

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 02-21130

KENNETH S. DELYSER, SR.,

Debtor.

DECISION & ORDER

MAINE FARMERS EXCHANGE,

Plaintiffs,

v.

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KENNETH S. DELYSER, SR.,

Defendant.

BACKGROUND

On March 28, 2001, Kenneth S. Delyser, Sr. (the "Debtor") filed a petition initiating a Chapter 7 case. On the Schedules and Statements required to be filed by Section 521 and Rule 1007, the Debtor indicated that: (1) he was the former president of FS&B Farms, Inc. (the "Farm"); (2) he was currently unemployed; (3) his total unsecured, non-priority indebtedness was \$250,609.19, which represented claims held by vendors; and (4) Maine Farmers Exchange ("Maine Farmers") was a vendor with an unsecured, nonpriority claim in the amount of \$17,127.15.

On July 25, 2002, Maine Farmers filed an Adversary Proceeding objecting to the discharge of its claim. The Complaint of Maine

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Farmers alleged that: (1) between April 14, 2000 and April 26, 2000, it sold seed potatoes¹ to the Farm; (2) these sales were sales of perishable agricultural commodities in interstate commerce; (3) under the agreements between Maine Farmers and the Farm, payment for each shipment was due within ten days after acceptance of the seed potatoes, and if payment was not made after demand, Maine Farmers was entitled to receive interest on all accounts thirty days past due at a monthly periodic rate of one and one-half percent, as well as all collection costs, including attorney's fees; (4) at all times in question, the Debtor was the Chief Executive Officer of the Farm who exercised or had the power to exercise control over all of its business activities and financial affairs; (5) in accordance with the trust provisions of the Perishable Agricultural Commodities Act of 1930, as amended ("PACA"), until full payment was received by Maine Farmers, a trust was established (the "PACA Trust") for its benefit, which extended to the seed potatoes, all inventories of food or other products derived from the seed potatoes and all receivables and proceeds from the sale of the seed potatoes or products;² (6) the invoices

¹ Seed potatoes are nothing more than small potatoes, which themselves can be cooked and eaten, but when planted by potato farmers, sprout out and grow into numerous potatoes.

² PACA Section 499e(c) provides in part that:

(2) Perishable agricultural commodities received by a commission merchant, dealer, or broker in all

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for the sales contained the statement permitted by PACA Section 499e(c)(4);³ (7) the Debtor, as an officer, director and controlling individual of the Farm, was a fiduciary with respect to the PACA Trust; (8) there was an unpaid balance due to Maine Farmers of \$12,575.82 plus interest from May 24, 2002; (9) the Farm and the Debtor failed to retain from the sale of the seed potatoes or their products, including the Farm's potato crop, sufficient funds to pay the amounts due to Maine Farmers, in violation of PACA, which constituted a breach of fiduciary duty that made the

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....

7 U.S.C. § 499 (2002).

³ PACA Section 499e(c)(4) provides in part that:

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. § 499 (2002).

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obligations due to Maine Farmers nondischargeable pursuant to Section 523(a)(4).⁴

On August 2, 2002, the Debtor filed a motion to dismiss (the "Motion to Dismiss") which alleged that: (1) the Complaint failed to allege that either the Farm or the Debtor was a commission merchant, dealer or broker within the meaning and intent of PACA; (2) neither the Farm nor the Debtor was a dealer within the meaning and intent of PACA because: (a) neither was acting as an intermediary; (b) neither was regularly engaged in the business of buying and selling perishable agricultural commodities; (c) neither fell under the definition of a dealer as set forth in the Department of Agricultural's administrative regulations; and (d) a finding that the Farm or the Debtor was a dealer⁵ within the

⁴ Section 523(a)(4) provides that:

(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.

11 U.S.C. § 523 (2002).

⁵ PACA Section 499a(6) provides that:

(6) the term "dealer" means any person engaged in the business of buying or selling in wholesale or jobbing quantities, as defined by the Secretary, any perishable agricultural commodity in interstate or foreign commerce, except that (A) no producer shall be considered as a "dealer" in respect to sales of any such commodity of his own raising; (B) no person buying any such commodity solely for sale at retail shall be considered as a "dealer" until the invoice cost of his purchases of perishable agricultural commodities in any

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meaning and intent of PACA would not implement the underlying purpose of the statute, which was to prevent a burden on commerce because intermediary buyers of perishable commodities were granting security interests on the commodities that in many cases were preventing growers and suppliers from getting paid; (3) court decisions holding that restaurants are dealers within the meaning and intent of PACA are distinguishable from the Farm that purchased seed potatoes in order to plant a potato crop; (4) exceptions to discharge should be narrowly construed so that an honest individual like the Debtor can obtain a fresh start; and (5) PACA is not a strict liability statute, and there was no allegation in the Complaint that there had been any actual defalcation by the Farm or the Debtor.

