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INDUSTRY VIEWPOINT

Fruitful results for produce sellers in recent bankruptcy proceedings

The Perishable Agricultural Commodities Act ("PACA") has recently fostered fruitful results for produce sellers in airline, hotel, supermarket and restaurant bankruptcy proceedings.

PACA grants qualifying sellers statutory trust beneficiary rights in fresh and frozen fruits and vegetables and the proceeds thereof. PACA trusts are floating, non-segregated trusts, created upon sellers sending certain proscribed statutory notices to buyers, which, among other things, provide that the produce is sold subject to the PACA trust. In light of the trust created, PACA imposes fiduciary duties upon purchasers and their controlling agents, each as trustees, to preserve the PACA trust property until the sellers as trust beneficiaries are repaid in full.

PACA trust property, whether segregated or commingled with non-PACA trust property, does not become property of a debtor's bankruptcy estate. While PACA trust property does not become property of a bankruptcy estate, bankruptcy courts are empowered to administer PACA trust assets. Accordingly, PACA creditors often need to

assert their claims in bankruptcy proceedings in order to ensure that they are paid through the bankruptcy process senior to other secured and unsecured creditors.

To enforce PACA trust rights in bankruptcy proceedings, PACA creditors may object to a debtor's request for authority to make payments to non-PACA creditors (i.e., banks, landlords, suppliers, or service providers) from monies or assets commingled with PACA trust property or to pay costs and expenses critical to a debtor's uninterrupted business operations. In certain instances, unpaid sellers may even assert claims under PACA for personal liability against a debtor's principal or commence a "claw back" action for monies paid by a debtor to a third party. Cautious of the implications of PACA, in several recent cases debtors have requested that the bankruptcy courts approve varying procedures to repay PACA creditors at the outset of the bankruptcy proceedings.

American Airlines, with \$24 billion in assets and \$29 billion of liabilities, filed chapter 11 in the United States Bankruptcy Court for the Southern

District of New York, AMR Corporation, et al., Case No.: 11-15463 (SHL). At the outset of its bankruptcy, American Airlines asked the Bankruptcy Court to approve certain procedures for the submission, review and treatment of PACA claims. The Bankruptcy Court approved American Airlines' proposed PACA claims procedures and entered a Court Order: (i) fixing a deadline for PACA creditors to submit PACA claims, (ii) establishing requisite contents for the submission of valid PACA claims, (iii) requiring American Airlines to file a report of PACA claims submitted and any objections thereto, (iv) providing a dispute resolution process for objections, and (v) barring PACA creditors from pursuing alternative avenues of recourse under PACA against American Airlines. As a result, PACA creditors were required to comply with PACA's statutory requirements, as well as the PACA claims procedures fixed by the Bankruptcy Court, to receive priority treatment.

MSR Resorts, with 30 luxury hotels, \$2.2 billion in assets and \$1.9 billion of liabilities, filed chapter 11 in the United States Bankruptcy Court for the Southern District of New York, MSR Resort Golf LLC, et al., Case No. 11-10372 (SHL).

At the outset of its bankruptcy, MSR Resorts requested approval of a Management Agreement Order, which, among other things, sought authority for MSR Resorts to pay amounts owed to its property management companies in efforts to ensure uninterrupted resort operations. The Bankruptcy Court approved the Management Agreement Order, which among other things, allowed for MSR Resorts to pay valid PACA claims early in the bankruptcy proceedings.

Fresh & Easy Neighborhood Market, a grocery chain with 167 stores located in California, Arizona and Nevada, with annual revenue in excess of \$1 billion, filed chapter 11 in the United States Bankruptcy Court for the District of Delaware, Old FENM Inc., et al., Case No.: 13-12569 (KJC). At the outset of its case, Fresh & Easy Neighborhood Market requested authority to pay approximately \$12 million in PACA claims pursuant to a PACA Claims Procedures Motion, as well as a corresponding Motion to Pay Certain Claims Pursuant to Section 503(b)(9) of the Bankruptcy Code (which provides a priority treatment for certain unpaid goods received by a debtor within the twenty (20) days immediately preceding a bankruptcy filing). The Bankruptcy Court approved both motions.

This year, Sbarro, with approximately 800 restaurants worldwide, filed chapter 11 in the United States Bankruptcy Court for the Southern District of New York, Sbarro LLC, et al., Case No.: 14-10557 (MG), and Quiznos, with over 2,000 restaurants worldwide, filed

chapter 11 in the United States Bankruptcy Court for the District of Delaware., QCE Finance LLC, et al., Case No.: 14-10543 (PJW). Both Sbarro and Quiznos immediately requested authorization to pay valid PACA claims in the ordinary course consistent with historical practice. Sbarro's PACA Motion indicated PACA claims aggregating \$190,000, and Quiznos' PACA Motion indicated PACA claims aggregating \$230,000. Both PACA Motions stated that: (i) valid PACA claims should be paid ahead of other secured and unsecured creditors, and (ii) prompt repayment to PACA creditors was necessary to ensure that the debtors' restaurants would continue to receive constant supplies of fresh fruits and vegetables.

These and other recent bankruptcy proceedings indicate that produce sellers must be familiar with their rights and protections afforded under PACA and take the necessary steps to perfect their PACA trust rights. Furthermore, upon receiving notice of a bankruptcy filing, qualifying PACA creditors must: (i) focus on the debtor's proposed treatment of PACA claims in the bankruptcy proceeding, (ii) be cognizant of any efforts by any party to obtain relief that could affect the rights of holders of valid PACA trust claims, and (iii) take appropriate steps to enforce PACA trust rights in the bankruptcy proceedings.

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