FPA AFLF
Fresh Produce Alliance | Alliance pour les fruits et les légumes frais

Building 75, 930 Carling Ave., Ottawa, Ontario, Canada K1A 0C6

Via Electronic Mail

Mr. Paul Halucha
Director-General,
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor, East Tower
Ottawa, Ontario
Canada K1A 0H5
E-Mail: insolvency-insolvabilite@ic.gc.ca

July 14, 2014

Dear Mr. Halucha,

The Fresh Produce Alliance, led by the Fruit and Vegetable Dispute Resolution Corporation, the Canadian Horticultural Council,[1] and the Canadian Produce Marketing Association, represents more than 15,000 growers, suppliers, dealers, wholesalers, distributors, retailers, and food service operators. We present for your consideration a submission regarding financial risk mitigation for the fresh fruit and vegetable sector in the event of insolvency.

Through the Canada-U.S. Regulatory Cooperation Council, efforts were made to find solutions that would enhance the comparability between the Canadian and U.S. systems of financial risk mitigation in the fresh fruit and vegetable industry in the event of insolvency. While market-based options such as bonding and insurance were explored, analysis by government and industry specialists showed that these options would be expensive and risk excluding small businesses from coverage. The most viable options are legislated amendments to the *Bankruptcy and Insolvency Act* (BIA).

Reforms to the existing protections for farmers set out in section 81.2 would provide marginal improvements to the status quo. However, the establishment of a limited statutory deemed trust, modeled on what currently exists in the United States, would provide effective and inclusive protection that takes into account the unique characteristics of trade in perishable products.

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[1] The members of the Canadian Horticultural Council have agreed unanimously by resolution to the adoption of a PACA-like trust in Canada. See list at the end of this submission.

Urgent action by the Government of Canada is needed in order to:

- Protect rural communities,
- Support thousands of Canadian businesses of all sizes,
- Ensure affordable, high-quality produce for Canadian consumers and
- Prevent disruptions of domestic and cross-border agri-food supply chains.

A limited statutory deemed trust for the fresh fruit and vegetable sector requires no government funding of any kind. Details of, and rationale for, the proposed reforms are set out in the following submission.

Sincerely,

Anne Fowlie	Ron Lemaire	Fred Webber
Executive V/P	President	President & CEO
CHC	CPMA	DRC

Attachments: List of endorsements from individual companies
Submission to Industry Canada regarding payment protection for FF&V
Annex I: CHC Member Organizations and example standing resolution

<u>List of companies who have asked to be individually identified as supportive of this submission beyond the support expressed by their national and regional organizations</u>

Au coeur de la pomme, Quebec
AMCO Produce Inc., Ontario
Atlantic Potato Distributors Ltd., New Brunswick
BC Fresh Vegetables Inc., British Columbia
BC Greenhouse Growers' Association, British Columbia
BC Hot House Foods Inc, British Columbia
British Columbia Produce Marketing Association, British Columbia
Calgary Produce Marketing Association, Alberta
California Strawberry Commission, California, United States
CFP Consolidated Fruit Packers Ltd., British Columbia
Chiquita Brands North America, Nova Scotia
Christofari Farms Inc., Ontario
Co-op Atlantic, New Brunswick
Coppola Farms Inc., Ontario
Costco Wholesale Canada Ltd. , Ontario
Courchesne Larose, Quebec
Dan's Produce Ltd, Ontario
Del Campo Supreme, Inc., Arizona, United States
Delhaven Orchards, Ontario
Florida Fruit and Vegetable Association, Florida, United States
Forthdale Farms, Ontario
Fresh Advancements, Ontario
Fresh Direct Produce Ltd., British Columbia
Fresh Produce Association of the Americas, Arizona, United States
Fresh Taste Produce Limited, Ontario
Frutas San Antonio, S.A. DE C.V., Mexico
Grupo Empaque Roquin S.A. DE C.V., Mexico
Gwillimdale Farms Ltd., Ontario
Isabelle Inc., Quebec
J.E.Russell Produce Ltd., Ontario
Jac Vandenberg, Inc., New York, United States
Kings Produce Ltd, Nova Scotia
Kuhl Spuds, Manitoba
Lingwood Farms, Ontario
Linkletter Farms, PEI
Mann Packing Company Inc., California, United States
Markon Cooperative Inc., California, United States
Missionero Vegetable Ltd. Ontario

Nature Fresh Farms Sales Inc., Ontario
North Canal Produce Inc., Ontario
Northwest Horticultural Council, Washington, United States
Nova Agri, Nova Scotia
Nova Produce, Florida, United States
Ocean Mist Farms., California, United States
Ontario Greenhouse Vegetable Growers, Ontario
Ontario Potato Board, Ontario
Ontario Produce Marketing Association, Ontario
Pandol Associates Marketing Inc., California, United States
Patterson Farm., North Carolina, United States
Peak of the Market, Manitoba
Pier-C Produce Inc., Ontario
Procyk Farms (1994) Ltd, Ontario
Quebec Produce Marketing Association, Quebec
Rally Logistics Inc., Ontario
Ranier Fruit Company., Washington, United States
Rodeva S.P.R. DE R.L., Chiapas, Mexico
Rollo Bay Holdings, PEI
Serres du Saint-Laurent (Savoura), Quebec
Sliced FC, Alberta
Sobeys Ltd, Ontario
Southern Manitoba Potato, Manitoba
Spearit Farms, Ontario
Star Produce, Saskatchewan
Sun Grape Marketing Inc., Quebec
Sun Rich Foods Inc., Ontario
Sunkist Growers, Inc., California, United States
Texas International Produce Association, Texas, United States
The DiMare Companies., Florida, United States
The Grocery People, Alberta
The Oppenheimer Group, British Columbia
Tecarte Farms, British Columbia
Tomato King, Ontario
United Fresh Produce Association, Virginia, United States
VegPro International Inc., Quebec
Vineland Growers, Ontario
Western Growers., California, United States
Wilmot Farms, Ontaio
Woodville Farms Limited, Ontario

