

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

ELVIS LYNN LOGAN
and SUE W. LOGAN,

Case No. 99-27815-L
Chapter 7

Debtors.

FLAVOR-PIC TOMATO COMPANY, INC.,

Plaintiff,

v.

Adv. Proc. No. 99-0810

ELVIS LYNN LOGAN, SUE W. LOGAN,
and NORTH MISSISSIPPI WHOLESALE
PRODUCE, INC., d/b/a THE GREEN GROCER,

Defendants.

MEMORANDUM OPINION

THIS ADVERSARY PROCEEDING came on for trial on November 20, 2002, pursuant to notice. This case arises under the Perishable Agricultural Commodities Act (7 U.S.C. § 499a *et seq.*). It raises the issue of whether individuals responsibly connected with a corporate PACA trustee may be liable for breach of the PACA “trust,” and if so, whether that obligation is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4). After considering the testimony of the witnesses, the stipulations of fact and the exhibits, the statute itself and its related legislative history, the court concludes that the remedies provided by PACA for dissipation of trust assets exclude the implication of a separate cause of action for breach of trust. Further the court finds that under the facts of this case, no breach of trust occurred. Finally the court concludes that any obligation arising under the

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

PACA trust, at least as to perishable commodities dealers, is dischargeable in bankruptcy. The court makes the following findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052(a). This is a core proceeding. 28 U.S.C. § 157(b)(2)(I).

I. FACTUAL BACKGROUND

The individual defendants operated a business known as The Green Grocer (“Green Grocer”) for some period prior to its incorporation as North Mississippi Wholesale Produce, Inc., in January 1998. Green Grocer primarily was in the business of buying and selling fresh produce in wholesale quantities, although at all times it also sold some produce at retail. None of the defendants was a licensed PACA dealer. Flavor-Pic Tomato Company, Inc. (“Flavor-Pic”), a corporation with its principal place of business in Birmingham, Alabama, sold produce to Green Grocer over an extended period through December 30, 1998, for which there remains an unpaid balance in the amount of \$218,270.75. The debtors introduced evidence tending to show that their relationship with Flavor-Pic began as early as 1993. Judgment was entered by this court against the corporate defendant in the amount of \$218,270.75 on November 8, 2000, based upon its breach of contract to pay for produce obtained from Flavor-Pic. Green Grocer is no longer doing business and has no assets, thus Flavor-Pic seeks to establish additional sources of repayment.

Flavor-Pic asserts that it reserved rights in the produce sold by it to Green Grocer pursuant to PACA. In mid-1996, Flavor-Pic added the following language to its pre-printed invoices:

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

The PACA commodities listed herein are sold subject to the statutory trust authorized by section 5(C) of the PACA 1930 (7USCA499E(C)). Flavor-Pic Tomato retains a trust claim over these commodities and all inventories of food or other products derived from these commodities and any receivable or proceeds from the sale of these commodities until full payment is received.

The amount of outstanding invoices containing this language is \$185,501.50. Flavor-Pic asserts that Green Grocer and the Logans individually are liable to it for breach of the statutory trust created by PACA because proceeds from the sale of produce were used to make payments to creditors other than Flavor-Pic.

Substantially all the income of Green Grocer was derived from the sale of produce. All of the produce supplied by Flavor-Pic was sold by Green Grocer to its customers (or credited to Green Grocer's outstanding debt due to spoilage). Proceeds from Green Grocer's sales of produce were deposited in either of two business accounts, one at Union Planters Bank and the other at Bank of Mississippi. At all relevant times, in addition to paying produce suppliers, Mrs. Logan paid the ordinary and necessary expenses of the business, including salaries of salespersons, note payments for real estate, equipment rental and maintenance, general and administrative expenses and the like with funds from the business accounts. The business operated from two locations owned by the Logans. The first location on Airways Road in Southaven, Mississippi, had been owned by the individual debtors for thirteen to fourteen years. The second, located on Goodman Road in Horn Lake, Mississippi, was owned only eleven months. Both buildings were encumbered, and the

corporation made regular monthly payments to the lienholders in lieu of paying rent. None of the business expenses of the Green Grocer was excessive or unusual.

Although both Mr. and Mrs. Logan worked in the business, only Mr. Logan drew a salary. Mr. Logan paid himself \$500 per week when there were funds available. Mr. Logan estimated that his salary averaged \$1,500 per month over the period May, 1997 through July, 1999. Other than the note payments on real estate used by the business, the Logans separated their business expenses from their personal expenses and did not pay personal expenses from the accounts of the business. The Logans maintained their personal checking account at First Tennessee Bank. Into this account they deposited rent received from a rental house owned by Mrs. Logan, Mrs. Logan's social security checks, and Mr. Logan's salary checks from Green Grocer. From this account they paid their personal expenses, including mortgage payments on their residence and the rental home.

