

# PERSONAL LIABILITY FOR CORPORATE DEBTS: THE REACH OF THE PERISHABLE AGRICULTURAL COMMODITIES ACT CONTINUES TO EXPAND

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## I. INTRODUCTION

The Perishable Agricultural Commodities Act of 1930 (PACA or Act), by its 1984 amendment, created a non-segregated floating trust.<sup>1</sup> By amending PACA, Congress broadened the protections afforded produce sellers and created a powerful

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<sup>1</sup>. PACA is located at 7 U.S.C. §§ 499a-499q, 499s (1994). The statutory trust provision of the PACA is located at 7 U.S.C. § 499e (1994). Congress initially enacted PACA in 1930 to regulate commerce in perishable agricultural commodities, which are defined by the Act as “whether or not frozen or packed in ice: [f]resh fruits and fresh vegetables of every kind and character.” 7 U.S.C. § 499a(b)(4)(A) (1994).

The term “floating trust” refers to the fact that the trust applies to “all of Debtor’s produce related inventory and proceeds thereof, regardless of whether [the seller claiming PACA trust protection] or another supplier was the source of such inventory.” *In re Fresh Approach, Inc.*, 51 B.R. 412, 422 (Bankr. N.D. Tex. 1985).

[T]here is no necessity to specifically identify all of the trust assets through each step of the asset accrual and disposal process. Since commingling is contemplated, all trust assets would be subject to the claims of unpaid sellers-suppliers and agents to the extent of the amount owed them. Beneficiary claimants have the responsibility of establishing through their business records the details of the transaction on which payment is sought.

H.R. REP. NO. 98-543, at 1-2 (1983), *reprinted in* 1984 U.S.C.C.A.N. 405, 409.

Although a PACA claimant has the burden to establish the details of the transactions, it need not trace the specific commodities furnished by it to the trust assets in the hand of a defendant. Instead, the burden is on the debtor to show that any disputed assets are not PACA trust assets. *See Sanzone-Palmisano Co. v. M. Seaman Enters., Inc.*, 986 F.2d 1010, 1014 (6th Cir. 1993); *Mid-Valley Produce Corp. v. 4-XXX Produce Corp.*, 819 F. Supp. 209, 211 (E.D.N.Y. 1995); *In re Richmond Produce Co.*, 112 B.R. 364, 378 (Bankr. N.D. Cal. 1990).

new tool for suppliers of fresh produce.<sup>2</sup> The PACA amendment provides that when a seller, dealer, or supplier ships produce to a buyer, a statutory trust is created on acceptance of the commodities.<sup>3</sup> The statutory trust is impressed on all inventory of food or other products derived from perishable agricultural commodities, as well as any receivables or proceeds from the sale of such commodities or products, until the seller is fully paid.<sup>4</sup>

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2. The 1984 PACA amendment recognized the burden on commerce created by financing arrangements whereby commission merchants, dealers, and brokers regularly purchase and/or handle produce on credit. The 1984 amendment recognizes such credit arrangements as “contrary to the public interest,” and therefore Congress enacted the amendment to “remedy such burden on commerce in perishable agricultural commodities and to protect the public interest.” 7 U.S.C. § 499e(c)(1) (1994); Perishable Agricultural Commodities Act of 1930, Pub. L. No. 98-273, 98 Stat. 165.

Congress enacted PACA “primarily for the protection of the producers of perishable agricultural products—most of whom must entrust their products to a buyer or commission merchant who may be thousands of miles away, and depend for their payment upon his business acumen and fair dealing.” H.R. REP. NO. 84-1196, S. REP. NO. 84-2507, at 2 (1955), *reprinted in* 1956 U.S.C.C.A.N. 3699, 3701.

3. For a general discussion of the steps necessary for a produce seller to preserve a PACA trust claim, see Thomas J. Cunningham, *Perils of the Perishable Agricultural Commodities Act: Ambushed by the Turnip Man!*, 27 UCC L.J. 139 (1994); Patricia J. Rynn, *Injunctive Relief Under the 1984 Trust Amendments to the Perishable Agricultural Commodities Act: A Necessary Means of Trust Enforcement*, 23 U.C. DAVIS L. REV. 625 (1990); Duane M. Geck, *The Perishable Agricultural Commodities Act Trust That Trumps Creditor Claims and Interests*, 21 CAL. BANKR. J. 231 (1993).

Congress recently amended the PACA in November 1995. One of the biggest changes was an increase in, and a simplification of, the available methods by which a produce seller may preserve a PACA trust claim. Pursuant to the 1995 amendments to the Act, a PACA licensee may now preserve its PACA trust rights by using ordinary and usual invoice statements to provide notice of the licensee’s intent to preserve its trust benefits. *See* 7 U.S.C. § 499e(c)(4) (1994). To preserve its trust rights under the 1995 amendments, a licensee must include the following statement on the face of its invoices:

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.

7 U.S.C.A. § 499e(c)(4) (West Supp. 1997).

The second method by which a PACA trust beneficiary can preserve its benefits under the 1995 amendments to PACA is for the PACA beneficiary to give timely notice to the debtor pursuant to 7 U.S.C. § 499e(c)(3) and 7 C.F.R. § 46.46. The PACA trust beneficiary must give written notice of intent to preserve the benefits of the trust to the buyer within 30 calendar days after expiration of the time by which payment must be made. *See* 7 U.S.C. § 499e(c)(3) (1994).

4. PACA provides in pertinent part:

Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.

Once the trust is created and the supplier's trust rights are properly preserved, the supplier obtains a priority interest in the trust assets held by the debtor.<sup>5</sup> The congressional finding, codified at 7 U.S.C. § 499e(c)(1) (1994), evidences the intent to give an unpaid produce supplier's claim priority over the claim of a creditor with a security interest in the buyer's inventory and proceeds thereof.<sup>6</sup> This priority status is superior to almost any other creditor, even if the debtor seeks protection under the bankruptcy laws.<sup>7</sup> Regardless of the debtor's solvency, a qualified PACA trust creditor can use the power of the federal courts and often obtain immediate relief.<sup>8</sup>

Whichever method of enforcement the PACA trust claimant selects, the main concern, of course, will be locating and recovering available assets to satisfy the unpaid claim. Recently, economic conditions have forced many debtors to seek the protection of bankruptcy liquidation or reorganization to overcome excessive debts.

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7 U.S.C. § 499e(c)(2) (1994). See *Deburyn Produce Co. v. Richmond Produce Co. (In re Richmond Produce Co.)*, 112 B.R. 364 (Bankr. N.D. Cal. 1990) (finding the PACA trust arises immediately upon delivery of produce and the unpaid seller is not required to trace the funds); *In re Atlantic Tropical Mkt.*, 118 B.R. 139, 141 (Bankr. S.D. Fla. 1990); *Blair Merriam Fresh Fruit & Produce Co. v. Clark (In re D.K.M.B., Inc.)*, 95 B.R. 774, 780 (Bankr. D. Colo. 1989).

<sup>5</sup>. See generally Thomas J. Cunningham, *Perils of the Perishable Agricultural Commodities Act: Ambushed by the Turnip Man!*, 27 UCC L.J. 139 (1994) (discussing the PACA trust, preserving a PACA trust claim, and tracing the proceeds of the trust to a third party lender).

<sup>6</sup>. 7 U.S.C. § 499e(c)(1) (1994) provides:

It is hereby found that a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased, contracted to be purchased, or otherwise handled by them on behalf of another person, encumber or give lenders a security interest in, such commodities, or on inventories of food or other products derived from such commodities, and any receivables or proceeds from the sale of such commodities or products, and that such arrangements are contrary to the public interest. This subsection is intended to remedy such burden on commerce in perishable agricultural commodities and to protect the public interest.