Submission to Industry Canada regarding amendments to the *Bankruptcy and Insolvency Act* to provide payment protection for Canada's fresh fruit and vegetable sector

By the Fresh Produce Alliance

July 14, 2014

PROFILE OF THE FRESH FRUIT AND VEGETABLE INDUSTRY

Canada's fresh fruit and vegetable sector makes an important contribution to national economic output and employment. In 2013, the fresh fruit and vegetable sector directly supported 76,700 jobs and contributed $4.8 billion in direct GDP. Additionally, the impact on the Canadian economy, especially in rural communities, is much larger. Once the indirect benefits of payments to suppliers and workers' wages are factored in, the fresh fruit and vegetable sector supports 147,900 jobs and creates $11.4 billion in real GDP. The multiplier effect of Canada's fresh fruit and vegetable sector output is that every $1 million increase in sales generates $2.4 million in real GDP.[2]

Canada's integrated supply chains with the United States are key to ensuring export markets for Canadian producers and a year-round supply of affordable fresh fruit and vegetables for Canadian consumers. Canada sells about 40 percent of its fruit and vegetable production to the United States – about $1.5 billion in sales in 2012 and Canada imported nearly $3.5 billion from the U.S. in the same year. This high level of integration is due to geographic proximity, complementary growing seasons, and strong cross-border cooperation.

But the unique characteristics of the fresh fruit and vegetable sector also make it vulnerable to payments disruption. Producers operate with low profit margins, normally between 3 and 5 percent of sales, and many rely on a single buyer to purchase their entire crop. The proliferation of small business make the fruit and vegetable industry uniquely vulnerable compared to other enterprises. Three quarters of Canada's 10,000 fruit and

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[2] Conference Board of Canada, *More Than A Healthy Habit: Assessing the Economic Contribution of Canada's Produce Industry* (May 2014).

vegetable producers are small businesses with average sales of less than $85,000 per year. These small firms have much lower risk tolerance and limited access to credit compared to their larger counterparts.

Perishability of the product also contributes to the unique and vulnerable nature of the sector. Fresh fruit and vegetables have a shelf life measured in hours and unpaid shipments cannot be repossessed and resold. Because of the distance between production and markets, and the short Canadian growing season, trade is fast moving, often resulting in expedited agreements and documentation.

Transactions are typically made over the telephone and contracts are finalized in a matter of minutes. The majority of the contracts are verbal. Written confirmation of the basic terms often follows while the shipment is in transit. Under these conditions it is difficult for sellers to make credit checks, negotiate conditional sales agreements, or take other traditional safeguards.

Growing, harvesting, packing and shipping perishables is risky: costs are high, capital is tied up in farm land and machinery, and returns are delayed until the crop is sold. Businesses depend on prompt payment to meet their financial obligations and the fresh fruit and vegetable seller who cannot realize a return on the sale of the crop may not be able to survive financially.

What have we done to mitigate risk and improve transparency?

Fresh fruit and vegetable sellers operate in a volatile financial environment but due diligence can help to rebalance the equation. In Canada, the Fruit and Vegetable Dispute Resolution Corporation (DRC) helps to reduce rise and increase transparency by providing:

- **A Single Authority for Rules and Practices -** For over 14 years, DRC has been recognized as the default authority for rules, standards and trading practices within Canada and the NAFTA trading area. A single authority helps to minimize duplication and inconsistency in rules and practices and increases information coherence and availability.

- **Licensing -** DRC provides a single membership system based on robust screening practices. Rules are consistently applied to all members. By mid-2015 all interprovincial and international dealers of fresh fruit and vegetables operating in Canada must be members of the DRC.[3] This will replace the former bifurcated

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[3] This requirement is included in the June 19, 2014 amendments to the *Safe Food for Canadians Act*.

system that required licensing by the Canadian Food Inspection Agency if fresh fruit and vegetable buyers were not DRC members.

- **A Single Dispute Resolution Body -** The DRC provides dispute settlement options ranging from mediation to mandatory arbitration for disputes related to payments and other business practices. The DRC oversees the enforcement of trading practices and financial protection measures and has the power to terminate memberships.

- **Default Contracts and Mandatory Business Practices -** Because many disputes are the result of informal or imprecise contracts, the DRC provides default contract language[4] and common operating rules such as for consistent terms for payment and delivery.

- **Information and Training –** DRC provides access to education, buyer information, and databases of credit worthiness.

But due diligence is only a partial solution. Even though due diligence can reduce the risk of buyer insolvency, it cannot eliminate it entirely. Once a bankruptcy occurs, fresh fruit and vegetable suppliers need an effective mechanism to recover payments.

IMPACT AND SCOPE OF FRESH FRUIT AND VEGETABLE SECTOR BANKRUPTCIES

Compared to other suppliers, fruit and vegetable producers are particularly hard hit when a buyer declares bankruptcy because repossession of highly perishable shipments is impossible. Fresh fruit and vegetable suppliers are particularly vulnerable to a practice known as "juicing the trades," when insolvent debtors order excessive amounts of inventory shortly before bankruptcy in order to increase the assets available to satisfy secured creditors.[5]

A single bankruptcy can devastate not only the producer but also all the businesses connected to that producer. The impact is exacerbated in rural communities where livelihoods are tied to the sales of just a few commodities (see Box 1).

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[4] Parties may use their own contract terms by agreement.

[5] Alysia Davies, *Bankruptcy: Protecting Unpaid Suppliers*, Legal and Legislative Affairs Division, Library of Parliament, PRB 02-38E, November 2008.

Box 1: Effects of a Fresh Fruit and Vegetable Sector Bankruptcy In 2011, a large produce buyer from British Columbia filed an assignment in bankruptcy in which the major secured creditor, a bank, received full payment of $562,000 while 102 unsecured creditors were unable to recover the $2,333,850 owing to them. The table below summarizes the uncovered debts in the fresh fruit and vegetable sector.		
Debt to Canadian growers/dealers	38 creditors	$639,868
Debt to American growers/dealers	21 creditors	$532,116
Total produce-related debt	59 creditors	$1,171,939
Compounding the loss, many of the same creditors are affected by multiple bankruptcies and receiverships. In 2010, ten of the produce creditors affected by the bankruptcy above were affected by another major B.C. bankruptcy. Two of the larger produce creditors lost $183,000 and $128,000 respectively from the two events.		