The financial difficulties of the Green Grocer extended over a substantial period of time. A complete payment history was not provided, but from the selected paid invoices introduced at trial, the court notes that although the pre-printed invoice forms used by Flavor-Pic indicate terms of payment of "net 10 days," as early as 1994, payments to Flavor-Pic were made several months after the date of the invoice. There is evidence that Green Grocer sometimes made payments on invoices more than one year after their due date, and included in the claim of Flavor-Pic are open invoices dated as early as May 28, 1997, more than two years prior to the date of the bankruptcy case.

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

Beginning January 1, 1999, Flavor-Pic required payment upon delivery of produce. The last open invoice from Flavor-Pic is dated December 30, 1998.

Prior to its incorporation, the Green Grocer was either a sole proprietorship owned by Mr. Logan or a partnership owned by both of the Logans. Upon its incorporation, the stock of Green Grocer was owned by Mr. and Mrs. Logan, either equally or with Mr. Logan owning 51% and Mrs. Logan owning 49% of the outstanding shares. Mr. and Mrs. Logan were the only officers of the corporation. Mr. Logan indicated that the business was incorporated because he wanted his customers to understand that he was operating a wholesale, rather than a retail business. It is apparent that even after the incorporation, the Logans continued to operate the business much as they had before, including buying produce in their own name. No assets were transferred to the corporation.

Although it is not clear from the record precisely when the Green Grocer ceased doing business, it was apparently sometime between May 16, 1999 (the date of the last check to Flavor-Pic) and July 1, 1999 (the date of the debtors' voluntary Chapter 7 petition). In addition to personal assets, the bankruptcy schedules filed by the Logans list the two parcels of real estate used in the business; accounts receivable in the amount of \$12,000; various items of furniture, fixtures and equipment valued at \$13,400; and a bob truck valued at \$10,000. Of the eighteen creditors who filed proofs of claim, four assert rights to the PACA trust. Their claims total \$117,285.79. Flavor-Pic did

not file a proof of claim. Instead, Flavor-Pic filed its “Complaint to Enforce PACA Trust Obligations and to Determine Dischargeability of Debt” with this court on October 1, 1999. Flavor-Pic asserts that (1) there was a breach of the PACA trust by the Green Grocer when it failed to remit proceeds from sales of produce to Flavor-Pic but instead used those proceeds to pay other obligations; (2) the individuals are liable to Flavor-Pic as controlling persons of Green Grocer for the breach of trust; and (3) the obligation of the individuals is not dischargeable in bankruptcy pursuant to 11 U.S.C. § 523(a)(4).

II. ANALYSIS

A. History and Background of the PACA Trust

The Perishable Agricultural Commodities Act was initially enacted in 1930 “to establish a code of fair trading practices governing the marketing in interstate and foreign commerce of fresh and frozen fruits and vegetables and cherries in brine and to aid in the enforcement of contracts for marketing these commodities.” S. Rep. No. 490, 91st Cong., 1st Sess. 1969. PACA provides for the licensing of dealers in and handlers of perishable agricultural commodities; specifies certain kinds of unlawful conduct with respect to the marketing of such commodities; and establishes remedies for violation of the act. Among those acts prohibited as unfair trade practices are the failure “to truly and correctly account and make full payment promptly in respect to any transaction . . .” and failure to “maintain the trust as required under section 5(c) [7 U.S.C. § 499e(c)].” 7 U.S.C. § 499b(4).

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

Persons aggrieved by violation of the act may make a complaint for reparation to the Secretary of Agriculture or any court of competent jurisdiction. *See* 7 U.S.C. § 499e-499g. In addition to awarding damages resulting from violation of PACA, the Secretary of Agriculture may conduct administrative proceedings to consider the imposition of sanctions, including suspension or revocation of licenses for violations of the act. 7 U.S.C. § 499h.

In 1984, PACA was amended to add as an additional remedy the creation of a statutory “trust” consisting of perishable agricultural commodities, inventories of products derived from such commodities, and accounts receivable and other proceeds derived from sale of such commodities and products in the hands of a commission merchant, dealer or broker. 7 U.S.C. § 499e(c)(1). The trust comes into existence upon the receipt of perishable agricultural commodities or products by a commission merchant, dealer or broker and continues until all suppliers, sellers or agents involved in a transaction have been paid. 7 U.S.C. § 499e(c)(2). The benefits of the trust are lost unless an unpaid supplier, seller, or agent gives notice of intent to preserve its interest within thirty days after the time for payment or receipt of notice of dishonor of a payment instrument. 7 U.S.C. § 499e(c)(3). In the alternative, a supplier, seller or agent may give notice of its intent to preserve trust benefits through its ordinary and usual billing or invoice statements. 7 U.S.C. § 499e(c)(4). The federal district courts are given jurisdiction to hear actions by trust beneficiaries to enforce payment from the trust and actions by the Secretary of Agriculture to prevent dissipation of the trust. 7 U.S.C.