<sup>7</sup>. For cases discussing the non-dischargeability of a debt under the PACA, see, for example, *Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416 (Bankr. E.D. Tenn. 1993) (holding debt owed to produce sellers for dealer's defalcation by failing to preserve PACA trust funds was non-dischargeable in responsible corporate officer's Chapter 7 case); *Tom Lange Co. v. Stout (In re Stout)*, 123 B.R. 412 (Bankr. W.D. Okla. 1990) (holding produce dealers failure to pay supplier proceeds from sale of produce constituted defalcation in fiduciary capacity resulting in non-dischargeable debt). See also *Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL. Adv. Nos. 91-4040-COL., 91-4062-COL., 1992 WL 119143 (M.D. Ga. Apr. 10, 1992) (finding non-dischargeability of debt under 11 U.S.C. § 523(a)(4)). See *infra* Part III.

<sup>8</sup>. The relief available and the appropriate method of enforcement depend on, among other things, whether the produce purchaser has filed a petition in bankruptcy. See, e.g., *St. Joseph Bank & Trust Co. v. DeBruyn Produce Co. (In re Prange Foods Corp.)*, 63 B.R. 211 (Bankr. W.D. Mich. 1986) (concerning the filing of adversarial complaint with bankruptcy court); *In re W.L. Bradley Co.*, 75 B.R. 505 (Bankr. E.D. Pa. 1987) (seeking motion for relief from stay and turnover of PACA trust assets); *Gullo Produce Co. v. Jordan*, 751 F. Supp. 64 (W.D. Pa. 1990) (granting an injunction against the debtor); *J.R. Brooks & Son v. Norman's Country Market*, 98 B.R. 47 (Bankr. N.D. Fla. 1989) (issuing an order requiring debtor to immediately establish separate escrow account for deposit of all proceeds received from sale of produce).

Many of these companies that file for relief under the bankruptcy code anticipate that all of their debts will be discharged, leaving the individuals free to begin new businesses without the burden of their prior obligations.

However, the PACA trust has additional protections for qualified creditors and the case law continues to strengthen and expand the reach of the PACA trust.<sup>9</sup> This Article reviews recent case decisions that have addressed the issue of the PACA trust and the imposition of personal liability on corporate officers, directors, and shareholders who previously may have been protected from liability by the corporate form. Also, the Article discusses personal individual liability in light of the recently decided Ninth Circuit Court of Appeals case of *Sunkist Growers, Inc. v. Fisher*,<sup>10</sup> which is the first published appellate decision to address the issue of potential liability of individual shareholders, officers, or directors for unpaid corporate debts under PACA.

Part II of this Article examines the development of case law that has gone beyond the usual theory of “piercing the corporate veil” to impose individual liability under the theory of breach of the PACA trust. Part III looks at the non-dischargeability of PACA trust debts in bankruptcy, and how many courts have concluded that PACA trust debtors cannot rely upon the bankruptcy laws to shield them from liability. Finally, Part IV examines trends in the case decision and explores just how far the reach of the PACA trust may expand in the future.

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<sup>9</sup>. For a discussion of the priority status of PACA claims, see Thomas J. Cunningham, *Perils of the Perishable Agricultural Commodities Act: Ambushed by the Turnip Man!*, 27 UCC L.J. 139 (1994); see also Thomas M. Fulkerson, *The Perishable Agricultural Commodities Act: Effective Help for Produce Growers and Sellers*, 52 Tex. B.J. 747 (1989) (discussing the methods for obtaining the benefits of the PACA trust).

<sup>10</sup>. 104 F.3d 280 (9th Cir. 1997). The Ninth Circuit Court of Appeals decided the *Sunkist* case on January 6, 1997. See *id.* at 280.

## II. BEYOND THE CORPORATE VEIL

The issue of individual liability under PACA generally arises when a produce company operating as a corporation is unable to pay all outstanding debts.<sup>11</sup> When a corporation is insolvent, the PACA trust creditor will look to other potential sources of recovery and the question becomes who may be liable for the corporation's unpaid produce debts under the PACA.<sup>12</sup>

Under state laws, when a business adopts the corporate form, the corporate structure insulates the individual corporate officers, directors, and shareholders from liability for the debts of the corporation.<sup>13</sup> Traditionally, the most successful option for pursuing individual liability against corporate principals had been to "pierce the corporate veil" by proving abuse of the corporate structure or fraud.<sup>14</sup> In construing PACA, however, courts have acknowledged other avenues of imposing individual liability.<sup>15</sup>

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<sup>11</sup>. Individual liability clearly exists for those individuals who operate as sole proprietors or as partners in general partnerships. See HARRY G. HENN, *LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* 57-60, 73-75 (3d ed. 1983). Generally, liability will be imposed on such individuals under state law. Consequently, this Article will only address the liability of corporate principals.

<sup>12</sup>. Because a produce creditor will look first to the corporation that is the licensed seller of the produce, PACA liability is considered to attach to the corporation first. If the corporation's assets are insufficient to satisfy the liability, then "others may be found secondarily liable if they had some role in causing the corporate trustee to commit the breach of trust." *Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703, 706 (E.D. Pa. 1994).

<sup>13</sup>. For a general discussion of corporate law and the corporate structure as insulation from individual liability, see 1 LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES* §§ 1-17 (perm. ed. rev. vol. 1992); James C. Lockwood et al., *Protecting Corporate Officers and Directors from Liability*, 1994 CONTINUING EDUC. BAR, CAL. 13 (on file with the *Drake Journal of Agricultural Law*).

<sup>14</sup>. Piercing the corporate veil is defined as follows:

Judicial process whereby court will disregard usual immunity of corporate officers or entities from liability for wrongful corporate activities; e.g. when incorporation exists for sole purpose of perpetrating fraud. The doctrine which holds that the corporate structure with its attendant limited liability of stockholders may be disregarded and personal liability imposed on stockholders, officers and directors in the case of fraud or other wrongful acts done in the name of corporation.

BLACK'S LAW DICTIONARY 1147-48 (6th ed. 1990). For discussions of the piercing the corporate veil doctrine, see 1 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 41-43 (perm. ed. rev. vol. 1996); STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* (1994); HARVEY GELB, *PERSONAL CORPORATE LIABILITY—A GUIDE FOR PLANNERS, LITIGATORS, AND CREDITORS' COUNSEL* (1991); EDWARD BRODSKI & M. PATRICIA ADAMSKI, *LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES* § 20 (1997); ROBERT W. HAMILTON, *THE LAW OF CORPORATIONS* (4th ed. 1996).