Source: Office of the Superintendent of Bankruptcy Canada; calculations by DRC.

It is important to note that the rate of business insolvencies in the fresh fruit and vegetable sector is lower than the national average and much lower than in sectors such as utilities, manufacturing and construction (see Table 1). Moreover, due diligence efforts by DRC and others are contributing to an overall decline in fresh fruit and vegetable sector bankruptcies (see Table 2). But bankruptcy rates in the sector remain higher than more regulated agricultural commodities such as grain, livestock, and poultry.

In a study commissioned by AFFC in 2013, actuarial specialists estimated that with $5 billion in annual sales, the average net bankruptcy loss in Canada's fresh fruit and vegetable sector is approximately $19 million per year. Canadian sales are liable for approximately 30 percent of the loss and U.S. sales make up the balance.

Table 1: Annual Business Insolvency Rates in Canada per 1000 Businesses

Sector	**2010**	**2011**	**2012**
Agriculture, Forestry, Fishing and Hunting	0.9	0.8	0.7
Utilities	4.4	6.2	8.5
Construction	3.2	2.8	3
Manufacturing	6.7	6.8	5.5
Average	2.3	2	1.8

Source: Office of the Superintendent of Bankruptcy Canada; sectors defined by North American Industry Classification System; average includes sectors not shown in this table.

Table 2: Overview of Bankruptcies in Canada's Fresh Fruit and Vegetable Sector

Year	Number of bankruptcies	Net Liability*	Average Severity
2007	51	$12,086,946	$236,999
2008	52	$34,254,969	$658,749
2009	48	$16,550,448	$344,801
2010	46	$52,128,580	$1,133,230
2011	29	$17,861,678	$615,920
2012	26	$12,702,867	$488,572
Average	42	$24,264,248	$579,712

*Net refers to non-recoverable assets

Source: Office of the Superintendent of Bankruptcy Canada and IOA Actuarial Consulting 2014

Small Businesses and the Fresh Fruit and Vegetable Sector

The results that Canada's fresh fruit and vegetable sector seeks from BIA reforms are threefold: to relieve produce sellers from bankruptcy limbo, to preserve rural livelihoods, and to support small business.

Canada's small businesses contribute between 25 and 41 percent to GDP. They employ nearly 70 percent of the total private labour force and, over the past decade, have created nearly 80 percent of new non-governmental jobs in Canada.[6] Seventy-five percent of Canada's fresh fruit and vegetable producers are small businesses. The sector as a whole makes an important contributor to output and employment, especially in rural Canada, but the high number of small businesses underscores the sector's vulnerability to buyer insolvency.

Also, even though most fruit and vegetable suppliers are small businesses, they represent only six percent of total domestic sales (see Figures 1 and 2). This means that instruments to mitigate bankruptcy risk must be flexible enough to accommodate suppliers of all sizes and credit ratings.

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[6] Industry Canada, *Key Small Business Statistics* (August 2013). Small business is defined as having fewer than 99 employees.

Figure 1: Number of Firms in Canada's Fresh Fruit and Vegetable Sector By Size

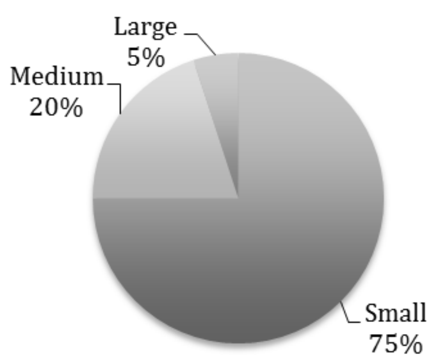
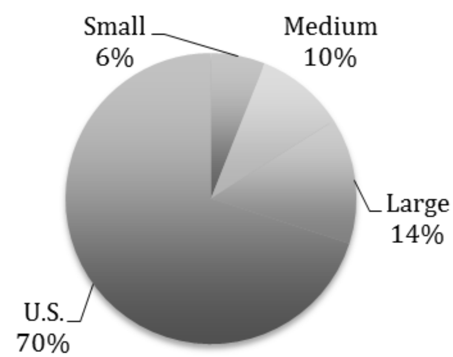


Figure 2: Sales in Canada by Firm Size Plus U.S. Firms (all sizes)



Source: IOA Actuarial Consulting 2014

THE NEED FOR A RESILIENT CANADA-U.S. SUPPLY CHAIN

More than 140 different commodities are traded under the fresh fruit and vegetable classification and most Canadian production takes place between the months of May and September. More than 1400 buyers and dealers are members of DRC, representing over 90 percent of the fresh fruit and vegetable industry in Canada. 300 members of the DRC are non-Canadian (mostly from the United States).

Canada's domestic farm gate receipts for fresh fruit and vegetables in 2012 were $2.72 billion.[7] About 40 percent of total Canadian production is sold to the United States (see Figure 3) and the United States buys approximately 85 percent of Canada's fresh fruit and vegetable exports.[8]

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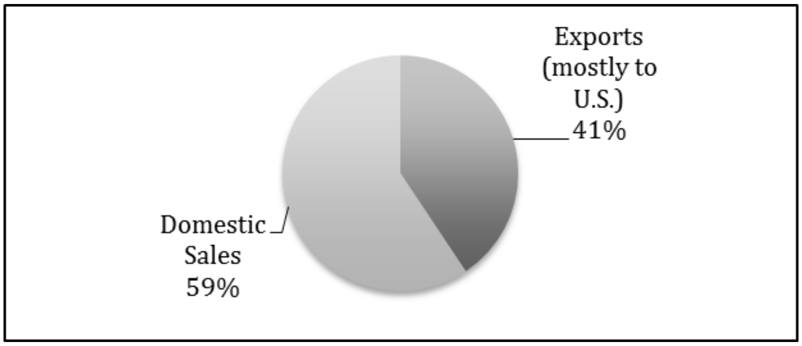
[7] All figures here exclude potatoes. For statistical purposes, potatoes are tracked separately but, if combined with other fruit and vegetable data, they would add more than $1 billion to 2012 farm gate receipts for the fresh fruit and vegetable sector.