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

§ 499e(c)(5). Failure to maintain the trust is an unfair trade practice that may be remedied by reparation order, or suspension or revocation of license. 7 U.S.C. § 499f- 499h.

According to legislative history, “The trust impressed by section 5(c)(2) of this Act [7 U.S.C. § 499e(c)(2)] is made up of a firm’s commodity related liquid assets, and is a nonsegregated ‘floating trust,’ which permits the commingling of trust assets.” H.R. Rep. No. 98-543, 1984 U.S.C.C.A.N. 405, 407. “The PACA trust is another form of protection under PACA which was established in 1984 to protect unpaid suppliers and sellers in the case of bankruptcy. The statutory trust consists of a buyer’s produce-related assets which are held for produce suppliers in the case of a business failure.” H.R. Rep. No. 104-207, 1995 U.S.C.C.A.N. 453, 459. In the event of the filing of a bankruptcy petition by or against a commission merchant, dealer or broker, assets subject to a PACA trust are not property of the bankruptcy estate. *Tom Lange Co., Inc. v. Kornblum & Co., Inc. (In re Kornblum)*, 81 F.3d 280, 284 (2nd Cir. 1996) (citations omitted). Produce suppliers are entitled to payment from the assets of the trust pro rata. *In re United Fruit and Produce Co., Inc.*, 119 B.R. 10, 12 (D. Conn. 1990) (citations omitted).

B. The Business of the Green Grocer is Subject to Regulation Under PACA

None of the defendants was licensed pursuant to PACA, but each has admitted that it was engaged in the business of buying perishable agricultural commodities in wholesale or jobbing quantities in interstate commerce. Thus, each of the defendants was subject to the regulations of the Act. *See* 7 U.S.C. §§ 499a(6); 499c(a); 499e(a); *see also United Potato Co., Inc., v. Burghard & Sons, Inc.*, 18 F. Supp. 2d 894, 897 (N.D. Ill. 1998) (“The Secretary has jurisdiction over a cause of action brought under PACA if: (1) the action involves a perishable agricultural commodity; (2) the transaction involves interstate commerce; (3) the action is against a licensee or someone operating subject to license under PACA; and (4) the complainant petitions the Secretary within nine months of the alleged harm.”) (citation omitted). The defendants have not contended that their business was not subject to regulation under PACA.

C. PACA Does Not Give Rise to a Separate Cause of Action for Breach of Trust

Flavor-Pic asserts that it is the beneficiary of a PACA trust established with respect to its transactions with Green Grocer. Based upon the bankruptcy schedules filed by the Logans, it appears that the only remaining assets potentially subject to the PACA trust are accounts receivable valued at \$12,000. Flavor-Pic asserts that in addition to the remedies provided by the statute, the PACA trust also gives rise to a separate cause of action for breach of trust against PACA “trustees” and persons responsibly connected with corporate PACA “trustees.” Flavor-Pic asserts that the resulting liability for failure to account for trust assets is nondischargeable in bankruptcy pursuant to 11

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

U.S.C. § 523(a)(4) because it results from the defalcation of a fiduciary. Flavor-Pic is not without support for its position.

The leading case imposing personal liability on controlling persons for breach of a PACA trust is *Morris Okun, Inc. v. Harry Zimmerman, Inc. (In re Zimmerman)*, 814 F. Supp. 346 (S.D.N.Y. 1993), which states:

PACA establishes a statutory trust for the benefit of sellers and suppliers. This trust arises from the moment perishable goods are delivered by a seller. An individual who is in the position to control trust assets and who does not preserve them for the beneficiaries has breached a fiduciary duty, and is personally liable for the 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.

Id. at 348. Two circuit courts of appeal, as well as a number of lower courts, have agreed with the analysis of *Zimmerman* imposing individual liability upon persons in control of a corporate PACA trustee. *See, e.g., Golman -Hayden Co., Inc. v. Fresh Source Produce, Inc.*, 217 F.3d 348 (5th Cir. 2000); *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280 (9th Cir. 1997); *Shepard v. K.B. Fruit & Vegetable*, 868 F. Supp. 703 (E.D. Pa. 1994); *Strube Celery v. Zois (In re Zois)*, 201 B.R. 501 (Bankr. N.D. Ill. 1996); *N.P. Deoudes, Inc. v. Snyder (Matter of Snyder)*, 184 B.R. 473 (D. Md. 1995); *Nuchief Sales Inc. v. Harper (In re Harper)*, 150 B.R. 416 (Bankr. E.D. Tenn. 1993). *Harper* specifically held that the resulting personal liability is not dischargeable in bankruptcy on the basis

that the “trust” created by PACA satisfies the statutory trust requirement for application of section 523(a)(4). *See Harper*, 150 B.R. at 419. *Harper* did not consider, however, whether the remedial scheme of PACA itself foreclosed additional remedies.