<sup>15</sup>. See, e.g., *Mid-Valley Produce Corp. v. 4-XXX Produce Corp.*, 819 F. Supp. 209 (E.D.N.Y. 1995). The court stated that, generally, individuals are not personally liable for a corporation's torts solely based on their positions as corporate stockholders, officers, and/or directors. See *id.* at 212. However, the court stated that an officer who causes a corporate trustee to commit a breach of trust which causes a loss to the trust is personally liable to the beneficiaries for that loss. See *id.* (citing *West Indian Sea Island Cotton Ass'n v. Threadtex, Inc.*, 761 F. Supp. 1041, 1054 (S.D.N.Y. 1991));

For example, in *Morris Okun, Inc. v. Harry Zimmerman, Inc.*,<sup>16</sup> the United States District Court for the Southern District of New York held the sole shareholder of a corporation liable as a corporate fiduciary for unpaid produce and stated:

PACA establishes a statutory trust for the benefit of sellers and suppliers. This trust arises from the moment perishable goods are delivered by the seller. An individual who is in the position to control the trust assets and who does not preserve them for the beneficiaries has breached a fiduciary duty, and is personally liable for that tortious act. This legal framework is to be distinguished from the piercing the veil doctrine, where the corporate form is disregarded because the individual has either committed a fraud, or because the corporation is a “shell” being used by the individual shareholders to advance their own purely personal rather than corporate ends.<sup>17</sup>

The first cases to address the issue of individual liability for breach of a statutory trust in this area arose under a federal act closely related to PACA, the Packers and Stockyards Act of 1921 (PSA).<sup>18</sup> Congress enacted PSA to protect unpaid cash sellers of livestock and livestock products.<sup>19</sup> In order to strengthen the protections afforded to livestock sellers, PSA imposes a statutory trust for the benefit of such suppliers.<sup>20</sup>

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*Woodworking Enters., Inc. v. Baird* (*In re Baird*), 114 B.R. 198, 204 (B.A.P. 9th Cir. 1990)); *see also* *N.P. Deoudes, Inc. v. Snyder* (*In re Snyder*), 184 B.R. 473, 475 (Bankr. D. Md. 1995) (holding personal liability for PACA debt will be imposed on controlling person of corporation for use of trust assets for any purpose other than repayment of debt).

<sup>16</sup>. *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346 (S.D.N.Y. 1993).

<sup>17</sup>. *Id.* at 348 (citing *Passalacqua Builders v. Resnick Developers*, 933 F.2d 131 (2d Cir. 1991)).

<sup>18</sup>. 7 U.S.C. §§ 181-217a, 221-229 (1994). The PACA trust was modeled on a similar trust provision of the PSA. The two trusts are so similar that case law arising under PSA has been held to apply to interpretation of the PACA trust. *See In re Fresh Approach, Inc.*, 51 B.R. 412, 414 (Bankr. N.D. Tex. 1985); *In re Fresh Approach, Inc.*, 48 B.R. 926, 928 (Bankr. N.D. Tex. 1985). For legislative history discussing how the PACA trust provisions were modeled after the PSA trust, *see* H.R. REP. NO. 98-543 at 1, 3-4 (1983), *reprinted in* 1984 U.S.C.C.A.N. 405, 407; *DeBruyn Produce Co. v. Victor Foods, Inc.*, 674 F. Supp. 1405, 1407-08 (E.D. Mo. 1987).

<sup>19</sup>. PSA defines “livestock” as “cattle, sheep, swine, horses, mules, or goats-whether live or dead.” 7 U.S.C. § 182(4) (1994). PSA defines “livestock products” as “all products and by-products (other than meats and meat food products) of the slaughtering and meat-packing industry derived in whole or in part from livestock.” 7 U.S.C. § 182(5) (1994).

<sup>20</sup>. Congress amended PSA in 1976 to specifically create a statutory trust for the benefit of all unpaid cash sellers, composed of livestock and proceeds therefrom until the packer pays for his or her purchases. *See* 7 U.S.C. § 196(b) (1994); S. REP. NO. 94-932, at 13 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2267, 2279. Congress intended all unpaid cash sellers, as beneficiaries of the statutory trust, to satisfy their claims from the defaulting packer’s assets. *See* S. REP. NO. 94-932, at 4-5 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2267, 2271.

Specifically, 7 U.S.C. § 196(b) creates that statutory trust under the PSA, and it provides:

All livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products

In *Hedrick v. S. Bonaccorso & Sons, Inc.*,<sup>21</sup> an unpaid livestock supplier brought suit under PSA against a packing company that was a closely held corporation and the individuals who were the officers and directors of the packing company.<sup>22</sup> The *Hedrick* court held that if an individual was a “person” and a “packer,” as defined under PSA, then the corporate structure would not shield the individual from personal liability for debts to unpaid cash sellers.<sup>23</sup> The court in *Hedrick* relied primarily on the closely held nature of the debtor corporation, as well as the individual’s active management role in the corporation, in deciding that the individual was a packer under the PSA, and thus potentially liable for the corporation’s trade-related debt.<sup>24</sup>

Turning to PACA, a growing number of courts addressing the issue of individual liability have generally concluded that the crucial factor in imposing such liability is the existence of fiduciary duties under the Act and a breach of those duties when the PACA trust is not preserved.<sup>25</sup> The PACA trust provisions impose liability

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derived therefrom, shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers: *Provided*, That any packer whose average annual purchases do not exceed \$500,000 will be exempt from the provisions of this section. Payment shall not be considered to have been made if the seller receives a payment instrument which is dishonored: *Provided*, That the 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 228b of this title, 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.

7 U.S.C. § 196(b) (1994).

<sup>21</sup>. *Hedrick v. S. Bonaccorso & Sons, Inc.*, 466 F. Supp. 1025 (E.D. Pa. 1978).

<sup>22</sup>. *See id.* at 1028; *see also* *Fillipo v. S. Bonaccorso & Sons, Inc.*, 466 F. Supp. 1008 (E.D. Pa. 1978) (addressing similar issues in a related case).

<sup>23</sup>. *Hedrick*, 466 F. Supp. at 1031 (stating “the Court finds that the corporate device cannot immunize individual defendants from liability once it is found they are ‘persons’ and ‘packers’ under the federal Act.”); *see also In re G & L Packing Co.*, 20 B.R. 789 (Bankr. N.D.N.Y. 1982) (discussing theory of piercing the corporate veil to impose liability under the PSA). For a discussion of how broadly courts have defined the term “packer” under the PSA, see Michael J. Guyerson & Keith Block, *Agricultural Lending in a Troubled Economy*, 16 COLO. LAW. 1773, 1781 (1987) and citations therein.

<sup>24</sup>. *Hedrick*, 466 F. Supp. at 1030-31. This finding was buttressed by 7 U.S.C. § 223, which imputes liability to the corporate packer for “the act, omission, or failure of any agent, officer, or other person acting for or employed by any packer . . .” *Id.*

<sup>25</sup>. For example, in *Mid-Valley Produce Corp. v. 4-XXX Produce Corp.*, 819 F. Supp. 209 (E.D.N.Y. 1995), the court stated:

In general, individuals are not personally liable for a corporation’s torts solely on the basis of their position as a corporate stockholder, officer, or director. However, an officer who causes a corporate trustee to commit a breach of trust which causes a loss to the trust is personally liable to the beneficiaries for that loss.

*Id.* at 212 (citing *West Indian Sea Island Cotton Ass’n v. Threadtex, Inc.*, 761 F. Supp. 1041, 1054 (S.D.N.Y. 1991)); *Woodworking Enters., Inc. v. Baird (In re Baird)*, 114 B.R. 198, 204 (B.A.P. 9th Cir. 1990)). The court in *Mid-Valley Produce* reasoned that by using PACA trust funds to pay salaries and

on a produce buyer, “whether a corporation or controlling person of that corporation, who uses that asset for any purpose other than repayment of the supplier.”<sup>26</sup>

Clearly, the PACA trust statute imposes the duties of a trustee on the buyers of perishable agricultural commodities.<sup>27</sup> The PACA statute itself provides that upon delivery of the commodities to the buyer, a trust is created and the buyer must hold all trust assets<sup>28</sup> “in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.”<sup>29</sup>

The single most persuasive factor in determining whether to impose individual liability in spite of the protection of the corporate structure is when fiduciary duties are not carried out by a business or corporation, but instead by those individuals responsible for the operation of the corporation.<sup>30</sup> In one recent federal decision under PACA, *Bronia, Inc. v. Ho*,<sup>31</sup> a United States district court in New York affirmed that the “primary actor responsible for [the corporation’s] failure to live up to its fiduciary responsibilities under PACA” will be personally responsible for the corporation’s breach of the trust.<sup>32</sup>

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make loan payments instead of paying unpaid PACA creditors, the corporation breached its fiduciary duties as trustee. *See Mid-Valley Produce Corp.*, 819 F. Supp. at 212. Thus, the court held the corporate officer who knowingly caused the corporation to breach its duty as trustee was personally responsible for the ensuing loss to the PACA trust beneficiaries. *See id.*

<sup>26</sup>. *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D.N.Y. 1993).

