

Draft Legislation and Regulations for a PACA-like Trust in Canada

DRAFT MODEL LAW FOR A FRESH FRUIT AND VEGETABLE INSOLVENCY ENHANCEMENT TOOL

Prof. R.C.C. Cuming

Legislative Objective

The legislative objective of this Act is to provide an important measure of protection for suppliers of fresh fruit and vegetable products from the effect of insolvency when their buyers fail to pay for the products they deliver to the buyers.

Fresh fruit and vegetable products are generally sold under terms that explicitly or implicitly provide that the buyer has a short period of time after delivery to pay the price. If the buyer fails to pay the seller, the seller becomes an unsecured creditor. It is impractical for sellers to take security interests in the products they sell or the proceeds of the sale of those products. The products are perishable and have no value after a very short period of time. Few sellers have the bargaining power or legal sophistication to require their buyers to give them security interests in accounts receivable owing to the buyers from the sale of the products or in any other property of the buyers.

As an unsecured creditor, a seller has a very weak legal status under current law to enforce payment should a buyer become insolvent. There is a very good chance that the buyer has granted a security interest in his property (including accounts receivable) to a commercial lender such as a bank. This security interest gives to the lender priority over unsecured creditors. If the buyer becomes a bankrupt, all of the buyer's property that is not subject to a security interest vests in the trustee in bankruptcy. While the seller would qualify as a creditor with a provable claim in the bankruptcy proceedings, the chances of getting substantial recovery of the claim from the bankruptcy distribution are very small. At best, the seller will get a few cents on each dollar of claim. If the buyer invokes proceedings under Part III, Division I of *the Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*, a seller is likely to be only in a marginally better position. At the very best, the buyer's reorganization proposal will not be implemented for many months and is very unlikely to provide to unsecured creditors more than a fraction of the amount of their claims.

The effect of the Act would be to change the priority position of unpaid sellers through the use of a limited statutory deemed trust. The legal effect of the trust is to give to the seller who is the beneficiary under the trust a first priority status with respect to trust property. This includes priority over secured creditors and other unsecured creditors of the buyer and over the buyer's trustee in bankruptcy. In addition, a seller is not negatively affected should the buyer invoke proceedings under Part III, Division I of *the Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*.

In order to have the benefit of the statutory trust, the seller need not establish that the product and proceeds that are subject to the trust are connected directly to his or her contract. Consequently, any products and proceeds covered by the trust that buyer has in his or her possession or control are also subject to the trust so long as any seller from whom the product was acquired remains unpaid.

The Act provides an administrative mechanism through which the claims of sellers to trust property are recognized and enforced.

The Act does not guarantee complete protection to unpaid sellers. The buyer is a trustee under the law of trust and is subject to the control of the court. However, there is no way to ensure that the buyer will fully or honestly discharge trust obligations. There are legal mechanisms through which a person who acts in breach of trust can be punished. However, this does not result in the debt owing to a seller being paid.

The Act applies only when the buyer has failed to pay a seller because of his or her insolvency. If the buyer is solvent at the date of delivery of the product, and remains solvent or for any reason does not pay a seller, the trust does not come into existence. The seller must rely on his rights under provincial law or the Fruit and Vegetable Dispute Resolution Corporation to enforce payment. However, if product is supplied when the buyer is solvent, but the seller is not paid by the time the buyer becomes insolvent, the trust automatically comes into effect. Under the Act, at this point any product or proceeds in the hands of the buyer is deemed to be subject to a deemed trust. However, until this point is reached, provincial law and not the Act governs the relationship between the seller and the buyer.

The Role of Trust Law

The central feature of the Act is the deemed trust that arises when product has been supplied to a buyer for which the seller has not been paid. The Act expressly invokes the law of trusts. Trust is an important and well-developed feature of the non-statutory law of common law jurisdictions of Canada and all other countries and states whose laws are based on the common law tradition. It has a statutory base in Quebec. The following is a simplified explanation of how basic trust law functions.

