

Chapman Client Alert

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Current Issues Relevant to Our Clients

Life is Not a Bowl of Cherries for PACA Claimant Objecting to Cash Collateral Use: *In re Cherry Growers, Inc.*

A debtor-in-possession is entitled to use cash collateral over the objections of PACA claimants so long as the debtor demonstrates that the interests of the PACA claimants are adequately protected, according to a recent ruling by Judge Dales of the United States Bankruptcy Court for the Western District of Michigan.

On November 1, 2017, Judge Dales issued an opinion approving the request of debtor-in-possession Cherry Growers, Inc. to use cash collateral over the objection of Farm Fresh First, LLC ("*Farm Fresh*"), a claimant asserting rights under the Perishable Agricultural Commodities Act of 1930 ("*PACA*").¹ Although the *Cherry Growers* court recognized that Farm Fresh held an equitable interest in the bankruptcy estate with respect to its \$337,159.18 PACA claim, that equitable interest was not sufficient to deny the debtor's requested (and otherwise consensual) use of its secured lender's cash collateral, especially where a sufficient equity cushion existed to adequately protect Farm Fresh's PACA claim.

Under PACA, growers and suppliers of perishable agricultural products who have properly preserved their rights under the statute are entitled to the benefit of a broad and powerful "floating trust" in their buyer's qualifying inventory and proceeds thereof. These trust claims are to be paid first from trust assets, even prior to any claims or interests of secured creditors in such property. Furthermore, commingling of trust assets is specifically contemplated under the federal regulations implementing PACA. As the *Cherry Hill* court recognized, PACA is "designed to promote priority payment to the PACA claimant."

It is often said, and Farm Fresh argued, that not only are PACA claimants' interests in PACA trust property senior to the claims and interests of other creditors, including secured creditors, but that PACA trust property is not even "property of the estate" in a debtor's bankruptcy case. With that in mind, while the debtor's secured creditors had consented to the debtor's use of cash collateral, Farm Fresh opposed such use and argued that potentially all of the property of the debtor was subject to the

PACA trust and could not be used by the estate without first paying all PACA claims in full.

In his opinion in *Cherry Growers*, however, Judge Dales clarified that while the PACA claimants' equitable interests in the PACA trust are not property of the estate, the assets themselves (that is, the inventory and other assets and proceeds thereof that are subject to the PACA trust) certainly are property of the estate under section 541 of the Bankruptcy Code.

Having so found, the court ruled that the debtor could use cash collateral, including property in which a PACA claimant may have an equitable interest, in accordance with section 363 of the Bankruptcy Code; *i.e.*, "as long as the DIP provides adequate protection of [the PACA claimant's] interests in the estate property." The court declined to allow Farm Fresh's "mere status as a PACA beneficiary" to otherwise preclude a debtor's ability to use to use cash collateral, stating that the court would not "permit the tail to wag the dog."

Because the \$337,159.18 Farm Fresh PACA claim was far less than the \$9,000,000 (or more) estimated value of the debtor's property (all of which Farm Fresh asserted was subject to the PACA trust), the court found that the interests of Farm Fresh were adequately protected.

In reaching its conclusion, the court also rejected the argument of Farm Fresh that the debtor had the burden of proving that the property that the debtor sought to use in its motion, whether cash collateral to fund operations or other assets to provide adequate protection to secured creditors, was not PACA trust property. The court found that while that burden may be appropriate in a proceeding to resolve competing property interests under Federal Rule of Bankruptcy Procedure

7001, a different burden of proof applied in a contested matter under section 363 of the Bankruptcy Code. Instead, the court found that the applicable burden of proof required Farm Fresh to establish that it had an interest in the debtor's property, after which the debtor had the burden to establish adequate protection of that interest.

Judge Dales' decision in *Cherry Growers* helps to identify certain limits of the otherwise powerful rights of PACA claimants in bankruptcy cases. This decision should be of great interest to potential debtors that may wish to use cash collateral despite owing amounts to PACA claimants, and to secured creditors that may want to work with those debtors to allow their cash collateral to be used on a consensual basis.

For More Information

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1 *Supplemental Opinion Regarding Cash Collateral Motion*, ECF No. 121, *In re Cherry Growers, Inc.*, Case No. 17-04127-swd, Bankr. W.D. Mich. (Nov. 1, 2017).

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