<sup>27</sup>. In *Sunkist Growers, Inc.*, the court adopted the following language:

An individual who is in the position to control the trust assets and who does not preserve them for the beneficiaries has breached a fiduciary duty, and is personally liable for that tortious act . . . . [A] PACA trust in effect imposes liability on a trustee, whether a corporation or a controlling person of that corporation, who uses the trust assets for any purpose other than repayment of the supplier.

*Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 283 (9th Cir. 1997) (quoting *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D.N.Y. 1993)) (citations omitted).

<sup>28</sup>. Trust assets are defined as “[p]erishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products.” 7 U.S.C. § 499e(c)(2) (1994); *see* 7 C.F.R. § 46.46(c) (1997).

<sup>29</sup>. 7 U.S.C. § 499e(c)(2) (1994); *see* 7 C.F.R. § 46.46(e) (1997).

<sup>30</sup>. *See Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 283 (9th Cir. 1997). The Ninth Circuit Court of Appeals stated, “We agree that individual shareholders, officers, or directors of a corporation *who are in a position to control PACA trust assets*, and who breach their fiduciary duty to preserve those assets, may be held personally liable under the Act.” *Id.* (emphasis added); *see also* *Strube Celery & Vegetable Co. v. Zois (In re Zois)*, 201 B.R. 501, 507 (Bankr. N.D. Ill. 1996) (finding that courts have imposed “individual responsibility for breaches of PACA while individuals were in the employ or an officer of a corporation”); *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473 (Bankr. D. Md. 1995) (stating personal liability may be imposed on the controlling person of corporation when trust assets are used for any purpose other than paying trust claim).

<sup>31</sup>. *Bronia, Inc. v. Ho*, 873 F. Supp. 854 (S.D.N.Y. 1995).

<sup>32</sup>. *Id.* at 861 (quoting *In re Nix*, No. 91-4040-COL, 1992 WL 119143, at \*5 (M.D. Ga. Apr. 10, 1992)); *see also* *A & J Produce Corp. v. CIT Group/Factoring, Inc.*, 829 F. Supp. 651 (S.D.N.Y.



This same principle, namely that “a corporation can act only through its agents and can thus fulfill fiduciary obligations only through its agents,”<sup>33</sup> has been affirmed and applied in PACA trust cases decided by U.S. district courts in Georgia,<sup>34</sup> New York,<sup>35</sup> a U.S. bankruptcy court in Tennessee,<sup>36</sup> and the Bankruptcy Appellate Panel of the Ninth Circuit Court of Appeals.<sup>37</sup> Applying this basic trust principle, courts focus on the actor responsible for the breach of fiduciary duty rather than on the corporate form.<sup>38</sup>

Once a court makes the threshold determination that the corporate structure does not shield individuals from liability for corporate trust debts, it is faced with the more problematic issue of determining who will be deemed “responsible” for the trust violations. To date, the PACA trust decisions have concentrated on the individual directors, officers, and shareholders of the PACA trustee corporation who are responsible for implementing the fiduciary obligations.<sup>39</sup>

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1993) (finding dealer in perishable agricultural commodities as sole shareholder and fiduciary of PACA trust could be held personally liable for any breach of trust).

<sup>33</sup>. *Shepherd v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703, 706 (E.D. Pa. 1994) (citing *Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143, at \*5 (M.D. Ga. Apr. 10, 1992)).

<sup>34</sup>. *See Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143, at \*5 (M.D. Ga. Apr. 10, 1992) (unpublished).

<sup>35</sup>. *See Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 349 (S.D.N.Y. 1993).

<sup>36</sup>. *See Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993).

<sup>37</sup>. *See Shipton v. Rio Grande Onions, Inc. (In re Shipton)*, B.A.P. No. CC-90-1368-OVP (B.A.P. 9th Cir. filed Oct. 25, 1991) (unpublished memorandum, on file with the *Drake Journal of Agricultural Law*).

<sup>38</sup>. *See, e.g., Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416 (Bankr. E.D. Tenn. 1993). The *Harper* court stated that “the defendant, as the responsible corporate officer, is personally liable for the tortious injury committed by her without taking into account a piercing of the corporate veil.” *Id.* at 419. The court continued, “The focus of fiduciary liability is upon the actor responsible for the act rather than the corporate form. Liability is premised upon the person who actually caused the harm.” *Id.* Furthermore, “[w]hen there are fiduciary responsibilities of a corporation, it is the employee or officer responsible for implementing the fiduciary responsibilities who is liable for any acts of defalcation.” *Id.*

<sup>39</sup>. *See Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 349 (S.D.N.Y. 1993). The court, in imposing secondary liability on Mr. Zimmerman, focused on the fact that he was the sole shareholder of the corporation. He controlled the day-to-day operations of the company, purchased the unpaid goods at issue in his own name, and accepted billing in his own name. *See id.* The court concluded that the corporation was liable in the first instance for the debt and Mr. Zimmerman was secondarily liable as the corporate fiduciary, for whatever amount of money that is not recoverable from the corporation. *See id.* at 349-50; *see also Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143 (M.D. Ga. Apr. 10, 1992) (finding primary actor responsible for company’s failure to live up to its fiduciary responsibilities under PACA, who was 100% shareholder, president, primary buyer, and controlled company, personally liable); *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473 (Bankr. D. Md. 1995) (imposing personal liability on controlling person of corporation where that person uses trust assets for any purpose other than repayment of PACA trust claims).

Noting the paucity of case law existing at the time on the topic of personal liability under PACA, the U.S. District Court for the Southern District of New York in *Morris Okun, Inc. v. Harry Zimmerman, Inc.*,<sup>40</sup> examined two unpublished decisions and adopted the reasoning of those courts.<sup>41</sup> The Bankruptcy Appellate Panel (BAP) of the Ninth Circuit Court of Appeals considered the issue of individual liability in *In re Shipton*.<sup>42</sup> The BAP in *Shipton*, in imposing liability on the sole shareholder of a corporation, applied the reasoning of another Ninth Circuit case, *In re Baird*.<sup>43</sup> *In re Baird* confirmed that any “officer who causes a corporate trustee to commit a breach of trust causing loss to the trust administered by the corporation is personally liable to the beneficiaries for the loss” without regard to whether the corporate veil may be pierced.<sup>44</sup>

The second case upon which the *Morris Okun* court based its decision was the Georgia district court case of *In re Nix*.<sup>45</sup> The individual defendant in *Nix* was the sole shareholder of the corporate trustee as well as a director and president of the corporation.<sup>46</sup> The court in *Nix* focused on the factors indicating that the individual defendant was the sole fiduciary responsible for the wrongful activities and concluded that the shareholder was personally liable for the breach of fiduciary duty.<sup>47</sup>

Applying the reasoning of both *In re Shipton* and *In re Nix*, the New York district court in *Morris Okun* found that the individual defendant was secondarily liable for the corporate trust debts as the corporate fiduciary.<sup>48</sup> Similarly, in two

<sup>40</sup>. *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346 (S.D.N.Y. 1993).