On August 16, 2002, Maine Farmers filed a Memorandum of Law in opposition to the Motion to Dismiss which asserted that: (1) each of the purchases by the Farm from Maine Farmers were in wholesale

calendar year are in excess of \$230,000; and (C) no person buying any commodity other than potatoes for canning and/or processing within the State where grown shall be considered a "dealer" whether or not the canned or processed product is to be shipped in interstate or foreign commerce, unless such product is frozen or packed in ice, or consists of cherries in brine, within the meaning of paragraph (4) of this section. Any person not considered as a "dealer" under clauses (A), (B), and (C) may elect to secure a license under the provisions of section 3 [7 USCS § 499c], and in such case and while the license is in effect such person shall be considered as a "dealer".

7 USCS § 499a (2002).

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or jobbing quantities as defined by the Secretary of Agriculture; (2) a non consumer purchaser of perishable agricultural commodities in wholesale or jobbing quantities can be a dealer even if the purchase of those commodities is not the primary business of the purchaser;⁶ (3) in order to be a dealer within the meaning and intent of PACA an entity must buy or sell, not buy and sell, perishable agricultural commodities in wholesale or jobbing quantities; (4) neither the Farm nor the Debtor fell under any of the specific dealer exceptions set forth in PACA, including the small retailers exception and the farmer exception, which only applied to the sale of the crops grown by the farmer; (5) contrary to the Debtor's assertion, the main purpose of the PACA statute is to assure that the suppliers of produce do not go unpaid; (6) courts have consistently held that a PACA trustee's failure to make payment out of the trust assets is a defalcation while acting in a fiduciary capacity under Section 523(a)(4).⁷

On August 15, 2002, Maine Farmers filed a Motion for Summary Judgment which alleged that: (1) it was owed \$12,575.82 plus interest from May 24, 2002 at the rate of one and one-half percent (1½%) per month for its sale of perishable agricultural commodities

⁶ See *Royal Foods Co. vs. RJH Holdings, Inc.*, 252 F.3d 1102, 1107 (9th. Cir. 2001) and *In re Magic Restaurants, Inc.*, 205 F.3d 108 (3rd. Cir. 2000), cert denied 531 U.S. 818 (2000).

⁷ See *In re Stout*, 123 B.R. 412, 415 (Bankr. N.D.Ok. 1990).

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to the Farm; (2) the Farm was a dealer within the meaning and intent of PACA Section 499e(c); (3) as the chief executive officer of the Farm, the Debtor was a fiduciary of the statutory trust created under PACA, which extended to the proceeds of the sale of the seed potatoes sold to the Farm and any products derived from the seed potatoes; and (4) the Debtor breached his fiduciary duty under PACA by failing to maintain sufficient assets from the sale of the seed potatoes and any products derived therefrom, including the Farm's potato crop, or to pay otherwise the amounts owed to Maine Farmers, which is a nondischargeable obligation under Section 523(a)(4).

On September 9, 2002, the Debtor filed a Response to the Motion for Summary Judgment which asserted that the Farm was not a dealer because it only purchased seed potatoes in a few transactions in wholesale or jobbing quantities at the beginning of each crop year for planting, not as a regular, frequent and persistent course of conduct.

In a September 10, 2002 affidavit, the Debtor indicated that: (1) his financial problems were the result of three consecutive poor yielding crop years; and (2) Maine Farmers showed less than good faith when, contrary to PACA's requirements, it extended months of credit for numerous years to the Farm, while it secretly

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intended to vigorously enforce its rights and claims under PACA in the event that it did not receive payment.

In a September 13, 2002 letter submission, the attorneys for Maine Farmers asserted that a PACA trust beneficiary does not lose its rights if it fails to strictly enforce its written payment terms, citing as a leading case, *In re Lombardo Food and Produce Co.*, 12 F.3d 806 (8th Cir. 1993).

In an October 11, 2002 letter submission, the attorney for the Debtor reiterated the Debtor's argument that the Farm was not a dealer because it was not engaged in the business of buying or selling commodities, since it only purchased two loads of perishable agricultural commodities annually for planting its potato crop.