Two district courts have called into question the judge-made extension of PACA. *See Deoudes v. Snyder (In re Snyder)*, 171 B.R. 532 (Bankr. D. Md. 1994) *overruled by* 184 B.R. 473 (D. Md. 1995); and *Farm-Wey Produce, Inc. v. Wayne L. Bowman Co., Inc.*, 973 F. Supp. 778 (E.D. Tenn. 1997). As *Farm-Wey* points out, “there is no indication in the statute itself, the associated regulations, or the legislative history that Congress intended to abrogate substantial portions of state corporation law by making a large class of individuals sureties on the contracts of produce buyers.” *Id.* at 783. There is no controlling precedent in the Sixth Circuit concerning the dischargeability of liability arising from dissipation of PACA trust assets.

PACA creates certain specific private rights. Failure to pay for commodities and failure to maintain the PACA trust are unlawful acts pursuant to 7 U.S.C. § 499b(4) triggering liability for resulting damages pursuant to section 499e(a). The liability may be established by complaint to the Secretary of Agriculture or by suit to a court of competent jurisdiction. 7 U.S.C. § 499c(b). A petition for reparation under the Act must be commenced within nine months after the cause of action accrues, which, if approved by the Secretary, becomes a complaint which is forwarded to the commission merchant, dealer or broker, for satisfaction or answer. 7 U.S.C. § 499f(a). An adverse

ruling upon a complaint results in the issuance of a reparation order. 7 U.S.C. § 499g(a). Failure to timely pay a reparation award gives rise to the right within three years of the date of the order to sue in federal district court to enforce the liability. 7 U.S.C. § 499g(b). The Secretary may refuse to award a license to anyone who “has failed, *except in the case of bankruptcy* and subject to his right of appeal under section 7(c) [7 U.S.C. § 499g(c)], to pay any reparation order issued against him within two years prior to the date of the application [for license]. 7 U.S.C. § 499d(b)(D)(emphasis added). By implication, reparation awards are dischargeable in bankruptcy. Because Congress understood that reparation orders would give rise to debts dischargeable in bankruptcy, the Bankruptcy Code was specifically amended to exempt the Secretary’s license revocation authority from the anti-discrimination provision of the Bankruptcy Code. *See Melven Beene Produce Co. v. Agricultural Marketing Service*, 728 F.2d 347, 351 (6th Cir. 1984); 11 U.S.C. § 525.¹ The Secretary may not refuse to issue a license to someone who fails to pay a reparation award because it has been

¹ 11 U.S.C. § 525(a) provides:

Except as provided in the Perishable Agricultural Commodities Act, 1930, the Packers and Stockyards Act, 1921, and section 1 of the Act entitled "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes," approved July 12, 1943, a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

discharged in bankruptcy, but may revoke a license or refuse to issue a license for any of the reasons set forth at section 499d(b)² notwithstanding the filing of a bankruptcy petition by the applicant.

In addition to the remedy of reparation, PACA also provides the remedy of “actions by trust beneficiaries to enforce payment from the trust.” 7 U.S.C. § 499e(c)(5). The language is very specific. It does not permit, for example, “actions by trust beneficiaries to establish liability for breach of trust,” or “actions by trust beneficiaries to establish liability for dissipation of trust assets.” The sole purpose of the PACA “trust” provisions is to establish priority with respect to commodities-related assets in the event of the business failure of a commission merchant, dealer, or broker.

Where Congress has made specific provision in PACA for remedies in the event of dissipation of trust assets and where that remedy is limited to the imposition of sanctions and/or the award of reparation, the courts should be extremely cautious in inferring the presence of additional,

² 7 U.S.C. § 499d(b) provides:

The Secretary shall refuse to issue a license to an applicant if he finds that the applicant, or any person responsibly connected with the applicant, is prohibited from employment with a licensee under section 499h(b) of this title or is a person who, or is or was responsibly connected with a person who --

- (A) has had his license revoked under the provisions of section 499h of this title within two years prior to the date of the application or whose license is currently under suspension;
- (B) within two years prior to the date of application has been found after notice and opportunity for hearing to have committed any flagrant or repeated violation of section 499b of this title, but this provision shall not apply to any case in which the license of the person found to have committed such violation was suspended and the suspension period has expired or is not in effect;
- (C) within two years prior to the date of the application, has been found guilty in a Federal court of having violated the provisions of sections 491, 493 to 497 of this title, relating to the prevention of destruction and dumping of farm produce; or
- (D) has failed, except in the case of bankruptcy and subject to his right of appeal under section 499g(c) of this title, to pay any reparation order issued against him within two years prior to the date of the application.