<sup>41</sup>. *See id.* (relying upon *Shipton v. Rio Grande Onions, Inc. (In re Shipton)*, B.A.P. No. CC-90-1368-OVP (B.A.P. 9th Cir. filed Oct. 25, 1991) (unpublished memorandum, on file with the *Drake Journal of Agricultural Law*) and *Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143 (M.D. Ga. Apr. 10, 1992)).

<sup>42</sup>. *See Shipton v. Rio Grande Onions, Inc. (In re Shipton)*, B.A.P. No. CC-90-1368-OVP (B.A.P. 9th Cir. filed Oct. 25, 1991) (unpublished memorandum, on file with the *Drake Journal of Agricultural Law*).

<sup>43</sup>. *Woodworking Enters., Inc. v. Baird (In re Baird)*, 114 B.R. 198, 205 (B.A.P. 9th Cir. 1990) (holding debtor, as officer of contractor, could be held liable for breach of trust under an Arizona statute which created a trust sufficient to establish a fiduciary relationship).

<sup>44</sup>. *Morris Okun, Inc.*, 814 F. Supp. at 349 (citing *In re Baird*, 114 B.R. 198 (B.A.P. 9th Cir. 1990)).

<sup>45</sup>. *Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143 (M.D. Ga. Apr. 10, 1992).

<sup>46</sup>. *See id.* at \*1.

<sup>47</sup>. The *Nix* court reasoned that “[i]t is equally well settled that personal participation by a corporate employee, officer, or director in the wrongful activities of a corporation is sufficient to make the individual as well as the corporation substantively liable for a tort.” *Id.* at \*5 (citing *DeLong Equip. Co. v. Washington Mills Abrasive*, 840 F.2d 843, 851 (11th Cir. 1988)). Specifically, the *Nix* Court relied upon the following factors in imposing personal liability: the individual was the 100% shareholder, president, the primary buyer of produce, the one who paid all of the bills, and the person who controlled all of the significant acts of the corporation. *See id.* at \*6.

<sup>48</sup>. *See Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 349 (S.D.N.Y. 1993); *supra* note 39 for a discussion of “secondary liability” in the context of the PACA trust; *see also*

other decisions, *In re Harper*<sup>49</sup> and *A & J Produce Corp. v. CIT Group, Inc.*,<sup>50</sup> the courts imposed liability on individuals who were actively involved in the daily operation of the PACA debtor. In both cases, the personally liable individuals were the sole shareholders, officers, and directors of the corporate trustee.<sup>51</sup>

The most recent decision to address personal liability under the PACA for a corporation's produce debts, and the first published federal court of appeals decision to address this issue, is *Sunkist Growers, Inc. v. Fisher*.<sup>52</sup> In *Sunkist*, a citrus producer, Sunkist Growers, sold fresh fruit to Quality Fresh Juice Company, for which Quality Fresh failed to pay.<sup>53</sup> After obtaining a state court judgment against Quality Fresh, Sunkist filed a federal district court case against Michael S. Fisher and Meryle Fisher alleging that they were the officers, directors, and sole shareholders of Quality Fresh who controlled its operations.<sup>54</sup> Sunkist argued that it was a beneficiary of the PACA trust which required Quality Fresh to hold its assets in trust to pay Sunkist and that the Fishers breached their fiduciary duties to maintain the trust and pay Sunkist.<sup>55</sup>

The Fishers' defense was that Sunkist had made the same factual claim in the Arizona state court action and was now collaterally estopped from bringing a new cause of action on the same facts.<sup>56</sup> Deciding that the Arizona state court judgment was res judicata under federal law, the district court held for the Fishers.<sup>57</sup> Sunkist then appealed the decision to the Ninth Circuit Court of Appeals.<sup>58</sup>

The Ninth Circuit Court of Appeals held that the Arizona state court action did not have res judicata effect because Sunkist raised new issues involving PACA that were not raised in the state court case, which was primarily a breach of contract case.<sup>59</sup> The court also held that the state court action did not have a collateral

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Shepard v. K.B. Fruit & Vegetable, Inc., 868 F. Supp. 703, 706 (E.D. Pa. 1994) (holding "PACA liability attaches first to the licensed seller of perishable agricultural commodities. If the seller's assets are insufficient to satisfy the liability, others may be found secondarily liable if they had some role in causing the corporate trustee to commit the breach of trust.").

<sup>49</sup>. *Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416 (Bankr. E.D. Tenn. 1993).

<sup>50</sup>. *A & J Produce Corp. v. CIT Group/Factoring, Inc.*, 829 F. Supp. 651 (S.D.N.Y. 1993).

<sup>51</sup>. *See Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993); *A & J Produce Corp.*, 829 F. Supp. at 660; *see also Lyng v. Frydman*, No. C86-1210Y, 1988 WL 168632 at \*4 (N.D. Ohio Mar. 23, 1988) (discussing the authority for an unpaid seller of perishable agricultural commodities to recover funds subject to the PACA trust even if the funds have been transferred to a secured creditor).

<sup>52</sup>. *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280 (9th Cir. 1997).

<sup>53</sup>. *See id.* at 281.

<sup>54</sup>. *See id.*

<sup>55</sup>. *See id.*

<sup>56</sup>. *See id.*

<sup>57</sup>. *See id.* at 281-82.

<sup>58</sup>. *See id.* at 282.

<sup>59</sup>. *See id.* at 284. The Ninth Circuit Court of Appeals reasoned as follows:

In the state-court action, Sunkist named only Quality Fresh and alleged simply that Quality Fresh became indebted to Sunkist by contract and paid only part of the debt, thus breaching the contract. The PACA complaint in federal court, by contrast,

estoppel effect because there was no opportunity to litigate the PACA issues in the state court case.<sup>60</sup>

Before rejecting the Fishers' res judicata and collateral estoppel arguments, the court of appeals addressed the issue of the potential individual liability for the corporation's unpaid debts under a PACA trust theory.<sup>61</sup> The court relied upon several district court decisions which concluded that individuals associated with corporate defendants may be liable under a PACA trust theory.<sup>62</sup> The Ninth Circuit Court of Appeals, after briefly summarizing several district court decisions imposing personal liability under the PACA, concluded, "We agree that individual shareholders, officers, or directors of a corporation who are in a position to control PACA trust assets, and who breach their fiduciary duty to preserve those assets, may be held personally liable under the Act."<sup>63</sup>

How broadly courts will interpret the above-quoted language in imposing individual liability under the PACA is still uncertain. However, by extending personal liability to those "who are in a position to control PACA trust assets," the

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named only the Fishers, and alleged that the Fishers were officers, directors, and sole shareholders active in the management of Quality Fresh, a closely-held corporation engaged in handling produce and vegetables in interstate commerce, and thus subject to PACA. The complaint alleged that Sunkist had preserved its trust benefits by correspondence with the Secretary [of Agriculture], and set out the elements of the PACA trust. Quality Fresh, under the Fishers' direction, failed to maintain the trust assets to satisfy the debt to Sunkist, instead diverting the assets to third parties. The Fishers therefore breached their fiduciary duties to maintain trust assets, and were personally liable for the amount still due and owing.

*Id.* (internal citations omitted).

<sup>60</sup>. *See id.*

<sup>61</sup>. *See id.* at 282-83.