[8] Agriculture and Agri-Food Canada, *Statistical Overview of Canadian Horticulture, 2010-2011* (October 2012).

Figure 3: Canada's Fruit and Vegetable Production



To ensure an affordable, year-round supply of fresh fruit and vegetables Canadians must rely on imports, especially during the winter months. In 2012, about 60 percent of Canada's imports came from the United States, an estimated $3.5 billion in sales. Therefore, disruptions caused by unstable supplies are certain to have a negative effect on price, selection and quality in Canada.

> A May 2014 report from the CD Howe Institute reveals that Canadians are already paying 57 percent more for food than American consumers and California's drought is exacerbating the problem.[9] Researchers at Arizona State University estimate that the prolonged lack of rainfall will cause U.S. fresh fruit and vegetable prices to rise by up to 34 percent through 2015.[10]
>
> Canada and the United States have worked hard to create aligned policies on such issues as produce inspection and certification but there are significant gaps in the area of payments protection.

In the United States, shippers are protected by a statutory deemed trust established through the *Perishable Agricultural Commodities Act* (PACA) in 1984. The PACA trust helps suppliers of perishable products ensure prompt payment by buyers. The trust makes suppliers' interests in a debtor's assets superior to those of other creditors, including secured creditors ("super priority"). When shipping to the United States, Canadian firms can receive the same PACA trust benefits as U.S. entities. This makes the U.S. a market of

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[9] Nicholas Li, *Sticker Shock: The Causes of the Canada-U.S. Price Differential,* CD Howe Institute, May 2014.

[10] "Attention Shoppers: Fruit and Vegetable Prices are Rising," *Wall Street Journal* (April 15, 2014).

choice (over Canada) for their products. Because of the high standard for treatment afforded by the PACA and because of their large Canadian market presence, U.S. suppliers and their government representatives are seeking reciprocal protection in Canada.

As Fred Webber, President of the DRC, notes, "U.S. suppliers are losing at minimum $10 million annually through Canadian buyer insolvency. This is, coincidentally, about the same amount as Canadian suppliers are recovering each year through the U.S. PACA trust."

Matt McInerney, Executive Vice President of Western Growers, one of the largest fresh fruit and vegetable organizations in the United States, stated in April 2014 that if progress toward equivalent levels of payment protection was not achieved, produce operators in the U.S. would encourage the U.S. government to withdraw preferential access to the PACA trust that Canadian suppliers currently enjoy.[11]

Lack of reciprocity also affects the price and quality of fresh fruit and vegetables available to Canadians. According to a USDA licensee survey, U.S. shippers already add a 5 to 15 percent price premium to fresh fruit and vegetable bound for Canada in order to compensate for the riskier environment.[12] And, Canadian producers routinely bypass the Canadian domestic market in order to take advantage of the superior protections offered in the United States. In order to shed its reputation as a secondary or inferior market, Canada must provide payment protections comparable to those offered in the United States.

CANADA'S EFFORTS TOWARDS PAYMENT PROTECTION FOR THE FRESH FRUIT AND VEGETABLE SECTOR

Industry Canada's request for stakeholder views on payment protections for the fresh fruit and vegetable industry specifically identifies the measures already contained in the BIA (section 81.2) providing farmers with the right to repossess the inventory of a bankrupt for unpaid amounts.[13] But, as will be discussed below, 81.2 in its current form is too limited to be useful for its intended beneficiaries. First, however, it is important to understand the

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[11] Tom Karst, "Frustration with Canada's Slow Progress in Risk Protection," *The Packer* (March 19, 2014).

[12] Presentation made by Karla Whalen, USDA lead for the RCC Fresh Produce Sub-Working Group On Data Analysis to the RCC stakeholder meeting, July 18' 2012 in Washington, D.C.

[13] Statutory Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00873.html.

role of bankruptcy reforms in the context of other attempts at policy reform and cooperation with the United States.

Regulatory Cooperation Council

In 2011, the Regulatory Cooperation Council Joint Action Plan committed to develop comparable risk management tools to protect Canadian and U.S. fruit and vegetable suppliers from buyer default in order to create a level playing field in the bilateral marketplace.[14]

The 2012 RCC Progress Report for Leaders noted that during the first year, the lead agencies, Agriculture and Agri-Food Canada (AAFC) and the U.S. Department of Agriculture's Agricultural Marketing Service completed information gathering and were ready to develop Canadian industry tools that are comparable to those available in the United States. Specifically, they sought "regulatory measures that could be adopted to better ensure industry payment to fresh produce sellers in cases of buyer bankruptcy and insolvency."[15]

A year later, the December 2013 RCC newsletter reported no new progress on bankruptcy and insolvency measures.[16] Since 2011, the RCC, together with industry and government counterparts, has helped to strengthen the licensing system and improve the dispute resolution mechanism but neither of these measures are helpful after bankruptcy has been declared. For this reason it is necessary to look at reforms to the *Bankruptcy and Insolvency Act* in order to ensure that payments owing to suppliers are protected.

Through collaboration facilitated by the RCC, the U.S. Department of Agriculture (USDA) has invested significant resources to develop a mechanism that provides protection similar to PACA's trust provision. In April 2014, Charles Parrott, Deputy Administrator of USDA's

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[14] Canada's Economic Action Plan. *Joint Action Plan for the Canada-United States Regulatory Cooperation Council* http://actionplan.gc.ca/en/page/rcc-ccr/joint-action-plan-canada-united-states-regulatory#s4.1.3

[15] Canada's Economic Action Plan. *2012 Progress Report to Leaders*. http://actionplan.gc.ca/en/page/rcc-ccr/2012-progress-report-leaders

[16] Canada's Economic Action Plan. *Canada-United States Regulatory Cooperation Council News December 2013*, http://actionplan.gc.ca/en/page/rcc-ccr/canada-united-states-regulatory-cooperation

Fruit and Vegetable Program, recognized Canada's efforts to move to a single licensing system but noted that licensing will not provide protection to unpaid sellers when the buyer declares bankruptcy. [17] To create comparable outcomes to the PACA trust, Parrott recommended the following:

- Establish clear criteria that the assets of a produce debtor are segregated for payment to produce creditors only;
- Ensure that the debtor's produce-related assets not be included in the bankruptcy estate;
- Ensure that produce creditors are afforded a "priority" status to assets;
- Establish a procedure to hold produce-related assets until all available funds are collected and valid claimants are identified; and
- Provide produce creditors with a pro-rata share of assets.

