

In the United States Bankruptcy Court

for the Northern District of Iowa

RICKI DARLE ENGELBY
MARY ANN ENGELBY

Bankruptcy No. 99-01581-C

Debtor(s).

Chapter 7

INTRA AMERICA SEED SERVICES, INC.
Plaintiff(s)

Adversary No. 99-9144-C

vs.

RICKI DARLE ENGELBY
Defendant(s)

ORDER RE PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This matter came before the undersigned on February 25, 2000 on Plaintiff's Motion for Summary Judgment. Plaintiff was represented by Attorney Philip E. Koenig. Debtor-Defendant was represented by Attorney Thomas G. McCuskey. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

STATEMENT OF THE CASE

Plaintiff IntraAmerica Seed Services, Inc. filed a Complaint for Damages and to Determine Dischargeability of Debt on August 26, 1999. Plaintiff claims that Debtor Ricki Darle Engelby violated a fiduciary duty when he failed to pay for 550 bushels of seed corn in a transaction between the parties. According to Plaintiff, this fiduciary duty arises by operation of the Perishable Agricultural Commodities Act (PACA), 7 U.S.C. §§ 499a-499t. Plaintiff now moves for summary judgment pursuant to Rule 7056 and 11 U.S.C. § 523(a)(4).

FINDINGS OF FACT

Plaintiff sold Debtor a total of 550 bushels of seed corn in two transactions in April 1994. One sale was for 300 units and the other for 250 units. Each unit equals approximately one bushel, or 50 pounds. Debtor was then doing business as Agra Seeds, Inc. He was the sole shareholder, officer, and board member. Agra Seeds employed some clerical workers, but control over business decisions and finances remained with Debtor alone.

Debtor sold Plaintiff's seed corn to a business in Nebraska at a profit. He made arrangements for the corn to be shipped directly to this third party; Debtor never took possession of the corn. Neither Debtor nor Agra Seeds paid Plaintiff for the corn, which had a fair market value of \$16,610.

Plaintiff claims that Debtor holds these proceeds in trust for its benefit by operation of 7 U.S.C. § 499e(c)(2) of the Perishable Agricultural Commodities Act (PACA). Debtor counters that PACA does not apply in this case.

MOTION FOR SUMMARY JUDGMENT

The standard for granting summary judgment under Rule 7056 requires that there be "no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." In considering a motion for summary judgment, the Court must view the facts in the light most favorable to the party opposing the motion, giving that party the benefit of all reasonable inferences which can be drawn from the record. United States v. One 1989 Jeep Wagoneer, 976 F.2d 1172, 1176 (8th Cir. 1992).

NONDISCHARGEABILITY UNDER 11 U.S.C. § 523(a)(4)

In order for Plaintiff to prevail on a Motion for Summary Judgment under 11 U.S.C. § 523(a)(4), it must establish two elements: (1) that Debtor owed Plaintiff a fiduciary duty; and (2) that a defalcation occurred. In re Kondora, 194 B.R. 202, 208 (Bankr. N.D. Iowa 1996). The existence of a fiduciary duty within the meaning of § 523(a)(4) is a question of federal law. In re Cochrane, 124 F.3d 978, 984 (8th Cir. 1997). Whether a defalcation occurred is a question of fact determined by an objective standard. Kondora, 194 B.R. at 208.

The term "fiduciary" in § 523(a)(4) refers only to trustees of express or technical trusts. In re Long, 774 F.2d 875, 878 (8th Cir. 1985). This interpretation accords with the principle that exceptions to discharge must be narrowly construed. Id. at 879. The term "defalcation" is given a broader construction and can include "the innocent default of a fiduciary who fails to account fully for money received." Cochrane, 124 F.3d at 984. Defalcation does not necessarily involve misconduct. In re Smith, 72 B.R. 61, 63 (Bankr. N.D. Iowa 1987).