unspecified remedies. Whether Congress intended a cause of action to be implied from legislation is a question of statutory construction. *Mobil Corporation v. Marathon Oil Co.*, 669 F.2d 366, 371 (6th Cir. 1981) citing *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 100 S. Ct. 242, 62 L. Ed. 2d 146 (1979). The question of whether a particular private right or remedy is to be implied in a federal statute is to be determined solely by reference to Congressional intent. *See Parry v. Mohawk Motors of Michigan, Inc.*, 236 F.3d 299, 308 (6th Cir. 2000) citing *Transamerica Mortgage Advisors*, 444 U.S. at 15-16; *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575, 99 S. Ct. 2479, 61 L. Ed. 2d 82 (1979). “The intent of Congress remains the ultimate issue ... and ‘unless this congressional intent can be inferred from the language of the statute, the statutory structure, or some other source, the essential predicate for implication of a private remedy simply does not exist.’” *Thompson v. Thompson*, 484 U.S. 174, 179, 108 S. Ct. 513 (1988) (citations omitted); *see also* Justice Scalia’s concurring opinion in *Thompson* for a thorough discussion of the evolution in the Court’s turn away from implied rights of action.

The particular concern of Congress in adding the trust provisions to PACA is clear. Congress was concerned that in the event of insolvency, the claims of produce suppliers were subordinate to those of secured lenders. 7 U.S.C. § 499e(c)(1). Legislative history is consistent with this statement. In addition to the selections already provided, the following should be considered. When the trust provision was added in 1983, the House Report explained:

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

Many commission merchants, dealers, or brokers, in the normal course of their business transactions, operate on bank loans secured by the inventories, proceeds or assigned receivables from sales of perishable agricultural commodities, giving the lender a secured position in the case of insolvency. Under present law, sellers of fresh fruits and vegetables are unsecured creditors and receive little protection in any suit for recovery of damages where a buyer has failed to make payment as required by the contract. . . .

This legislation would provide a remedy by impressing a trust in favor of the unpaid seller or supplier on the inventories of commodities and products derived therefrom and on the proceeds of sale of such commodities and products in the hands of the commission merchant, dealer or broker in the same manner that has been provided by 'trust' amendments to the packers and stockyards act adopted in 1976. . . .

These amendments would give the industry and department effective new tools to overcome the payment problems. *However, they do not replace the need for sellers to exercise good business judgment by making necessary credit and trade rating checks, wherever possible, before agreeing to ship goods to a buyer. Nor will they change the methods of doing business by either the seller or the buyer.* Under the provisions of H.R. 3867 the unpaid seller must accept the burden to preserve the trust by notifying both the secretary and the commission merchant, dealer, or broker within 30 days after expiration of the prompt payment date or date on which a payment instrument has been dishonored, or the trust benefits will be lost.

H.R. Rep. No. 98-543 (1983), reprinted in 1984 U.S.C.C.A.N. 405, 407-408 (emphasis added).

When the trust provisions were amended in 1995, the House Report stated:

Under current law, the trust is in effect at the time of shipment of the perishable commodity. The unpaid supplier, seller, or agent must provide notice of trust coverage to the buyer in order to preserve

these trust benefits. Consistent with this principle, this legislation, under paragraph 4 of section 5(c) of PACA, provides that the supplier, seller, or agent may perfect its trust claim by giving notice to the buyer on the invoice or billing statement. This change to the Act provides both a convenience and cost savings to the unpaid supplier, seller or agent. The Committee intends the effect of notice provided through the use of usual billing or invoice statements to be *the legal equivalent* to the current practice of providing notice subsequent to the payment date by means independent of the billing statement or invoice.

H.R. Rep. No. 104-207 (1994), reprinted in 1995 U.S.C.C.A.N. 453 (emphasis added).

The focus of Congress both in enacting the PACA trust and in its subsequent amendment was on preserving commodities assets from the liens of lenders other than suppliers of commodities in the event of insolvency. Nowhere does the legislative history indicate that a new type of liability was being imposed upon individuals under PACA. Rather, the statute provides a specific remedy in the event of dissipation of trust assets: the issuance of a reparation order.

The facts in this case make it abundantly clear why the trust provisions of PACA should not be read to impose individual liability for breach of trust. The Logans were woefully behind in paying their bills to Flavor-Pic long before Flavor-Pic ever began adding PACA language to its invoices. Until Green Grocer was placed on COD terms, it was the practice of both Flavor-Pic and the Logans to pay the oldest outstanding invoice first. Cathy Wickstrom, accounts receivable clerk for Flavor-Pic, indicated that this practice went back at least to 1995, and that PACA language was not added to the Flavor-Pic invoices until the summer of 1996. Prior to 1996, Flavor-Pic would have lost its