A, who owns property, transfers ownership of that property to B subject to conditions specified by A. These conditions usually provide that B will hold and administer the trust property for the benefit of a third person, C. In this scenario, B is the trustee and C is the beneficiary. While legal title to the trust property is held by B, the law requires B to hold and administer the property as required by the conditions under which he obtained it. The result is that, for many purposes, C is viewed as the “beneficial owner” of the trust property.

An aspect of trust law is that, should the trustee dispose of the trust property, any property of any kind received by the trustee (cash or accounts receivable) is treated as trust property so long as it can be identified or traced. This property is referred to in the draft Act as proceeds.

The law of trusts would operate in the context of the *Fresh Fruit and Vegetable Products Protection Act* in the following way.

The Act creates a statutory trust of product supplied by the seller to a buyer under a deferred payment contract providing for payment not later than 30 days from the date of delivery. The sellers offering terms longer than 30 days would not qualify for protection under this Act. The result is that, if the procedural requisites are met (the appropriate notice is given to the buyer by the seller) the product delivered to the buyer is in law not treated as the buyer’s property. It is property that is “beneficially owned” by the seller. The trust arises automatically if the failure on the part of the buyer to pay result from his or her insolvency. In the context of the Act, the seller is deemed to have transferred property (product) to the buyer to be held under the trust condition that it or its proceeds will be held for the benefit of all unpaid sellers who qualify for the protection of the Act.

There are significant implications associated with the legal conclusion that that the property held in trust by the buyer is beneficially owned by the seller. Should the buyer become a bankrupt, the trust property does not become part of the buyer’s bankruptcy estate. The trustee in bankruptcy may not treat trust property as property that can be sold and the money received distributed to the unsecured creditors of

the buyer. If the buyer invokes insolvency proceedings, the trust property cannot be treated as property of the buyer that can be included in an insolvency proposal.

One of the features of trust law that is implicitly imported into the Act is the concept of tracing. Tracing rules (actually, legal presumptions) were developed to deal with situations in which trustees used trust property for purposes not authorized by the trust conditions on which the property was transferred to them. These rules were designed to protect the interests of the beneficiaries of trusts. Using tracing rules, a court can conclude that the beneficial interest in the original trust property can be "traced" into other property acquired by the trustee even though there is no factual connection between the two. For example, when the buyer deposits trust property in the form of cash in his or her personal account and not, as required by the Act, in a separate account, the funds remains trust property. This is so even though the buyer makes withdrawals from the deposit account and dissipates the money so withdrawn, and subsequently makes additional deposits of his individual funds in the account.

The deemed trust has important implications for a lender who has taken a security interest in property of the buyer to secure operating loans made to the buyer. Under the secured transactions laws of all provinces and territories, it is possible for a lender to contract for a security interest in existing and future acquired property other than land. Under these laws, as soon as the borrower acquires property that falls within the description of the property taken as security, a security interest (charge) comes into existence. Generally, so long as the secured creditor has effected a registration in a public registry as required by the secured transactions law, it has priority over subsequent interests in the property that buyer acquires. This creates a problem if the statutory trust comes into existence only after the product is delivered and the seller is unpaid. In other contexts, the Supreme Court has concluded that the trust can only affect the interest of the buyer existing at the date the trust comes into effect. However, this interest is subject to the security interest that came into existence as soon as the product was delivered.

The Act deals with this issue by making it clear that the deemed trust takes priority over any security interest in the product or the proceeds regardless of when the trust comes into effect or when the security agreement creating the security interest came into effect.

Typical Scenario

The legal structure contemplated by the proposed *Fresh Fruit and Vegetable Products Protection Act* would function as follows:

Seller 1 (as defined in section 2, including the definition of "unpaid seller") and Buyer (hereafter, "Debtor" as defined in section 2, including the definition of "insolvent debtor") enter into a contract under which Seller agrees to supply "product" (as defined in section 2 of the Act and section 1 of the Regulations) to Debtor. Payment of the price is to be made at a date other than the date of delivery but not later than 30 days from the date of delivery. The product is delivered to Debtor.

Seller 1 sends with the invoice, or in an email message, a notice as provided in section 8 of the Act and section 4 of the Regulations. The message must be received by the Debtor not more than 30 days from the date payment was due under the contract.