DISCUSSION

I. Summary Judgment

Fed.R.Civ.P. 56, incorporated by reference in Fed.R.Bankr.P. 7056, "provides that summary judgment shall be granted when there is no genuine issue as to any material fact and the moving party is entitled, as a matter of law, to a judgment in its favor." *In re Bennett Funding Group, Inc.*, 220 B.R. 743 (Bankr. N.D.N.Y. 1997), citing *Federal Deposit Ins. Corp. v. Bernstein*, 944 F.2d 101, 106

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(2d Cir. 1991). The moving party has the initial burden of demonstrating that there is no genuine issue of material fact for trial. *In re Corcoran*, 246 B.R. 152, 158 (Bankr. E.D.N.Y. 2000), citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 106 S.Ct. 1348 (1986). Once the moving party has met its initial burden, "the non-movant must then come forward with sufficient evidence on the elements essential to its case to support a verdict in its favor." *Corcoran*, 246 B.R. at 158, citing *Celotex Corp. v. Catrett*, 106 S.Ct. 2548 (1986).

In deciding to grant or deny summary judgment, "the trial court must resolve all ambiguities and draw inferences in favor of the party against whom summary judgment is sought." *Bennett Funding Group, Inc.*, 220 B.R. at 751, citing *LaFond v. General Physics Servs. Corp.*, 50 F.3d 165, 171 (2d Cir. 1995); *Corcoran*, 246 B.R. at 156, citing *Reyes v. Delta Dallas Alpha Corp.*, 199 F.3d 626, 627-28 (2d Cir. 1999). Summary judgment is therefore inappropriate if any evidence exists in the record upon which a reasonable inference may be drawn in favor of the non-moving party. *Id.*, citing *Chambers v. TRM Copy Ctrs. Corp.*, 43 F.3d 29, 37 (2d Cir. 1994).

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II. Motion to Dismiss

This Court, in considering motions to dismiss under Rule 7012 for a failure to state a claim upon which relief can be granted, is aware that: (1) the purpose of such a motion is to test the legal sufficiency of a complaint; (2) the court should view the complaint in a light that accepts the truth of all material factual allegations and draw all reasonable inferences in favor of the plaintiff; (3) the complaint need only meet the liberal requirement of a short and plain statement of the claim that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests; and (4) nevertheless, the complaint should be well pleaded and it must contain more than mere conclusory statements that a plaintiff has a valid claim of some type and is thus deserving of relief, See In re Johns Insulation, Inc., 221 B.R. 683, 687 (Bankr. E.D.N.Y. 1998) and the cases cited therein.

The Court is also aware that: (1) a motion to dismiss pursuant to Rule 7012 may not be granted unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief; and (2) the Bankruptcy Court is not entitled to consider matters outside the pleadings or to weigh evidence that might be presented at trial. See In Re Albion Disposal, Inc., 217 B.R. 394, 401 (W.D.N.Y. 1997).

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III. PACA

The parties in their well-written and thorough submissions have each made persuasive arguments for the applicability or inapplicability of PACA to the transactions in question.

For the following reasons, the Court finds that: (1) PACA and its statutory trust provisions apply to the Farm's purchase of seed potatoes from Maine Farmers; (2) the Farm breached its fiduciary duty under PACA when it failed to pay Maine Farmers from the proceeds of the sale of its potato crop, which was derived from the seed potatoes; (3) the Debtor, as a principal and chief operating and financial officer of the Farm, was a trustee of the PACA Trust, and he breached his fiduciary duty when he failed to pay Maine Farmers from the proceeds of the sale of the Farm's potato crop; and (4) the Debtor's obligation as a trustee of the PACA Trust for the repayment of the principal amount due to Maine Farmers is nondischargeable pursuant to Section 523(a)(4):

- A. The parties do not dispute that: (i) the seed potatoes purchased by the Farm from Maine Farmers were perishable agricultural commodities; (ii) the Farm purchased those perishable agricultural commodities in interstate commerce in wholesale quantities, as defined by the Secretary of Agriculture; (iii) the PACA Trust provisions could only apply to the Farm and the Debtor if the Farm

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was a dealer for purposes of PACA; (iv) the Farm was a commercial enterprise which engaged in business for a profit; (v) the Farm did not pay Maine Farmers from the proceeds of its potato crop which was derived from the seed potatoes; (vi) there is a principal balance due Maine Farmers of \$12,575.82; and (vii) the Maine Farmers' invoices sent to the Farm included the PACA coverage language permitted by Section 499e(c)(4);

- B. It does not have to be its sole or even principal business for an entity to be engaged in the business of buying perishable agricultural commodities within the meaning and intent of PACA Section 499e(c) (See *Royal Foods Co. vs. RJH Holdings, Inc. at page 5*);
- C. The components of the business operation of the Farm were to plant, grow, harvest and sell potatoes. Buying seed potatoes in wholesale quantities in order to plant its crop was an annual and integral component of the Farm's business, which is sufficient, on all of the particular facts, circumstances and evidence presented, to find that the Farm is a dealer under PACA;
- D. Finding the Farm to be a dealer within the meaning and intent of PACA, so that the grower, Maine Farmers, is protected by a PACA Trust, is not an absurd result under