OTHER OPTIONS

Insurance

Reports conducted by government-industry working groups and insurance industry specialists provide a number of reasons why neither buyers' nor sellers' insurance are feasible options.[18] The major conclusions are:

1. High insurance premiums required will erode the thin profit margins of fresh fruit and vegetable suppliers and costs will be passed on to consumers;
2. Smaller buyers and sellers might not have credit history to be eligible without financial support and credit guarantees from government; some 25 percent of businesses could be excluded;
3. Buyers' insurance would induce a moral hazard problem, increasing incentive to default;

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[17] Charles Parrott, Deputy Administrator, Fruit and Vegetable Program, USDA, *Address to Canadian Produce Marketing Association, North American Trade Committee,* Vancouver BC (April 2, 2014).

[18] Most recent recommendations are contained in AOL Actuarial Consulting (An AON Company), *Feasibility of Private Insurance Models for Canada's Fresh Produce Industry*, study prepared for AAFC Canada, January 2014. See also Fresh Produce Alliance, *Securing Payments and Regulating Business Practices for the Canadian Fresh Fruit and Vegetable Industry*, November 2012; and *Final Report of the Federal-Provincial Working Group on Fair and Ethical Practices in the Canadian Horticultural Sector*, study prepared for the Federal-Provincial-Territorial Agriculture Policy Assistant Deputy Minister Committee and Federal-Provincial-Territorial Agriculture Regulatory Assistant Deputy Minister Committee, May 2009.

4. Commercial insurance providers would not be willing to provide buyers insurance without institutional support from some type of new entity that would cost an estimated $25 million to launch.

The RCC Producer Payment Security Models Working Group summarized the problem with insurance as follows:

> The cost of the insurance would fall to the party who is most at risk. In the case of fresh produce, this would be the producer who has the least amount of market power. The additional cost to the producer, i.e. the insurance premium, would erode profitability at the primary level of production. [Moreover] it is unlikely that retailers, who have the most amount of leverage in the fresh produce industry, would agree to insure themselves for the benefit of the producers.[19]

Insurance premiums for Canada's $5 billion fresh fruit and vegetable sector are projected to cost Canadian suppliers approximately $4.5 million per year and U.S. suppliers would pay $10.5 million per year plus sales tax and brokerage fees.[20] For U.S. suppliers, being forced to take on this additional financial burden (for protection they receive at home at no cost) would be a strong incentive to stop shipping Canada in favour of other markets.

Options such as insurance (as well as bonds and factoring) that avoid the credit market are too expensive and would exclude most members of the fresh fruit and vegetable marketing chain.[21] These options will raise prices for consumers and deter U.S. shipments to Canada. Thus, targeting the individual bankruptcy through a deemed trust is the most cost-effective and inclusive way to provide payment protection in the fresh fruit and vegetable sector.

CHANGES TO *THE BANKRUPTCY AND INSOLVENCY ACT*

Industry Canada has requested stakeholder views regarding the existing special provisions for farmers to repossess inventory as set out in Section 81.2 in the BIA, "potentially expanding it to benefit U.S.-based fresh produce farmers and extending the delivery period

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[19] Presentation by the Producer Payment Security Models Working Group to the Canada-U.S. Regulatory Cooperation Council Meeting, Washington DC, July 18, 2012.

[20] Calculations of premiums and fees based on insurance industry calculations made for Agriculture and Agri-Food Canada, 2013. Premium estimate: 30 basis points for each $100,000 of sales. Brokerage fees estimated at 5 to 10 percent of annual premium. Provincial tax range from 12 to 24 percent.

[21] Full inclusion would government-backed credit guarantees and administration.

from 15 days to 30 days, which is more consistent with practices in the marketplace."

In its current form, 81.2 is largely ineffective; it excludes most members of the fresh fruit and vegetable marketing chain and imposes conditions that are unachievable in most bankruptcies. As will be explained below, 81.2 could be marginally improved but it would still be a much less effective and inclusive mechanism than the statutory deemed trust that exists in the United States.

81.2 – Intention and Reality

In 1992 the BIA was amended to provide unpaid suppliers with the right to repossess their own goods from bankrupt buyers (section 81.1). A second level of protection (81.2) was added for suppliers of perishable products -- farmers, fishers and aquaculturists -- so that they might make a claim on the full inventory of the purchasers.

During the 2003 review of the BIA, the Senate Banking, Trade and Commerce Committee concluded that sellers were receiving little practical protection from the BIA because of the difficulties in meeting the administrative requirements. The Committee re-affirmed the need for specific protections for suppliers of perishable goods but did not recommend a specific course of action.[22]

The three most problematic areas of 81.2 are the **definition of farmer**, restricting **assets to inventory only**, and the **timelines** regarding delivery to purchaser and demand for repossession.

Definition of farmer

The special rights of 81.2 (which also covers fisherman and aquaculturists) apply only to "a farmer" who "has sold and delivered products of agriculture." In the Act, farmer is defined as "the owner, occupier, lessor and lessee of a farm." Products of agriculture refer to "grain, hay, roots, vegetables, fruits, other crops and all other direct products of the soil."[23]

But, a farmer, as defined by the Act, is only a small part of the process in the real world. Use of this definition does not reflect the reality of the fresh fruit and vegetable marketing chain. Small shipments are aggregated into larger ones as the product moves from the original grower through dealers, wholesalers, retailers and finally to consumers. In practical application, buyers can also be sellers and the risk of dealing in perishable

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[22] Davies, 2008.