The effect of this notice is that, should the Debtor be insolvent upon its receipt or any time thereafter when Seller 1 has not been paid, a trust comes into existence on all product then in possession of the

Debtor or thereafter acquired and on any proceeds of the sale of product (*e.g.*, accounts and other payment obligations) sections 3 and 4. Debtor is under obligation to segregate trust property in the form of cash or a deposit account. Subsection 3(3). Money in a deposit account cannot be taken in set-off against an obligation owing by the Debtor to the deposit-taking institution. Subsection 6(4).

Assume that the event described above with respect to Seller 1 occurred also with respect to Seller 2. The trust that arose in the context of the Seller 1 transaction now gives corresponding rights to Seller 2. It automatically encompasses any product supplied by Seller 1 and Seller 2 and any proceeds obtained by Debtor as a result of the disposition of that product. In effect, the trust property is all product and proceeds of Debtor and the joint beneficiaries are Seller 1 and Seller 2. Section 5.

Notwithstanding the trust, Debtor is able to continue selling perishable agricultural products obtained from Seller 1 and Seller 2 so long as Debtor has not become a bankrupt, its assets are not under the control of a receiver or a court has not ordered seizure of the trust property under section 9. Ordinary course buyers of product take the product free from the trust. Section 6. However, any other type of buyer of the product or proceeds of the product or any secured party who is given a security interest in the trust property takes subject to the trust if the buyer or secured party is aware or has reasonable basis to be aware of the trust. Subsection 6(1). If either or both sellers register their beneficial interests in the Personal Property Registry (or the Quebec Registre des droit personnels et réels mobiliers), buyers of trust property, other than ordinary course buyers, and secured parties are deemed to know of the existence of the trust and, consequently, take subject to it. Subsection 6(2). However, registration is not required in order for the trust to come into effect.

If the Debtor pays Seller 1 and Seller 2, the trust disappears. If Debtor pays only one of them, the trust continues for the benefit of the unpaid seller. Section 5.

If the Debtor becomes a bankrupt, any trust property existing at the date of the bankruptcy does not vest in the trustee and is not part of the bankruptcy estate. It must be held by the trustee for the benefit of Seller 1 and Seller 2. Subsection 3(5).

One or more of the unpaid sellers, a trade organization acting on behalf of unpaid sellers, or any other “interested party” may apply to the superior court of the province in which the debtor is located for an order requiring collection, sale and distribution of the trust property. Section 9.

Draft Act

An Act to provide for a statutory trust to protect the right of sellers of fresh fruit and vegetable products to be paid for the products they deliver.

Her Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:

SHORT TITLE

1. This Act may be cited as the *Fresh Fruit and Vegetable Products Protection Act*

2. The definitions in this subsection apply to this Act.

“product” means the items prescribed that are intended for human consumption supplied by a seller and received by a debtor whether or not the debtor was an insolvent debtor at the time the product was supplied;

“court” means the superior court referred to in subsection 183(1) or (1.1) of the *Bankruptcy and Insolvency Act* of the jurisdiction in which the debtor carries on business.

“debtor” includes a person who acting in the ordinary course of business as agent, commission merchant, dealer, broker, consignee or consignor engages or has engaged in or facilitates or has facilitated on behalf of another person, the purchase and sale of a product, and, where the context permits, includes an insolvent debtor, but does not include:

(a) a person who sells product directly to consumers if that person paid less than the sum prescribed, for the product purchased by the person within the previous 12 month period;

(b) a person who sells principally product he or she grows himself or herself; or

(c) a person who only purchases less than the quantity prescribed of fresh fruits and vegetables on any day.

(d) an organization that is a registered charity as defined in subsection 248(1) of the *Income Tax Act* or is a club, society or association described in paragraph 149(1) (l) of that Act.

(e) a person engaged in a business as prescribed;

“insolvent debtor” means a debtor:

(a) who is for any reason unable to meet his or her obligations as they generally become due;

(b) who has ceased paying his or her current obligations in the ordinary course of business as they generally become due;

(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his or her obligations, due and accruing due;

(d) who has made or is deemed to have made an assignment in bankruptcy or is the subject to a bankruptcy order under section 43 of the *Bankruptcy and Insolvency Act*;

(e) whose property is in the possession or control of a receiver within the meaning of subsection 234(2) of the *Bankruptcy and Insolvency Act*; or,

(f) with respect to whom proceedings under the *Bankruptcy and Insolvency Act* or the *Companies’ Creditors Arrangement Act* have been commenced.