trust benefits on a regular basis as invoices went unpaid for more than thirty days. After the amendments, those benefits appear to continue for all outstanding invoices covered by PACA language, no matter how long they remain unpaid. Under this system, suppliers such as Flavor-Pic have fewer incentives to act promptly to protect their rights. They can allow the outstanding balance owed to them to grow, knowing that their rights to the assets of their customer will prime those of any other lender. This is a substantial benefit in and of itself, and a source of concern to secured lenders. *See, e.g.,* Thomas J. Cunningham, *Perils of the Perishable Agricultural Commodities Act: Ambushed by the Turnip Man!*, 27 U.C.C.L.J. 139, 164 (1994); Thomas J. Cunningham, *The Amended Perishable Agricultural Commodities Act: Further Concealment of a Lien Already Invisible*, 116 BANKING L.J. 253 (1999). If, in addition, the court were to interpret PACA as creating a separate cause of action for breach of trust, such suppliers would have further cause simply to sit on their rights. Nothing in the statute itself or the legislative history indicates that this was the intent of Congress in adding the trust provisions to PACA. There is no indication that Congress intended to impose strict liability upon agricultural commodities dealers, and no indication that it intended to transform dischargeable reparation orders into nondischargeable judgments for breach of trust. The court holds that PACA does not create a separate remedy for breach of trust against either a corporate dealer or its individual officers, directors, or shareholders.

**D. Even if PACA is Read to Give Rise to a Cause of Action for Breach of Trust,
the Payment of Ordinary and Necessary Business Expenses**

Does not Constitute Breach

Even if one were to infer an implied cause of action for breach of trust in PACA, the cause of action should not extend to payments of ordinary and necessary business expenses by commodities dealers. In adding the trust provision to PACA, Congress intended to create a “non-segregated ‘floating trust,’ made up of all a firm’s commodity related liquid assets.” H.R. Rep. No. 98-543 (1983), reprinted at 1984 U.S.C.C.A.N. 405 (1984). So long as the trust continues in its “floating” status, it is contemplated that the liquid assets of a commodities dealer will be used to pay the ordinary and necessary expenses of operating its business. Congress specifically rejected any requirement that commodities proceeds be segregated for the benefit of commodities suppliers. *Id.* For many dealers, such as Green Grocer, all liquid assets will consist of trust assets. Until steps are taken to enforce payment from the trust and/or to prevent dissipation of trust assets, or until the insolvency of a commodities dealer and cessation of its business, the payment of ordinary and necessary business expenses does not constitute a breach of the PACA trust.

Flavor-Pic’s proof of breach of trust by Green Grocer consists of a list of the obligations paid by Green Grocer during the two years preceding the cessation of its business. Upon prompting from counsel for Flavor-Pic, Mr. Logan estimated that he drew \$36,000 in salary from the business; paid mortgage payments to the three banks for properties used by the business in the approximate amount of \$143,640; paid salaries to company salespersons and office employees of \$230,000; paid vehicle

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

leasing and related expenses of \$66,800; and paid utilities of approximately \$30,000. In that same two-year period, Green Grocer paid Flavor-Pic \$180,275.70, roughly equivalent to the amount of open invoices owed to Flavor-Pic containing the PACA notice, although approximately \$60,000.00 of this amount related to COD shipments. It is not clear what payments were made to other commodities suppliers.

There is nothing unusual or unreasonable in the payments made by the Logans. Flavor-Pic seems especially aggrieved that mortgage payments were made by the corporation for properties owned by the individuals, but for the first eight months of this period the corporation did not exist, and thereafter the corporation did not pay rent. It certainly cannot be argued that Mr. Logan's salary of \$1,500 per month was extravagant. The court finds that the only expenses paid by the Green Grocer other than produce suppliers were ordinary, necessary, and reasonable expenses related to the business.

Thus in order for Flavor-Pic to prevail, the court must conclude as a matter of law that the payment of ordinary business expenses and salaries constitutes a breach of the PACA trust. The Sixth Circuit has not considered this issue. Those courts that have are predictably divided. Courts that have concluded that the PACA trust precludes the payment of all non-produce expenses, including legitimate business expenditures, include *Morris Okun*, 814 F. Supp. at 348; and *Red's Market v. Cape Canaveral Cruise Line, Inc.*, 181 F. Supp. 2d 1339, 1344 (M.D. Fla. 2002). Other

courts, including the Second Circuit Court of Appeals, have reached the opposite result. *See C. H. Robinson Co. v. Alanco Corp.*, 239 F.3d 483, 488 (2nd Cir. 2001); *Farm-Wey Produce*, 973 F. Supp. at 784; *Calloway Produce Co., LLC v. Bear Kodiak Produce, Inc. (In re Bear Kodiak Produce, Inc.)*, 283 B.R. 577, 587 (Bankr. D. Ariz. 2002). Because PACA specifically does not require the segregation of trust assets or the posting of a bond, the court agrees with the reasoning of *Farm-Wey* and *Bear-Kodiak*. It cannot be the case that Congress intended that every payment of salary or expense by a produce dealer be considered a breach of trust. Among other problems with such an interpretation, the statute provides no limitation as to how far back in time such an inquiry might be pursued. Because the PACA trust is a floating, non-segregated and rolling trust, expenses paid years before a produce supplier experienced financial difficulties could be treated as a technical breach of trust, potentially subjecting individuals to personal, even nondischargeable liability. This anomalous result points again to the need to read PACA more narrowly than is suggested by *Flavor-Pic*. The PACA trust was intended to operate only in the event of business failure and then only to provide priority to produce suppliers over the blanket liens of secured lenders. The payment of ordinary business expenses and salaries by Green Grocer did not constitute a breach of trust.