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the statute, which is meant to and does protect growers like Maine Farmers;

- E. Even though such regulations are not binding when interpreting an unambiguous controlling statute, under the regulations of the Secretary of Agriculture, a dealer includes a grower who sells the crops of other growers. This indicates that farmers are not always excepted from the coverage of PACA;
- F. The invoices sent by Maine Farmers to the Farm, even though they may have only been its standard invoices, clearly indicated and notified the Farm and the Debtor that Maine Farmers believed that the transactions in question were covered by PACA, even though the Farm was a farmer that would use the commodities purchased to plant its crop. There is no evidence presented by the Debtor that he objected to this notice or the position of Maine Farmers that PACA applied;
- G. Given: (i) the PACA Notice on its invoice; and (ii) the lack of evidence of a written agreement for different payment terms, the failure to insist upon strict compliance with the payment provisions of its invoices was not a waiver by Maine Farmers of its rights under PACA, See *In re Lombardo Food and Produce*, at page 7; and

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H. Although there is no evidence in the record to indicate that the Farm had ever sold in crops in a manner to make it a beneficiary and protected grower under PACA,⁸ it is reasonable to assume that the Debtor, as a farmer and seller of perishable agricultural commodities, was familiar with PACA and its trust provisions.

IV. Prejudgment Interest and Attorney's Fees

Although Maine Farmers has: (1) asserted that it had agreements with the Farm that provided that if the Farm failed to pay the amounts due within thirty days of a demand, it would be responsible for interest at one and one-half percent per month and all collection costs, including attorney's fees; and (2) included as exhibits to its Complaint invoices with those provisions, Maine Farmers has not produced a writing signed by the Farm agreeing to those terms, whether in the form of a signed purchase order, master purchasing agreement or otherwise.

In the absence of a written agreement, the attorney's fees and collection costs requested by Maine Farmers are not recoverable, and prejudgment interest, even if awarded by the Court in its

⁸ There is no evidence in the record as to how the Farm sold its crop each year.

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discretion, would not be required to be at a rate of one and one-half percent per month as set forth on its invoices.⁹

Since it is possible that Maine Farmers could produce evidence of a course of conduct or the ratification of the terms set forth on its invoices which might entitle it to recover collection costs and interest at one and one-half percent per month, the Court will not grant either the Motion to Dismiss or the Motion for Summary Judgment on the issue of attorney's fees and prejudgment interest.

With regard to attorney's fees and prejudgment interest, this Court does not agree with the decisions of several other courts which have decided that collection costs, including attorney's fees and prejudgment interest, must be awarded under PACA Section 499e(c) as sums owing in connection with the PACA covered transactions.¹⁰

V. Overview

Article 3A of the New York State Lien Law ("Article 3A") provides a statutory trust for laborers and materialmen who improve real property. Numerous states have similar statutes to protect this often favored class of creditors. Contractors who improve real property are very familiar with the provisions of Article 3A,

⁹ The Court might, for example, award prejudgment interest at the federal judgment rate of interest.

¹⁰ See *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F.Supp. 590 (S.D.N.Y. 1995).

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even though they may not always honor its requirements when they are a trustee for the benefit of subcontractors, laborers or materialmen, while at all times being trustees for their own workmen, on some jobs those contractors are trustees of the trust, and on other jobs are they the beneficiaries of the trust. Nevertheless, at all times they are familiar with the protections and benefits of Article 3A.

In the transactions between Maine Farmers and the Farm, the Debtor, as a potato grower, was eligible for the protections and benefits of PACA, which he could enjoy depending upon how he sold his crop. As in the case of the contractors of real property, there is no doubt that the Debtor knew: (1) about PACA and its protections and obligations; and (2) the seed potatoes the Farm purchased in wholesale quantities were the kinds of perishable agricultural commodities that were protected by PACA. Given the invoices received from Maine Farmers which contained the PACA notice, it should not have been a surprise to the Debtor when Maine Farmers sought to enforce its PACA rights against him as a trustee. Despite those notices, the Debtor made a conscious decision not to use the proceeds of the Farm's potato crop to first pay Maine Farmers.

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CONCLUSION

The Motion for Summary Judgment of Maine Farmers is granted to the extent that the principal balance owed to it in the amount of \$12,575.82 is found to be a nondischargeable obligation of the Debtor under Section 523(a)(4). This matter will be set down for a pretrial conference and further proceedings in connection with the issues of collection costs and prejudgment interest.

The Debtor's Motion to Dismiss is in all respects denied.

IT IS SO ORDERED.

HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE

Dated: November 26, 2002