<sup>62</sup>. *See id.* In reaching its conclusion, the Ninth Circuit Court of Appeals relied on decisions in several jurisdictions. *See Frio Ice v. SunFruit, Inc.*, 724 F. Supp. 1373 (S.D. Fla. 1989), *rev'd on other grounds*, 918 F.2d 154 (11th Cir. 1990) (holding the seller of produce could bring PACA action against principal officer of buyer to compel payment of funds subject to trust and for judgment for failure to pay such sums); *Bronia, Inc. v. Ho*, 873 F. Supp. 854 (S.D.N.Y. 1995); *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346 (S.D.N.Y. 1993) (holding the sole shareholder, director, and president of corporation personally liable for corporation's breach of PACA trust); *Mid-Valley Produce Corp. v. 4-XXX Produce Corp.*, 819 F. Supp. 209, 212 (E.D.N.Y. 1993) (holding an officer personally liable for corporate debt where officer caused corporate trustee to commit the breach of trust resulting in loss to PACA trust); *Strube Celery & Vegetable Co. v. Zois (In re Zois)*, 201 B.R. 501 (Bankr. N.D. Ill. 1996) (finding that courts generally hold individual officers of a corporation responsible for breaches of the PACA); *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473 (Bankr. D. Md. 1995) (stating a controlling person of a corporation may be held liable when PACA trust assets used for any purpose other than repayment of debt (citing *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp. 346, 348 (S.D.N.Y. 1993))); *Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703, 706 (E.D. Pa. 1994) (holding that when seller's assets are insufficient to satisfy a liability, corporate principals may be secondarily liable if they had some role in causing the corporate trustee to commit the breach of the PACA trust).

<sup>63</sup>. *Sunkist Growers*, 104 F.3d at 283.

Ninth Circuit Court of Appeals opinion can clearly be read as an intent to broaden the potentially liable parties under the PACA.<sup>64</sup>

Prior to the *Sunkist* decision, courts had been very reluctant to impose liability on individuals who were not active in the day-to-day operations, even though they may have been shareholders or officers of a corporate PACA trust debtor.<sup>65</sup> In *Shepard v. K.B. Fruit & Vegetable, Inc.*,<sup>66</sup> however, a Pennsylvania district court imposed liability on individuals who did not have the same degree of active involvement in the PACA trust debtor's daily business as had been the case in prior decisions.<sup>67</sup> Acknowledging that individuals often may be shareholders and even officers in corporations in which they have no daily participation, the *K.B. Fruit* court reasoned that the lack of daily participation does not automatically cut-off an individual's liability.<sup>68</sup>

The *K.B. Fruit* court read prior cases on the PACA trust as establishing the following proposition: "PACA liability attaches first to the licensed seller of perishable agricultural commodities. If the seller's assets are insufficient to satisfy the liability, others may be found secondarily liable if they had *some role* in causing the corporate trustee to commit the breach of trust."<sup>69</sup> Now more cases, including the *Sunkist* case, have begun to focus on the issue of how broadly to interpret the term "some role."<sup>70</sup>

The *K.B. Fruit* court decided that determining liability requires a two-step inquiry: (1) whether the individual's involvement in the corporation is sufficient to establish legal responsibility; and (2) whether the individual has breached a fiduciary duty.<sup>71</sup> Although the individuals in *K.B. Fruit* claimed not to be involved in the daily business, the court determined their involvement sufficient to demonstrate "active involvement."<sup>72</sup>

In *K.B. Fruit*, the Pennsylvania district court held that the individuals breached a fiduciary duty owed to the PACA creditors.<sup>73</sup> Applying the common law

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<sup>64.</sup> *Id.*

<sup>65.</sup> *See, e.g.,* *Mid-Valley Produce Corp. v. 4-XXX Produce Corp.*, 819 F. Supp. 209 (E.D.N.Y. 1993) (holding that Alice Melfi, a sole shareholder who was not an officer, director, or employee of the PACA trust debtor, was not individually liable for trust debt).

<sup>66.</sup> *See* *Shepard v. K.B. Fruit & Vegetable, Inc.*, 868 F. Supp. 703 (E.D. Pa. 1994).

<sup>67.</sup> *See id.* at 706-07. The court did find, however, that the individuals' involvement with the corporate debtor was sufficient to demonstrate "active involvement" in the operation of the business. *Id.* Although the individuals claimed to be merely uninvolved "silent" corporate officers, and although the court was "sympathetic" to their situation, the court held them liable based on their establishment of the business, albeit for another individual's sake, their use of the corporate premises, and their continuation of the business after it had been abandoned by the operator during the time period in question. *Id.*

<sup>68.</sup> *See id.* at 706.

<sup>69.</sup> *Id.* (emphasis added).

<sup>70.</sup> *See* *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280 (9th Cir. 1997).

<sup>71.</sup> *See* *K.B. Fruit*, 868 F. Supp. at 706.

<sup>72.</sup> *Id.*

<sup>73.</sup> *See id.*

of trusts, the court emphasized that a trustee “is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.”<sup>74</sup> Moreover, the trustee has a duty to take reasonable steps to control the trust property and to entrust the control of trust property to another when it is reasonable to do so.<sup>75</sup>

Applying these general trust principles, the *K.B. Fruit* court found that allowing the appointed manager to operate the business without seeing that PACA creditors were paid was not reasonable.<sup>76</sup> Therefore, if the individual defendants had exercised reasonable care to ensure proper management of the company, then the breach of fiduciary duty may have been avoided.<sup>77</sup> The court granted summary judgment which imposed personal liability on the individuals who were the shareholders, officers, and directors of the company.<sup>78</sup>

The *Sunkist* and *K.B. Fruit* decisions are only two decisions broadening the reach of liability to those who may not have exercised the same degree of active daily involvement in corporate operations as previously required, but these decisions have opened the door for courts to extend personal liability under PACA. Consequently, the reasoning and the extension of personal liability, as seen in *Sunkist*, *K.B. Fruit*, and the application of trust principles, is likely to be applied in future PACA trust cases to further broaden the reach of the PACA trust for purposes of imposing personal liability on previously shielded individuals.<sup>79</sup>

<sup>74</sup>. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 174 (1959)).

<sup>75</sup>. *See id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 175 (1959)).

<sup>76</sup>. *See id.* at 706-07.

<sup>77</sup>. *See id.*

<sup>78</sup>. *See id.* The court stated:

In conclusion, while we are sympathetic to the Kaleck's situation, having to shoulder responsibility for Blumberg's failures to pay trust creditors, we must keep in mind the intent of Congress in establishing PACA: that a burden on commerce in perishable agricultural commodities was caused by dealers receiving goods without having made payment for them. The statutory trust remedy was created to ensure that farmers do not suffer when the agricultural produce dealers abandon their businesses without paying their debts. While the Kalecks have been rewarded for their familial loyalty with the threat of loss of their own business, had they exercised reasonable care to see that [the corporation] was properly managed, this lawsuit may well have been avoided. For the reasons stated, the motion of the plaintiffs for summary judgment will be granted.

*Id.* at 707.

<sup>79</sup>. However, despite the broadening of personal liability under the PACA as seen in cases such as *Sunkist* and *K.B. Fruit*, not all recent cases have sought to expand the reach of the PACA. For example, in *Farm-Wey Produce, Inc. v. Wayne L. Bowman Co.*, Nos. 1:96-CV-397, 1:96-CV-513, 1997 WL 450752, at \*5-6 (E.D. Tenn. June 26, 1997), the court rejected plaintiffs' argument that the president and sole shareholder should be personally liable under the PACA for his company's failure to pay for perishable agricultural commodities. The Tennessee court opined that the plaintiffs, in attempting to hold the president personally liable for the corporation's produce-related debts, were in effect asking the court to create a rule of strict liability, an argument which the court rejected. The court stated that the legislative history of PACA does not indicate a Congressional intent to abrogate state corporate and contract law and apply a strict liability theory to PACA cases. Also see *Ideal Sales, Inc.*

### III. NON-DISCHARGEABILITY OF PACA TRUST DEBTS

The current trend in case decisions holding that the principals of produce dealers, brokers, and commission merchants can be personally liable for PACA trust debts incurred by their businesses, has caused these individuals to consider this potential liability when filing for protection under the bankruptcy laws. Individuals who may be liable for trust debts cannot merely rely on the bankruptcy laws to shield them, as may have been possible in the past.