FIDUCIARY DUTY UNDER THE PERISHABLE AGRICULTURAL COMMODITIES ACT (PACA)

PACA was designed to protect small farmers and growers from unscrupulous buyers and brokers in the perishable commodities industry. In re Lombardo Fruit and Produce Co., 12 F.3d 110, 112 (8th Cir. 1993). Before PACA, buyers could wrongfully reject a shipment of perishable commodities by claiming some defect upon delivery. See Joseph Martinelli & Co., Inc. v. Simon Siegel Co., 176 F.2d 98, 100 (1st Cir. 1949). The sellers would often sustain a loss due to the perishable nature of their product and the distances between the parties. See Id. In order to prevent such situations, PACA imposes a fiduciary duty upon buyers and brokers to hold a supplier's commodities or the proceeds therefrom in trust until the supplier is paid. This trust is created by 7 U.S.C. § 499e(c)(2), which provides:

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. Payment shall not be considered to have been made if the supplier, seller, or agent

receives a payment instrument which is dishonored. The provisions of this subsection shall not apply to transactions between a cooperative association, as defined in section 1141j(a) of Title 12, and its members.

This trust arises automatically upon delivery of the commodity. Hull Co. v. Hauser's Foods, Inc., 924 F.2d 777, 782 (8th Cir. 1991).

In order to demonstrate the existence of a fiduciary duty under PACA, Plaintiff must prove three things. First, the goods in question must be perishable agricultural commodities. Second, the commodities must have been received by a commission merchant, dealer, or broker. Third, the claimant must have provided written notice of its intent to preserve its rights under a PACA trust within thirty days of the date payment became due. See In re Long John Silvers Restaurants, Inc., 230 B.R. 29, 32 (Bankr. D. Del. 1999); In re L. Natural Foods Corp., 199 B.R. 882, 885 (Bankr. E.D. Pa. 1996).

SEED CORN AS A "PERISHABLE AGRICULTURAL COMMODITY"

Only entities who deal or negotiate in perishable agricultural commodities are covered by PACA. See 7 U.S.C. § 499a(b)(5)-(7). The phrase is defined in § 499a(b)(4):

(4) The term "perishable agricultural commodity" -

(A) Means any of the following, whether or not frozen or packed in ice:
Fresh fruits and fresh vegetables of every kind and character; and

(B) Includes cherries in brine as defined by the secretary in accordance with trade usages.

Anticipating the confusion that might result from such broad language, the Secretary of Agriculture promulgated regulations further defining "fresh fruits" and "fresh vegetables." The regulatory definition provides:

Fresh fruits and fresh vegetables include all produce in fresh form generally considered as perishable fruits and vegetables, whether or not packed in ice or held in common or cold storage, but do not include those perishable fruits and vegetables which have been manufactured into articles of food of a different kind or character. The effects of the following operations shall not be considered as changing a commodity into a food of a different kind or character: Water or steam blanching, chopping, color adding, curing, cutting, dicing, drying for the removal or surface moisture; fumigating, gassing, heating for insect control, ripening and coloring; removal of seeds, pits, stems, calyx, husk, pods, rind, skin, peel, etcetera; polishing, precooling, refrigerating, shredding, slicing, trimming, washing with or without chemicals; waxing, adding of sugar or other sweetening agents; adding ascorbic acid or other agents used to retard oxidation; mixing of several kinds of sliced, chopped, or diced fruits or vegetables for packaging in any type of containers; or comparable methods of preparation.

7 C.F.R. § 46.2(u). These definitions suggest that PACA covers only those commodities that are in their natural form, or that are subject to a minor change in form that does not alter the fruit or vegetable's essential nature. Endico Potatoes, Inc. v. CIT Group/Factoring, Inc., 67 F.3d 1063, 1070 (2d Cir. 1995).

Measures aimed at temporarily preserving the fruit or vegetable do not alter its essential nature. Id. Freezing or adding a preservative will not necessarily remove a commodity from the orbit of PACA. Id.; A&J Produce Corp. v. CIT Group/Factoring, Inc., 829 F.Supp. 651, 658 (S.D.N.Y. 1993). When determining whether particular vegetables are perishable agricultural commodities, a bankruptcy court's task is to determine whether the vegetables in question are of a different character or kind than they were before any processing or treatment. Long John Silver's Restaurants, Inc., 230 B.R. at 33.