“proceeds” includes all identifiable or traceable personal property of any kind, whether tangible or intangible, derived directly or indirectly by a debtor from any processing, manufacturing, repacking or other dealing with product subject to a trust provided in section 3, and includes proceeds of proceeds.

“seller” means a person who in the ordinary course of business supplied a product to a debtor;

“trust” means the trust as provided in section 3;

“unpaid seller” means a seller who:

- (a) supplied a product to a debtor under a contract providing for payment before the expiry of 30 days from the date of delivery;
- (b) has not received the consideration payable by the debtor in the amount provided in the contract; and
- (b) delivered to the debtor the notice referred to in section 8.

3. (1) Notwithstanding any other enactment of Canada, any enactment of a province or any other law, where an insolvent debtor has defaulted in payment to an unpaid seller, the product held by the insolvent debtor and proceeds of a product, equal in value to the amount or amounts in default and such other amounts as prescribed are deemed:

- (a) not to be and never to have been part of the estate or property of the insolvent debtor whether or not the property has been kept separate and apart as property held in trust;
- (b) to be held in trust from the time that the property was received by the debtor;
- (c) to be beneficially owned by the unpaid seller.

(2) Subsection (1) applies without regard to:

- (a) the terms of a security agreement between the debtor and a secured party under which the product or proceeds is collateral;
- (b) the date attachment of a security interest arising under such security agreement; or
- (c) date when the insolvency of the debtor arose.

(3) Property deemed held in trust in the form of cash or a deposit at a deposit-taking institution shall be segregated and kept separate from property of the debtor that is not trust property.

(4) An unpaid seller:

- (a) is not required to prove as a condition of being a beneficiary under a trust referred to in subsection (1) that trust property held by the debtor is proceeds of the same product supplied to the debtor by the unpaid seller; and

(b) does not cease to be a beneficiary under the trust when the product supplied by the unpaid seller to the debtor or the proceeds of that product have been sold or otherwise disposed of.

(5) A trust arising under subsection (3) is deemed to be a trust within clause 67(1) (a) of the *Bankruptcy and Insolvency Act*.

4. Personal property acquired by an insolvent debtor while any amount remains owing to a seller is outstanding is presumed to be subject to the trust unless it is established that the property was not obtained by the debtor from proceeds of a product.

5. The trust referred to in section 3 is discharged when all payment obligations owing to all unpaid sellers who supplied product to a debtor have been paid.

6(1) A person who acquires an interest in property subject to a trust referred to in section 3 takes the property subject to the trust interest unless:

(a) the person gave full value for the interest and did not know and did not have reasonable basis for knowing that the property is subject to the trust; or,

(b) the property subject to the trust was acquired by the person in a sale occurring in the ordinary course of the debtor's business.

(2) A person referred to in subsection (1) (a) is deemed to know of the trust if a notice of the trust is registered as prescribed.

(3) For the purposes of subsection (1) cancellation of a debt owing by the debtor to the person does not constitute value.

(4) An account debtor of the debtor may not set-off against an account that is trust property an obligation of the debtor to the account debtor.

7. Except as otherwise provided in this Act, the law of trusts as established by the courts of equity and law apply to a trust referred to in section 3.

8. (1) In order to be beneficiary of a trust referred to in section 3, a seller must deliver a written notice, as prescribed, to a debtor of his or her intention to assert rights as a beneficiary under the trust not more than 30 days after the date payment is due under the contract of sale.

(2) The notice referred to in subsection (1) may be:

(a) contained on an invoice or billing document delivered separately or accompanying delivery of the product to the debtor; or

(b) delivered by sending it as electronic mail to the address of the debtor set out on a universal resource locator or any public documentation of the debtor.