[23] 81.2 also applies to "indirect products of the soil" including and honey, meat, livestock, dairy products, and eggs.

products is transferred successively along each node of the supply chain. The wholesaler might well have paid off the grower's invoices before finding himself liable for a retailer's nonpayment. Thus, restricting the 81.2 rights to farmers excludes most members of the supply chain, including many small, rural businesses.

A more effective definition would cover any domestic or international seller of fresh fruit and/or vegetables.[24] By comparison, the PACA provides coverage for any participant in the market, including farmers, packers, dealers, and wholesalers.

Inventory assets

The right of repossession applies only to inventory. For creditors in the fresh fruit and vegetable sector, any inventory left unsold after a few days will be spoiled and worthless. While 81.2 does offer farmers the right to other inventory, this only applies to inventory not claimed by other suppliers (who are given similar repossession rights under 81.1). In order for fresh fruit and vegetable creditors to receive compensation for unpaid shipments it is necessary to expand the scope of allowable assets from inventory to include cash and accounts receivable related to the fruit or vegetable sale.

In the United States, PACA-trust assets include cash, accounts receivable, and inventory derived from the sale of fresh produce. Trust assets may be traced to other assets if the debtor has dissipated the trust.

Delivery and demand periods

For a fresh fruit and vegetable seller to use the repossession right in 81.2, the product must have been delivered to the purchaser within the fifteen day period <u>before</u> the day on which the purchaser became bankrupt or subject to receivership. The seller must also file a written demand for repossession within fifteen days <u>after</u> the purchaser became bankrupt or subject to receivership.

Even though 81.2 was intended to provide priority status for suppliers of perishables, the 15-day delivery window is actually much less than the 30-day period that other suppliers are granted. However, equity with other types of suppliers is much less important than the fact that, as stated above, fresh fruit and vegetable sellers will not have any of their own inventory to repossess and the chances of making a successful claim against the inventory of other suppliers are very small.

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[24] Such a definition would also be more inclusive of U.S. suppliers since few U.S. "farmers" are selling directly to Canada.

Other challenges

Other gaps in BIA coverage for the fresh fruit and vegetable sector include the need to provide protection under the *Companies Creditors' Arrangement Act* in instances of company reorganization, and also the need to ensure that any new protections are fully accessible to U.S. suppliers.

One of the most important challenges, however, is how to help small, under-resourced suppliers successfully navigate complicated bankruptcy processes. Just as Canada simplified procedures for individual wage earners to collect what was owing to them through the *Wage Earner Protection Program Act* (WEPPA), the PACA process requires trustees and receivers to automatically separate PACA-trust assets from other assets. As long as PACA licensees have the required PACA-trust language on their invoices or fulfilled the statutory requirement of placing the debtor on notice of the trust, the segregation of monies owing to fresh fruit and vegetable sellers is automatic. While payments may not be received through ordinary bankruptcy proceedings for a year or more, the PACA trust is usually able to provide payments within a matter of weeks, ensuring minimal disruption of normal business activities and preventing the chain reaction of bankruptcies that often results from payment interruptions.

Effective and reciprocal protection?

Comprehensive reforms could help make 81.2 somewhat more effective, however, it would still be weaker than a deemed trust in terms of accessibility and effectiveness (see Table 3). Moreover, an amended 81.2 would fall short of the U.S. demands for reciprocal treatment under the PACA-trust and this gap would likely provoke removal of Canada's priority access to the PACA-trust.

Table 3: Payment Mechanisms for Fruit and Vegetable Suppliers

	81.2 current	**81.2 modified (as proposed)**	**PACA-like trust***
Accessible to businesses of all types and sizes	No	Yes	Yes
Accessible to U.S. shippers (other than U.S. farmers)	No	Yes	Yes
Provides effective payment recovery	No	Uncertain	Yes
Provides timely payment recovery	No	Uncertain	Yes
Estimated time for payment recovery:	n.a.	1 year or more	2 - 8 weeks
Qualifies for U.S. reciprocal treatment under PACA	No	No	Yes
* In Canada, a statutory deemed trust **Payment before secured creditors			

Limited Statutory Deemed Trust

Legal advice and experience in other jurisdictions indicates that the most effective way to provide protection to fresh fruit and vegetable sellers in Canada is through the creation of a limited statutory deemed trust to ensure that bankruptcy assets are secure and accessible.

A limited deemed trust:

- Ensures that the debtor's fresh fruit and vegetable-related assets are not included in the bankruptcy estate;
- Ensures that fresh fruit and vegetable creditors are afforded limited priority status with respect to assets;
- Establishes a procedure to hold fresh fruit and vegetable-related assets until all available funds are collected and valid claimants are identified;
- Establishes criteria so that fresh fruit and vegetable creditors share in pro-rata distribution of assets;
- Is limited to the accounts receivable, cash, and inventory stemming from the sale of the suppliers' goods and does not apply to buildings, equipment, vehicles and non-fresh fruit and vegetable related assets;
- Does not require a costly administrative or institutional structure;
- Does not require government funds or credit guarantees.

The deemed trust mechanism has a 30-year track record of success in the United States. Not only are PACA suppliers able to collect debts owed ahead of other creditors, they are relieved of the difficult process of tracing funds owed to them because PACA creates a floating trust that attaches to all of the debtor's assets derived from fresh fruit and vegetable sales. The trust is effective and imposes no additional costs on buyers, sellers, or government agencies.

Effects of bankruptcy protection on the cost of borrowing

One of the criticisms of providing priority status to suppliers of perishable fruit and vegetables is that it will reduce the pool of assets available to other creditors, including banks, and thereby increase the cost of borrowing. However, potential liabilities through fresh fruit and vegetable sector bankruptcies average less than $20 million a year, less than half of the liabilities associated with the Wage Earner Protection Program.