**E. The Obligations Imposed by PACA Upon Commodities Dealers
Are Dischargeable in Bankruptcy**

Even if the court were to find that the Logans individually are liable for the actions of Green Grocer with respect to proceeds from the sale of produce, that obligation would nevertheless be

dischargeable in bankruptcy. While there is no controlling precedent in the Sixth Circuit concerning the dischargeability of obligations arising under PACA, there are decisions in analogous situations. In an unpublished opinion, *Penick v. Peoples Bank & Trust Co.*, 149 F.3d 1184, 1998 WL 344039 (6th Cir. 1998), the court reviewed its prior decisions concerning defalcation while acting in a fiduciary capacity.³ Because its own analysis of the cases is the best guide to the court's position, an extensive quotation is included here:

We have employed a narrow exception for defalcation while acting in a fiduciary capacity. In a series of three cases, we developed the rule the statute requires not only a pre-existing fiduciary relationship, but also a pre-existing express or technical trust whose res encompasses the property at issue. In *Carlisle Cashway, Inc. v. Johnson*, 691 F.2d 249 (6th Cir. 1982), we considered whether the requirements of § 17(a)(4) of the Bankruptcy Act of 1898, 11 U.S.C. § 35(a)(4) (1976), the immediate predecessor to § 523(a)(4), were satisfied by statutory trusts created under Michigan's Building Contract Fund Act, M.C.L. §§ 570.152-570.153, when a contractor or subcontractor receives payments in connection with a building project. We noted that “[t]he question of who is a fiduciary for purposes of section 17(a)(4) is one of federal law, although state law is important in determining when a trust relationship exists.” 691 F.2d at 251. We then recognized that “[t]he term ‘fiduciary’ applies only to express or technical trusts and does not extend to implied trusts, which are imposed on transactions by operation of law as a matter of equity.” In conclusion, we held that statutory trusts under the Building Contract Fund Act satisfy this requirement for the

³ 11 U.S.C. § 523(a)(4) provides:
(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

following reasons: “The trust relationship is unambiguously imposed on a contractor or subcontractor by language of the statute. The trust res is clearly defined as the monies paid by any person into the building contract fund. [And][t]he trustee is charged with specific affirmative duties....” *Id.* at 252.

In Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.), 760 F.2d 121, 124 (6th Cir. 1985), we found that under the Michigan Insurance Code of 1956, M.C.L. § 500.1207(1), “premium payments received by an insurance agency have the status of trust funds for the benefit of the insurance principal.” We held that the insurance agent's breach of this fiduciary relationship satisfied the requirements of § 17(a)(4) under the old Bankruptcy Act, and rendered the resulting debt non-dischargeable.

In the third of this trio of cases, *In re Garver*, we drew guidance from *In re Interstate Agency, Inc.*, and explicitly considered “the nature of the fiduciary relationship required under the defalcation provision of § 523(a)(4).” 116 F.3d at 179. *In re Garver* involved a debtor, Garver, who had been the attorney of the creditor, R.E. America, Inc. (“REA”). Garver and REA entered a joint venture in which each party was supposed to contribute \$600,000 towards the ownership by equal shares of another company. REA turned over the money to Garver, who issued REA an unsecured promissory note executed on behalf of a holding company that Garver controlled. Despite the parties’ agreement, Garver contributed only \$17,500 of his own money towards the purchase. The joint venture failed, and Garver filed for bankruptcy the following year. In a state court proceeding, a jury found that Garver breached his contract with REA and committed legal malpractice by violating his fiduciary duties to his client, and awarded REA \$600,000. In the bankruptcy proceeding, REA sought to have the \$600,000 debt excluded from discharge under the defalcation provision of § 523(a)(4). The bankruptcy court ruled the debt non-dischargeable and the district court affirmed. On appeal, we considered whether the fiduciary relationship between

attorney and client satisfied the “fiduciary capacity” required by § 523(a)(4).