This determination requires careful examination of the processes used in preserving or otherwise altering a batch of fresh commodities. In Long John Silver's Restaurants, Inc., 230 B.R. at 33-34, the bankruptcy court examined the entire process used in making french fries to determine whether it altered a potato's "essential character" so as to remove the product from the shelter of PACA. In L. Natural Foods Corp., 199 B.R. at 886-889, the court conducted a careful inquiry into the nature and effect of the process used to make plums into prunes, ultimately concluding that the dehydration process changed the essential nature of the fruit.

The record in this case provides very little insight into the process used to change ear corn into seed corn. In an Affidavit in Support of Motion for Summary Judgment, Plaintiff asserts that some drying, treatment, and packaging occurs when producing seed corn. Specifically, the corn is treated with fungicide and insecticide, making it unfit for consumption. The intensity of these processes is not described, nor is the change in the nature of the corn fully explored.

The facts currently available suggest that seed corn is not a perishable agricultural commodity under PACA. Debtor's affidavit states that seed corn, when stored properly, can last for months or even years. It is not immediately apparent that a commodity of such durability is "perishable" under PACA. The fact that seed corn has been treated to a point where it is unfit for consumption suggests that its natural, edible state has been significantly altered. While seed corn, like a loaf of bread, may perish under the wrong conditions, this alone does not bring it within the definition of "perishable agricultural commodity" under 7 U.S.C. § 499a(b)(4) and 7 C.F.R. § 46.2(u).

In sum, the current record is insufficient to make a conclusion regarding the status of seed corn as a perishable agricultural commodity under PACA. A detailed exploration of the process and effects of producing seed corn from regular corn is required. In order to make an adequate determination, further evidence is necessary. Under the present record, a grant of summary judgment to Plaintiff is inappropriate.

DEBTOR AS "COMMISSION MERCHANT," "DEALER," OR "BROKER"

Debtor argues in his Affidavit and in his Memorandum of Authority that he is not a commission merchant, broker, or dealer as defined in 7 U.S.C. § 499a(b)(5)-(7) and that he is not subject to the provisions of PACA. Debtor points to the fact that neither he nor Agra Seeds has ever been licensed as a perishable commodities dealer under PACA. He also states that no regulators from the Department of Agriculture have inspected Debtor's business operations.

The fact that Debtor has never been visited by USDA officials or obtained a license under PACA does not mean that its provisions do not apply. PACA applies to commodity merchants, brokers, and dealers in perishable agricultural commodities, whether or not they are licensed. Consolidated Citrus Co. v. Goldstein, 214 F.Supp. 823, 827 (E.D. Pa. 1963). A commission merchant, broker, or dealer who fails to obtain a license may be fined. 7 U.S.C. § 499c(a). Section 499h(d) demonstrates that PACA applies to the unlicensed: "any commission merchant, dealer, or broker who engages in or operates such business without a valid and effective license. . . shall be liable. . . for an injunction to

restrain such defendant from further continuing so to engage in or operate such business." 7 U.S.C. § 499h(d).

Obtaining a license under PACA is not a condition precedent to the creation and enforcement of a PACA trust. See Consolidated Citrus Co., 214 F.Supp. at 827. Section 499e(c)(2), which creates the trust, makes no mention of licensing. The trust applies to a person who is a "commission merchant, dealer, or broker." 7 U.S.C. § 499e(c)(2). This construction accords with the remedial purposes of PACA, which was designed to regulate the entire perishable commodities industry. Consolidated Citrus Co., 214 F.Supp. at 827.

Under PACA, the term "dealer" is defined as "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," subject to three exceptions. 7 U.S.C. § 499a(b)(6). Those persons selling commodities of their own raising, those selling commodities solely at retail, and those buying commodities for canning are not "dealers." Id.

Corporations such as Agra Seeds, Inc. can be dealers under PACA. 7 U.S.C. § 499a(b)(1), (4). Of course, they must be dealing in "wholesale or jobbing quantities" of "perishable agricultural commodities" in interstate commerce. The USDA defines "wholesale or jobbing quantities" as 2,000 pounds or more of all types of produce in any day shipped, received, or contracted to be shipped or received. 7 C.F.R. § 46.2(x). Assuming, without deciding, that seed corn is a perishable commodity, Agra Seeds qualifies as a "dealer" under PACA since it bought approximately 15,000 pounds of seed corn from a company in Illinois and sold it to a company in Nebraska. None of the three exceptions to being a dealer under PACA applies.