The 2008 *Wage Earner Protection Program Act* (WEPPA) is a government-administered program that provides super-priority status to unpaid employee wages in the event of bankruptcy. While some have indicated that it has had a downward effect on the amount that banks are willing to lend to Canadian businesses (see Box 2), no studies were found that quantify WEPPA-related credit reductions. Anecdotal evidence suggests that obligations are weighted differently by different financial institutions. Accueval, a corporate advisory and evaluation service, speculates that since many Canadian lenders were already honoring payroll obligations prior to WEPPA to avoid negative publicity, the new program effectively codified existing practice, rendering post-WEPPA reductions to credit facilities "unduly conservative."[25]

Box 2: Effect of WEPPA on Bank Lending
Prior to WEPPA, banks were paid before unsecured creditors. Under the WEPPA, employees can receive up to $3000 in back wages before the banks are paid. This has reduced waiting times for unpaid wages from years to weeks but it also potentially reduces the pool of credit available to business. For example, a bank might lend up to 75 percent of a company's accounts receivable value, thus a company with $1 million in receivables could borrow up to $750,000 to finance operations and payroll. However, if the company has a biweekly payroll of $200,000, the bank may reduce the company's line of credit by that amount since it might lose that money in the event of a bankruptcy.[26]

When new super-priorities are added ahead of secured creditors, banks might reduce the amount of financing provided, raise lending rates or require additional security to account for new risks.[27] However, options for payment protection that do not affect the credit market must be guaranteed by some sort of fund, presumably one requiring signification government contribution.

The WEPPA and a possible deemed trust for the fresh fruit and vegetable sector are not comparable in terms of size and administrative burden. The annual bankruptcy liability for unpaid wages in Canada is $30 to $50 million while fresh fruit and vegetable sector bankruptcies are about $20 million. As well, the WEPPA is structured so that the Government of Canada, not the individual wage earners, become the creditor, imposing a much greater administrative burden on the government than the type of deemed trust

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[25] http://www.accuval.net/insights/featuredarticle/detail.php?ID=22

[26] J. Douglas Hoyes, "Canadian Bankruptcy Reform: Bill C-55 and the Wage Earner Protection Program," *Hoyes Michalos Ontario Bankruptcy Blog*, http://www.hoyes.com/blog/canadian-bankruptcy-reform-bill-c-55/

[27] Cassels Brock Lawyers, "Wage Earner Protection Program Act Comes Into Force: Secured Creditors Be Wary," July 2008, http://www.casselsbrock.com/Doc/_i_Wage_Earner_Protection_Program_Act__i__Comes_Into_Force___Secured_Creditors_Be_Wary

proposed for the Canadian fresh fruit and vegetable sector. The latter would be managed in normal course by the trustee along with other creditor claims. "

Acceptance of the PACA trust in the United States

Three decades of PACA trust operations in the United States provide important insight into what could be expected in Canada from a similar program. First, while some U.S. banks do reduce credit facilities for buyers with PACA obligations, they also tend to expand lending to suppliers covered by the PACA because of the positive benefits generated from payments protection and regularized cash flow.

The overall effect of the PACA in the U.S. has been to expand lending security, not reduce it. For example, once a fresh fruit and vegetable buyer resells the product to a customer, that sale and resulting account receivable are also protected by the deemed trust. Thus, the account receivable secured by the bank, is now also secured by the deemed trust. Since PACA benefits accrue not just to a single supplier but to all other members of the supply chain, the trust provides protection against the domino effect of payment disruption.

In three decades of operation, there has been no movement by the U.S. banks or fresh fruit and vegetable buyers to remove or challenge the PACA. Agricultural lenders have supported the trust because it makes farm loans more secure. It is important to note that many Canadian banks have operations in the United States and so they are already operating in a lending environment that protects fresh fruit and vegetable sellers through a deemed trust. Fresh fruit and vegetable buyers support the PACA trust because it facilitates supply chain security, ensuring quick and hassle-free movement of fresh fruit and vegetables from the farm, through various dealers and wholesalers and into the hands of consumers.

Doesn't priority status encourage lax credit practices by suppliers?

Mechanisms that grant priority status are not a guarantee of payment. Recovery tools are restricted to the accounts receivable, cash, and inventory specifically derived from the sale of the fresh fruit and vegetable asset. One hundred percent payment recovery is not expected and actual amounts will be tied to the suppliers' own due diligence efforts with respect to the transaction and procedures for past due accounts. Good credit practices are at the core of a successful payments recovery system.

By ensuring priority status in bankruptcy, Canada would also be providing a backstop for fair and ethical trading practices in the fresh fruit and vegetable sector. Under current conditions, unscrupulous buyers who are habitually late or skip payments can force sellers into accepting their terms by threatening bankruptcy, in which case the fresh fruit and vegetable creditor gets nothing. In the United States, where the debt to the fresh fruit and vegetable creditor survives the bankruptcy, unscrupulous buyers must either adopt better practices or exit the market for good.

CONCLUSION: A CONSENSUS FOR CHANGE

There is a solid consensus in favour of the establishment of a deemed trust among the diverse membership of Canada's $5 billion fresh fruit and vegetable supply chain. Growers, shippers and suppliers see obvious benefits to a more secure payments system. Retailers and fresh fruit and vegetable marketers also support reforms because they help prevent supply disruptions and provide predictability to sales and marketing decisions. Furthermore, there is agreement among Canadian and U.S. stakeholders that a level playing field in payments protection is a strong contributor to an integrated, competitive North American fresh fruit and vegetable market. The commitment made by Prime Minister Harper and President Obama in 2011 to elevate the issue within the Regulatory Cooperation Council underscores its importance to both countries.

Having thoroughly evaluated all other options, it is clear that leadership by Industry Canada to reform the *Bankruptcy and Insolvency Act* is required to achieve the long-awaited protections for the fruit and vegetable sector promised since 1992.

Action is urgently required. Continued delays will result in supply chain disruptions, higher costs for consumers, heightened vulnerability of small businesses and rural communities, loss of priority status for Canadian exporters to the United States, and U.S. opposition to future cooperation within the Regulatory Cooperation Council and other international trade fora.