Although the parties in that case had “stipulated to the existence of a fiduciary relationship satisfying the defalcation provision of § 523(a)(4),” we held nonetheless that “[t]he attorney-client relationship, without more, is insufficient to establish the necessary fiduciary relationship for defalcation under § 523(a)(4). Instead the debtor must hold funds in trust for a third party to satisfy the fiduciary relationship element of the defalcation provision of § 523(a)(4).” 116 F.3d at 179. Under this narrow construction of this provision, “[t]he mere failure to meet an obligation while acting in a fiduciary capacity does not rise to the level of defalcation; an express or technical trust must also be present.” *Id.* We reemphasized this requirement as we concluded: “In sum, under *Interstate Agency* the defalcation provision of § 523(a)(4) is limited to only those situations involving an express or technical trust relationship arising from placement of a specific res in the hands of the debtor.” *Id.* at 180.

1998 WL 344039 at **3-4. The *Johnson* opinion is especially instructive. In that opinion, the court explained that, “A debt created while acting in a fiduciary capacity is a special debt, created by a breach of trust obligations defined by law, and is separate and distinct from any underlying contractual debt which arises from a bankrupt’s agreement with respect to goods and services.” *Johnson*, 691 F.2d at 251 (citations omitted). “[T]he requisite trust relationship must exist prior to the act creating the debt and without reference to it. State statutes which impose a trust *ex-maleficio* are not within the scope of section 17(a)(4) since such trusts only arise upon an act of misappropriation.” *Id.* at 252 (citations omitted).

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

Application of these precedents to PACA indicates a number of problems with application of the section 523(a)(4) exception to discharge to the “trustee” of a PACA trust. In the examples of the building contract or insurance contract, it is clear that the statutory trustee acts as a middleman between the supplier of a product and its ultimate purchaser. Building materials are purchased for incorporation into a specific home; an insurance contract is generated for a specific purchaser. When the purchaser pays for the home or insurance contract, the proceeds are readily identifiable and the supplier of the materials or insurance is readily identified. In the case of Michigan Building Contract Fund Act, which was the subject of the *Johnson* opinion, a separate building contract fund is established for the particular project for the receipt of payments and payment of laborers, subcontractors and materialmen before the balance of funds becomes available to the contractor for his fees. The contractor is given specific fiduciary duties with respect to his handling of building contract funds which exclude the use of such funds for any purpose other than the payment of laborers, subcontractors and materialmen. In the case of the Michigan Insurance Code, the subject of the *Interstate Agency* case, there is no requirement of a separate fund for receipt of premium payments, but a principal-agent relationship is established. The insurance agent holds the funds as agent for his principal, not in his own behalf.

There is language in PACA that would suggest that the trust is intended to be limited to commodities identifiable to a particular transaction. In section 499(e)(c)(1), the identified concern

is about “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 . . .**” In section 499e(c)(2) reference is made to proceeds from the sale of commodities being held “in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents **involved in the transaction . . .**” The fact that “transaction” here is in the singular suggests that the transaction contemplated is a resale of commodities, rather than the numerous “transactions” whereby commodities are acquired for a particular transaction. In section 499e(c)(3) it is specified that, “**The written notice to the commission merchant, dealer, or broker shall set forth information in sufficient detail to identify the transaction subject to the trust.**” It is impossible to explain the emphasized language if the statute contemplates mere purchases of commodities for resale on the dealer’s own behalf.

While the court is not prepared to hold that the PACA trust is limited to commodities identified to a particular transaction, the emphasized language adds support to the conclusion that the transactions between Flavor-Pic and Green Grocer were not of the type identified by the Sixth Circuit as giving rise to fiduciary obligations for purposes of section 523(a)(4). Green Grocer purchased on its own behalf, not as agent, commission merchant, or broker. Purchases from Flavor-Pic were not identified to any particular transactions of resale. Under the reading of PACA suggested by Flavor-Pic, the act creating the trust is indistinguishable from the act creating the

In re Elvis Lynn Logan and Sue W. Logan
Chapter 7 Case No. 99-27815-L
Flavor-Pic Tomato Company, Inc. v. Elvis Lynn Logan, Sue W. Logan, and
North Mississippi Wholesale Produce, Inc. d/b/a The Green Grocer
Adv. Proc. No. 99-0810
Memorandum Opinion

contractual obligation to pay for commodities. PACA creates no obligation to segregate trust assets, but contemplates that trust assets be used to pay other obligations. The duties imposed by PACA, at least with respect to perishable commodities dealers as opposed to commission merchants or brokers, simply do not rise to the level required by the Sixth Circuit to establish the nondischargeability of an obligation under section 523(a)(4).

III.

For the foregoing reasons, judgement will be entered for the defendants on all counts arising out of an alleged breach of the PACA trust. The court has previously entered judgment against the corporate defendant in the amount of \$218,270.75.

BY THE COURT,

JENNIE D. LATTA
United States Bankruptcy Judge

Dated: _____

cc: Debtors/Defendants
Attorney for Debtors/Defendants
Plaintiff
Attorney for Plaintiff