The Bankruptcy Code expressly excepts certain types of debts from discharge in bankruptcy.<sup>80</sup> Specifically, 11 U.S.C. § 523(a)(4) excepts from discharge any debts that arise from “fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny.”<sup>81</sup> The two primary considerations in determining whether 11 U.S.C. § 523(a)(4) applies to PACA trust obligations are: (1) whether the PACA trust creates the requisite fiduciary duties which must be imposed prior to, and not by virtue of, any claimed misdirection of funds; and (2) whether a defalcation has occurred.<sup>82</sup>

To invoke the 11 U.S.C. § 523(a)(4) exclusion, there must first be a fiduciary relationship based on a technical trust, an express trust, or a statutorily imposed

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v. *McGriff*, No. CA 3:95-CV-0091-R, 1997 WL 560779 (N.D. Tex. Sept. 2, 1997), wherein the court held that the 20% shareholder of a corporation that failed to pay for produce was not personally liable for the company’s debts under the PACA. The same court had previously granted plaintiffs’ summary judgment motion imposing personal liability against the company’s president and 80% shareholder. *Ideal Sales, Inc. v. McGriff*, No. CA 3:95-CV-0091-R, 1997 WL 148043 (N.D. Tex. Mar. 26, 1997). The court in the second *McGriff* case reasoned that while the case decisions do not foreclose holding more than one individual in a company personally liable, the cases do require a showing of “near-absolute control over the affairs of the company such that the court can fairly conclude that every individual held personally liable caused the breach of the trust.” *Id.* The court ultimately held that, unlike the president and 80% shareholder, a genuine issue of material fact existed as to whether the 20% shareholder was sufficiently engaged in the daily management, direction, and control of the company to be personally liable for the corporation’s debts. *See id.*; *see also* *Weis-Buy Services, Inc. v. Rancone*, No. 95 C 6602, 1997 WL 323523 (N.D. Ill. June 9, 1997) (granting summary judgment against two of the three individual defendants, but holding facts created a genuine issue as to the degree of influence and control the third individual had over company’s policies and practices concerning PACA trust assets).

<sup>80.</sup> *See* DAVID G. EPSTEIN ET AL., *BANKRUPTCY* § 7-16 (1992).

<sup>81.</sup> 11 U.S.C. § 523(a)(4) (1994). Debts arising from fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny are not discharged under §§ 727, 1141, 1228(a), 1228(b), or 1328(b) of Title 11.

<sup>82.</sup> *See* 11 U.S.C. § 523(a)(4) (1994). The Bankruptcy Code does not define “defalcation,” and thus, one must look to other federal and state laws to define this term. *See, e.g.,* *Nuchief Sales, Inc. v. Harper* (*In re Harper*), 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993) (defining “defalcation” as “the misappropriation of trust funds held in any fiduciary capacity, and the failure to properly account for such funds.”); *Green v. Pawlinski* (*In re Pawlinski*), 170 B.R. 380, 389 (Bankr. N.D. Ill. 1994) (holding an objective standard is used to determine a defalcation—intent or bad faith is not a requirement).

trust.<sup>83</sup> In addition, the fiduciary duties of the trustee must be independent of any obligations imposed by contract between the parties.<sup>84</sup>

Existence of a fiduciary relationship, the first element, is fairly easy to prove and has been held to exist in a variety of situations.<sup>85</sup> Because the PACA trust is imposed on the produce-related assets, as defined under the statute and regulations, and because the duties are imposed by statute upon delivery of the perishable commodities to the buyer and continue until the seller is fully paid, the requirements necessary to invoke 11 U.S.C. § 523(a)(4) are met by this statutory trust.<sup>86</sup>

The case of *In re Stout* confirmed that courts have generally held that the PSA trust satisfies the fiduciary requirement of 11 U.S.C. § 523(a)(4).<sup>87</sup> The *In re Stout* holding accords with the well-established rule that a statutory trust creates a fiduciary relationship which gives rise to a valid claim of non-dischargeability of a debt.<sup>88</sup>

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<sup>83</sup>. See *Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416, 418 (Bankr. E.D. Tenn. 1993) (holding that PACA statutory trust satisfies express or technical requirements of provision of Bankruptcy Code rendering non-dischargeable a debt for fraud or defalcation while acting in fiduciary capacity and thus PACA debt held non-dischargeable); *Tom Lange Co. v. Stout (In re Stout)*, 123 B.R. 412, 414 (Bankr. W.D. Okla. 1990) (stating that debtor's failure to pay PACA supplier proceeds from the sale of produce constitutes defalcation in fiduciary capacity that results in non-dischargeable debt); *Collins Bros. Corp. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143 (M.D. Ga. Apr. 10, 1992) (recognizing that the PACA trust creates a true trust and fiduciary relationship for purposes of 11 U.S.C. § 523(a)(4)).

<sup>84</sup>. See *Besroi Constr. Corp. v. Kawczynski (In re Kawczynski)*, 442 F. Supp. 413 (W.D.N.Y. 1977) (holding that for debt to be dischargeable under fiduciary capacity requirement, trustee must have duties which are independent from any contractual obligations between the parties).

<sup>85</sup>. See, e.g., *Lewis v. Short (In re Short)*, 818 F.2d 693, 695 (9th Cir. 1987) (holding partner is a trustee of all partnership assets under Washington law); *Ragsdale v. Haller*, 780 F.2d 794 (9th Cir. 1986) (explaining the trust relationship between partners); *Kwiat v. Doucette*, 81 B.R. 184, 189 (Bankr. D. Mass. 1987) (stating that the attorney-client trust relationship exists even in the absence of an express agreement); *Capitol Indem. Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.)*, 760 F.2d 121, 124-25 (6th Cir. 1985) (holding that insurance premiums collected have trust fund status for insurance principal's benefit under Michigan law); *Besroi Constr. Corp. v. Kawczynski (In re Kawczynski)*, 442 F. Supp. 413 (W.D.N.Y. 1977) (discussing a New York statute which requires segregation of funds thereby creating a trust relationship).

<sup>86</sup>. Several courts have looked to PSA and have acknowledged that the trust created under PACA satisfies the fiduciary capacity requirement of § 523(a)(4). See, e.g., *Tom Lange v. Stout (In re Stout)*, 123 B.R. 412, 415 (W.D. Okla. 1990) (citing *National Bonding & Accident Ins. Co. v. Petersen*, 51 B.R. 486, 488 (Bankr. D. Kan. 1985)); see also *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473, 474-75 (Bankr. D. Md. 1995) (holding that the PACA trust creates a fiduciary relationship for purposes of non-dischargeability under § 523(a)(4)); *Baugh v. Matheson (In re Matheson)*, 10 B.R. 652, 656 (Bankr. S.D. Ala. 1981) (holding that PSA regulations showed Secretary of Agriculture's intent to place stockyard dealer in a fiduciary position and thus debts are non-dischargeable).

<sup>87</sup>. *Tom Lange Co. v. Stout (In re Stout)*, 123 B.R. 412 (Bankr. W.D. Okla. 1990).