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Annex I

As far back as 1999, the members of the Canadian Horticultural Council have unanimously adopted a series of resolutions at numerous Annual General Meetings (see below for most recent example); seeking resolution to issues related to financial protection for producer sellers through a "US PACA-like" deemed trust provision or other means to provide a comparable tool to Canadian producers.

The Canadian Horticultural Council is an association of associations which represents producers and packers of more than 120 fruit and vegetable crops from across Canada. Collectively, the member associations represent over 15,000 producers.

Membership

British Columbia

BC Blueberry Council

BC Cranberry Marketing Commission

BC Fresh Inc.

BC Fruit Growers' Association

BC Greenhouse Growers' Association

BC Potato & Vegetable Growers' Association

BC Raspberry Industry Development Council

BC Tree Fruits Cooperative

BC Tree Fruits Limited

BC Vegetable Marketing Commission

Fraser Valley Strawberry Growers Association

Fraserland Organics Inc.

Island Vegetable Co-operative Association

Okanagan Grown Produce Limited

Vancouver Island Produce Ltd.

Alberta

Alberta Farm Fresh Producers Association

Alberta Greenhouse Growers Association

Alberta Seed Potato Growers Association

Lamb Weston, Division of ConAgra Ltd.

Potato Growers of Alberta

Red Hat Co-Op

Sunfresh Farms Ltd.

The Little Potato Company

Saskatchewan

Bischlers Produce

Saskatchewan Fruit Growers Association

Saskatchewan Greenhouse Growers Association

Saskatchewan Ministry of Agriculture

Saskatchewan Seed Potato Growers' Association

Saskatchewan Vegetable Growers Asociation

Manitoba

Chipping Potato Growers of Manitoba

Connery's Riverdale Farms

Jeffries Brothers Vegetable Growers

Keystone Potato Producers Association Inc.

Manitoba Root Crop Producers' Marketing Board

Meyer Farms Co., Ltd.

Peak of the Market

Prairie Fruit Growers Association

Seed Potato Growers Association of Manitoba

Simplot

Vegetable Growers Association of Manitoba

Ontario

Algoma Orchards Ltd.

Apple Marketers' Association of Ontario

Asparagus Farmers of Ontario

Bayshore Vegetable Shippers

Bradford Co-op Storage

Central Erie Fruit & Vegetable Growers' Association

East Central Fruit and Vegetable Growers' Association

Eastern Ontario Fruit and Vegetable Growers' Association

Elgin County Fruit and Vegetable Growers' Association

Essex County Associated Growers'
Fresh Vegetable Growers of Ontario
Garlic Growers Association of Ontario
Georgian Bay Fruit Growers' Inc.
Grand Bend Vegetable Growers' Association
Grape Growers of Ontario
Halton & Wentworth Growers' Association
Holland Marsh Growers Association
Ippolito Produce
Middlesex Lambton Fruit and Vegetable Growers'
Niagara Peninsula Fruit and Vegetable Growers' Association
Norfolk Fruit Growers' Association
Ontario Apple Growers
Ontario Berry Growers Association
Ontario Farm Fresh Marketing Association
Ontario Fresh Grape Growers' Board
Ontario Fruit and Vegetable Growers' Association
Ontario Ginseng Growers Association
Ontario Greenhouse Vegetable Growers
Ontario Highbush Blueberry Growers' Association
Ontario Potato Board
Ontario Tender Fruit Producers Marketing Board
QMI-SAI Global
R & A Kukielka Produce
South Western Ontario Rutabaga Growers' Association
Thedford-Grand Bend Vegetable Growers' Association

Québec

A. Lassonde Inc.
Association des emballeurs de pommes du Québec
Association des producteurs de fraises et framboises du Québec
Association des producteurs maraîchers du Québec
Association québécoise de la distribution de fruits et légumes
Conseil québecois de l'horticulture
Farnham Farms
Fédération des producteurs de pommes de terre du Québec
Fédération des producteurs de pommes du Québec

FERME

Groupe FSR

Groupe Vegco

Pommes Philip Cassidy Inc

Quebec Wild Blueberries / Bleuets sauvages

Serres Belle-de-jour

Syndicat des producteurs de bleuets du Québec

Syndicat des producteurs d'oignons du Québec

Syndicat des producteurs en serre du Québec

Les Vergers Leahy

New Brunswick

Apple Growers of New Brunswick

Bleuets NB Blueberries

Canneberge NB Cranberries

Horticulture Producers of Southern New Brunswick

McCain Foods Canada

New Brunswick Potato Processor Growers Association

New Brunswick Potato Shippers' Association

New Brunswick Seed Potato Growers Association

Potatoes New Brunswick

Nova Scotia

Horticulture Nova Scotia

Nova Scotia Fruit Growers' Association

Oxford Frozen Foods

Wild Blueberry Producers Association of Nova Scotia

Prince Edward Island

Cavendish Farms

Jasper Wyman & Son Canada, Inc.

Linkletter Farms

Mid Isle Farms

PEI Horticultural Association

PEI Potato Board

PEI Potato Dealers Association

PEI Potato Processing Council

PEI Seed Potato Growers Association

PEI Wild Blueberry Growers' Association

Potato Producers Association of PEI

Newfoundland and Labrador

Newfoundland and Labrador Horticulture Producers Council Inc.

Canadian Horticultural Council | Conseil canadien de l'horticulture

Unanimously adopted by the Membership
89th Annual General Meeting of the
Canadian Horticultural Council

Westin Ottawa
Ottawa, Ontario
March, 11, 2011

Resolution: 2011-24 Fair and Ethical Trading / Financial Risk Mitigation

WHEREAS producers selling into the United States market are financially protected by PACA; and

WHEREAS producers selling into the Canadian market have no such financial protection; and

WHEREAS this lack of protection has caused many producers undue hardship; and

WHEREAS the Canadian government has an obligation to producers to protect them from unethical traders and unforeseen events; and

WHEREAS a PACA-like trust in Canada would protect producers from financial hardship caused by unethical business in the produce market,

THEREFORE BE IT RESOLVED

that CHC work with all its member organizations in all provinces to actively engage in this effort and relentlessly pursue the legislation required to bring a PACA-like trust to Canada.