9. On application of an unpaid seller, the debtor or other interested person, the court may:

- (a) determine the property that is subject to the trust;
- (b) determine the sellers who are beneficiaries of the trust;
- (c) designate a person to act with or without security as administrator of the trust property and give directions to such person with respect administration of the trust and compliance with this Act;
- (d) grant to the person referred to in (c) the power to take possession of the trust property and deeds, books, records and documents relating thereto;
- (e) order delivery of trust property and deeds, books, records and documents relating thereto to the person referred to in (c);
- (f) order account debtors to make payment to the person referred to in (d) trust property in the form of accounts that are due and payable and accounts that are due when the accounts become payable;
- (g) order a trustee appointed pursuant to the *Bankruptcy and Insolvency Act* or a liquidator appointed pursuant to the *Winding-up and Restructuring Act* who is in possession or control of the property to transfer it the person referred to in (c);
- (h) set a date for distribution of the trust property held by the person referred to in (c);
- (i) order payment out of the amount held by the person referred to in (c) or payable to such person:
 - (i) the court and administrative costs; and
 - (ii) the balance pro rata to the unpaid sellers who became trust beneficiaries before the date set for distribution of the amounts paid to the person referred to in (a);
- (j) order discharge and, when appropriate replacement, of a person referred to in clause (c);
- (k) make any other order the court considers appropriate in order to implement the provisions of this Act.

10. (1) An application under section 9 is not an action, suit or proceeding to which sections 11, 11.01 or 11.02 of the *Companies' Creditors Arrangement Act* apply.

(2) The rights of an unpaid seller under this Act are not affected by Part III of the *Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*.

11. The obligations of a debtor under this Act apply with necessary modifications to a receiver within the meaning of subsection 234(2) of the *Bankruptcy and Insolvency Act*, and any other person who has been lawfully appointed to take or has lawfully taken possession or control of any property of the debtor that is an product or proceeds of an product.

12. Any agreement or undertaking providing that this Act does not apply to a contract between a seller and a debtor is void.

13. The Governor in Council may make regulations for carrying out the purposes and provisions of this Act and prescribing anything that is to be prescribed under this Act and, without limiting the generality of the foregoing, may make regulations:

- (a) defining the kinds of fresh fruits and vegetables included in the definition of “product”;
- (b) setting the amount referred to in clause (a) and (c) of the definition of “debtor”;
- (c) setting the amount referred to in subsection 3(1);
- (d) defining the kinds of persons engaged in a businesses to which this Act does not apply;
- (e) defining the contents of notice which may be given referred to in subsection 8(1).
- (f) prescribing the procedures for applications under subsection 9(1).

14. The Act comes into force on a day or days to be fixed by the Governor General.

Fresh Fruit and Vegetable Products Protection Regulations

FRESH FRUIT AND VEGETABLE PRODUCTS PROTECTION ACT

SOR/2016-___

His Excellency the Governor General in Council, on the recommendation of the Minister of Agriculture, pursuant to section 13 of the *Fresh Fruit and Vegetable Products Protection Act* hereby makes the annexed Fresh Fruit and Vegetable Products Protection Regulations.

1. In section 2 of the Act, the term “product” means all fresh fruits and vegetables and edible fungi but does not include:
 - (a) any fruit or vegetable that has been planted as seed;
 - (b) nuts and wild fungi.
2. The amount referred to in clause (a) of the definition of “debtor” in section 2 of the Act is \$100,000.
3. The amount referred to in clause (c) of the definition of “debtor” in section 2 of the Act is one metric ton (2205 lbs).
4. The notice referred to in subsection 8(1) shall be clearly titled “Notice of Intent to Preserve Trust Benefits” and shall contain:

- i. Name and address of debtor;
- ii. Name and address of seller;
- iii. Date of the transaction,
- iv. A brief description of the product sold,
- v. Invoice price;
- vi. Terms of payment;
- vii. Amount unpaid.

5. Members of the Fruit and Vegetable Dispute Resolution Corporation may provide the notice referred to in subsection 8(1) by alternatively including the exact statutory wording below on all invoices and billing statements:

The products listed on this notice are sold subject to the trust authorized by subsection 3(1) of the Fresh Fruit and Vegetable Products Protection Act. The seller of these commodities retains beneficiary status 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.