<sup>88</sup>. See *Allen v. Romero (In re Romero)*, 535 F.2d 618, 622 (10th Cir. 1976) (holding the required fiduciary duty for non-dischargeability exists under New Mexico law that provides for revocation of contractor's license if he diverts funds from one obligation to another); *Purcell v. Janikowski (In re Janikowski)*, 60 B.R. 784, 788 (Bankr. N.D. Ill. 1986) (discussing fiduciary relationship requirement and holding that to be a fiduciary for purposes of non-dischargeability, the



The second element required before 11 U.S.C. § 523(a)(4) can be invoked is “defalcation.” An act of defalcation under the Bankruptcy Code includes embezzlement or misappropriation of trust funds as well as the failure to properly account for trust funds held in a fiduciary capacity.<sup>89</sup> The concept of defalcation includes failure to pay monies in trust as required pursuant to trust obligations.<sup>90</sup> Furthermore, defalcation can be “a mere deficit resulting from the debtor’s misconduct, even though he derived no personal gain, and may be through negligence or ignorance rather than misconduct.”<sup>91</sup>

The *In re Stout* court expressly held that the “failure to pay [the supplier] the proceeds from the sale of produce is a defalcation.”<sup>92</sup> Moreover, the element of defalcation does not require proof of wrongful intent by the trustee; only some minimal amount of willful neglect by the trustee is required.<sup>93</sup> Applying an objective standard, the buyer of produce must take some action to protect the trust interest of the trust creditors, and failure to do so is a defalcation while acting in a fiduciary capacity.<sup>94</sup>

Bankruptcy courts have recognized that when a debt is incurred in the context of a breach of the fiduciary duty imposed by PACA (*i.e.*, the buyer of

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debtor must be a trustee under either an express or technical trust); *Gagliano v. Reliance Insurance Co.* (*In re Gagliano*), 44 B.R. 259, 261 (Bankr. N.D. Ill. 1984) (holding that an insurer’s judgment for unpaid premiums collected by debtor, who had been authorized on behalf of insurer to solicit insurance applications, was non-dischargeable where debtor acted in fiduciary capacity when collecting premiums); *Waters v. Capital Aggregates, Inc.* (*In re Waters*), 20 B.R. 277, 279 (Bankr. W.D. Tex. 1983) (stating an innocent failure to account for funds received under a construction contract rendered the debt non-dischargeable); *Besroi Constr. Corp. v. Kawczynski* (*In re Kawczynski*), 442 F. Supp. 413, 418 (W.D.N.Y. 1977); *see also C & E Enters., Inc. v. Milton Poulos, Inc.* (*In re Milton Poulos, Inc.*), 947 F.2d 1351, 1353 (9th Cir. 1991) (*per curiam*) (holding produce dealer as defined by PACA holds trust assets as a fiduciary until full payment is made to the supplier).

<sup>89</sup>. *Nuchief Sales, Inc. v. Harper* (*In re Harper*), 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993).

<sup>90</sup>. *Travelors Express Co. v. Niven* (*In re Niven*), 32 B.R. 354, 356 (Bankr. W.D. Okla. 1983) (citing *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 512 (2nd Cir. 1937)) (noting that defalcation normally implies some moral dereliction, however, in a bankruptcy context, it may include innocent default, including those by all fiduciaries, who were for any reason short in their accounts).

<sup>91</sup>. *Green v. Pawlinski* (*In re Pawlinski*), 170 B.R. 380, 389 (Bankr. N.D. Ill. 1994) (citing *Purcell v. Janikowsky* (*In re Janikowsky*), 60 B.R. 784, 788 (Bankr. N.D. Ill. 1986)).

<sup>92</sup>. *Tom Lange Co. v. Stout* (*In re Stout*), 123 B.R. 412, 415 (Bankr. W.D. Okla. 1990) (citing *National Bonding & Accident Ins. Co. v. Petersen* (*In re Petersen*), 51 B.R. 486, 488 (Bankr. D. Kan. 1985) and *Baugh v. Matheson* (*In re Matheson*), 10 B.R. 652, 655 (Bankr. S.D. Ala. 1981)).

<sup>93</sup>. *See Moreno v. Ashworth* (*In re Moreno*), 892 F.2d 417, 421 (5th Cir. 1990) (holding defalcation does not require the existence of fraud, only some willful neglect of duty); *Carlisle Cashway, Inc. v. Johnson* (*In re Johnson*), 691 F.2d 249, 256 (6th Cir. 1982) (finding mere negligence or mistake of fact sufficient for defalcation); *Codias v. Morales* (*In re Codias*), 78 B.R. 344, 346 (Bankr. S.D. Fla. 1987); *Blackhawk B.M.X., Inc. v. Anderson* (*In re Anderson*), 64 B.R. 331, 334 (Bankr. N.D. Ill. 1986); *Oster v. Levitt* (*In re Levitt*), 18 B.R. 598, 602 (Bankr. E.D. Pa. 1982).

<sup>94</sup>. *See Collins Bros. Corp. v. Nix* (*In re Nix*), Bankr. No. 91-40817-COL., 1992 WL 119143 at \*4 (M.D. Ga. 1992).

produce fails to maintain the PACA trust), the debt becomes non-dischargeable in bankruptcy.<sup>95</sup>

Several judicial circuits have not addressed the issue. However, when PACA trust creditors have asserted defalcation claims, the courts have readily accepted the argument that the PACA debts are non-dischargeable. Therefore, in addition to the powerful weapon of personal liability for debts under the PACA, the non-dischargeable nature of PACA debts further benefits an unpaid produce seller in the event of a buyer's untimely bankruptcy filing.

#### IV. TRENDS AND CONCLUSION

The increasing number of cases that address the issue of individual liability for corporate debts under PACA clearly evidence the judicial trend to broaden the protections afforded to unpaid produce suppliers. Congress recognized that the nature of the produce industry to be primarily financed by credit is contrary to the public interest, but in recent years it has been the courts that have followed through and increased the payment tools available to the always-vulnerable growers, shippers, and brokers of perishable agricultural commodities.

However, while some district courts and the Ninth Circuit Court of Appeals have certainly extended the reach of the PACA trust by imposing personal liability for corporate debts, the precise boundaries are still undetermined. Both the Ninth Circuit Court of Appeals in *Sunkist* and the Pennsylvania Eastern District Court in *K.B. Fruit* have left it for future courts to decide just how broadly and how far liability will extend under the PACA.

Because the case law interpreting the 1984 PACA trust amendments continues to grow and evolve, predicting just how far courts will go to protect the public interest and to remedy the burden on commerce caused by such credit arrangements is difficult. One thing is certain, by continuing to supplement the PACA, originally enacted in 1930, with such weapons as personal liability for corporate debt and non-dischargeability in bankruptcy, the balance of power in recent years has clearly shifted in favor of the produce suppliers and sellers.

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<sup>95</sup>. See *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473, 475 (Bankr. D. Md. 1995); *Morris Okun, Inc. v. Harry Zimmerman, Inc.*, 814 F. Supp 346, 348-49 (S.D.N.Y. 1993); *Collins Bros. v. Nix (In re Nix)*, Bankr. No. 91-40817-COL., 1992 WL 119143 at \*6 (M.D. Ga. 1992); *Fresh Western Marketing v. Pieper (In re Pieper)*, 119 B.R. 837, 840 (Bankr. M.D. Fla. 1990); *Tom Lange Co. v. Stout (In re Stout)*, 123 B.R. 412, 415 (Bankr. W.D. Okla. 1990).