of the origin of the farm products they intend to purchase.[402] Central filing systems are specific to the state of a farm product's origin.[403] Thus, a Kansas purchaser who intends to buy crops from Nebraska must register in Nebraska to ensure compliance with the FSA.[404] Failure to register in the state of origin results in the preservation of the lender's lien, assuming the lender properly filed an effective financing statement in the state of origin.[405] Although the FSA was enacted to limit potential double liability for purchasers, it actually places the burden on purchasers to inquire as to the origin of farm products they intend to purchase.[406]

In the context of bankruptcy and the claim payment hierarchy, the FSA is a disruptive statute. Lenders seeking to preserve secured status, and therefore a right to first payment from assets of the estate, must work hard to ensure proper compliance with the FSA.[407] Bankrupt purchasers may, on the other hand, attack a secured creditor's effective financing statement or direct notice letter in

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398. *Id.* § 1631(c)(4)(H); Tallahatchie Cnty. Bank v. Marlow (*In re* Julien Co.), 141 B.R. 384, 391–92 (Bankr. W.D. Tenn. 1992) (holding that failure to identify a farmer's identification number and location of the farm where crops were grown was fatal to notice the found in an effective financing statement as to the portion of crops grown by the unlisted farmer). The court's logic in *Julien Co.* is consistent with the "seriously misleading" caveat found in § 1631(c)(4)(H). 7 U.S.C. § 1631(c)(4)(H); *Julien Co.*, 141 B.R. at 391. An effective financing statement is intended to provide notice of liens on specific farm products produced by specific sellers. 7 U.S.C. § 1631(c)(4)(C). Failure to include a seller and its crop would seriously mislead a registered purchaser into believing that no such lien existed. *See Julien Co.*, 141 B.R. at 392. As noted in *Fin-Ag, Inc. v. Cimpl's, Inc.*, a registered buyer has no duty, other than evaluating the master list, to determine whether a seller's product is subject to a lien protected by the FSA. Fin-Ag, Inc. v. Cimpl's, Inc., 754 N.W.2d 1, 14 (S.D. 2008).

399. 7 U.S.C. § 1631(c)(4)(B).

400. *Id.* § 1631(c)(2)(E).

401. AG Servs. of Am., Inc. v. United Grain, Inc., 75 F. Supp. 2d 1037, 1046–51 (D. Neb. 1999) (holding that a buyer who failed to register with a state's central filing system took farm products subject to a registered lender's security interest and was subject to suit for conversion for nonpayment to the lender).

402. *Julien Co.*, 141 B.R. at 390–91. The court in *Julien Co.* noted that under the FSA, a purchaser must register with the Secretary of State for the state "in which the farm product was produced." *Id.* at 390. Failure to register in the state of a product's origin may subject the purchaser to the lender's security interest. *Id.* at 390–91.

403. *Id.* at 390.

404. *E.g.*, *id.* at 390–91.

405. *Id.*

406. *See id.*

407. *See supra* Part Four.

an effort to eliminate a secured creditor's security interest in assets of the estate.[408] If a secured creditor loses its security interest in farm products purchased by the debtor, it loses its entire claim in the bankruptcy case.[409] Thus, lenders must be particularly careful to ensure proper compliance with all notice provisions of the FSA, or they may face dire consequences in bankruptcy cases.

VII. CONCLUSION

Bankruptcy cases involving agricultural commodities raise the prospect of significant risks for asset-based lenders. Those risks create opportunities for debtors, suppliers, and other creditors to attack a secured creditor's position on the claims hierarchy.[410] It is, therefore, crucial for all parties in interest to understand the detailed contours of the risks and opportunities that special interest legislation provides.[411] As to trust fund statutes, this requires familiarity with the sometimes detailed steps that must be taken to establish and maintain a trust fund claim.[412] As to liens, this includes understanding when a floating lien does—and does not—extend to property acquired post-petition, as well as understanding when the FSA can—and cannot—be used to avoid an otherwise properly perfected lien.[413] A party wading into an agricultural bankruptcy case without a deep understanding of these statutory game-changers risks the possibility of leaving behind significant funds that otherwise may have been recoverable.

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408. 7 U.S.C. § 1631(d)–(e) (2012).

409. *See supra* Part Six, Section B.2. If the bankrupt purchaser took the farm product free and clear of liens, the lender has no secured claim against the bankrupt purchaser's estate. *Supra* Part Six, Section B.2. The lender is unlikely to have any other claims against the purchaser, since the lender's borrower remains the party with the contractual obligation to satisfy any outstanding debt. *Supra* Part Six, Section B.2.

410. *See supra* Part Five.

411. *See supra* Part Five.

412. *See supra* Part Five.

413. *See supra* Part Two, Section C.