Again, the definition of "dealer" turns on a finding that seed corn is a "perishable agricultural commodity." For the reasons previously discussed, no such finding can be made at this time. Assuming, without deciding, that Agra Seeds was a dealer under PACA, the question of whether this label can be imputed to Debtor remains. In order for Debtor to be held personally liable for his corporation's debt to Plaintiff, Plaintiff must prove that the circumstances warrant piercing the corporate veil of Agra Seeds, Inc.

Whether to pierce the corporate veil is a determination made with reference to state law. Stoebner v. Lingenfelter, 115 F.3d 576, 579 (8th Cir. 1997). Under Iowa law, a corporation is an entity separate and distinct from its shareholders. Northwestern Nat'l Bank v. Metro Center, Inc., 303 N.W.2d 395, 398 (Iowa 1981). This separation may only be disregarded "under exceptional circumstances, for example, where the corporation is a mere shell, serving no legitimate business purpose, and used primarily as an intermediary to perpetuate fraud or promote injustice." Briggs Transportation Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805, 810 (Iowa 1978).

There is nothing in this record to support a finding that Debtor established Agra Seeds for a fraudulent purpose. Nor has Plaintiff established that Agra Seeds was undercapitalized, without finances separate from Debtor's personal funds, or without separate books. While it is undisputed that Agra Seeds failed to pay Plaintiff, no evidence exists to suggest that this failure to pay was fraudulent. A genuine issue of material fact exists regarding Debtor's personal liability for Agra Seed's corporate debt.

In sum, Debtor's status as "dealer" is contingent on two findings: (1) whether or not seed corn is a perishable agricultural commodity; and (2) whether the Court can pierce the corporate veil of Agra Seeds, Inc. Plaintiff has failed to establish that no genuine issue of fact exists regarding either of these elements, rendering summary judgment inappropriate.

WRITTEN NOTICE OF INTENT TO CLAIM PACA TRUST

The PACA trust elevates the unpaid seller to a priority position above that of all the buyer's secured creditors. Lombardo Fruit and Produce Co., 12 F.3d at 112. However, the unpaid seller loses the protection provided by the trust unless it gives written notice to both the buyer and the Secretary of Agriculture that it wishes to preserve the benefits of the trust. 7 U.S.C. § 499e(c)(3). This notice must be provided within 30 days of one of three specified events. Id. Those events are:

(i) after expiration of the time prescribed by which payment must be made, as set forth in regulations issued by the Secretary, (ii) after expiration of such other time by which payment must be made, as the parties have expressly agreed to in writing before entering the transaction, or (iii) after the time the supplier, seller, or agent has received notice that the payment instrument promptly presented for payment has been dishonored.

Id. The time period described in (i) is 10 days after the produce is accepted by the buyer. 7 C.F.R. § 46.2(aa)(5). The time period described in (ii) may not exceed 30 days. Id. at § 46.46(f)(2). If the parties have agreed to extend the time for payment beyond 10 days, such agreement must be reduced to writing before the transaction occurs in order to be effective. Lombardo Fruit and Produce Co., 12 F.3d at 113. If the parties have agreed to extend the time for payment beyond 30 days, such an agreement amounts to a waiver of PACA trust benefits. See Hull Co., 924 F.2d at 781.

The record before the Court contains no allegations that Plaintiff complied with these notice requirements. Debtor maintains in his Memorandum of Authority and Response to Motion for Summary Judgment that he never received notice of Plaintiff's intent to preserve benefits under a PACA trust. Failure to comply with the notice provisions of § 499e(c)(3) results in a loss of benefits under the trust. Id. at 112; Hull Co., 924 F.2d at 782; L. Natural Foods Corp., 199 B.R. at 885. At the very minimum, Plaintiff must provide a good faith allegation that these notice requirements have been met before any benefit in a PACA trust can be claimed.

DEFALCATION IN A FIDUCIARY CAPACITY

Because Plaintiff has not established the existence of a fiduciary relationship between itself and Debtor, it is unnecessary to determine whether any defalcation occurred. Defalcation cannot occur without the prerequisite finding of a fiduciary relationship. In re Madsen, Adv. No. 98-9003-W, slip. op. at 18 (Bankr. N.D. Iowa July 21, 1998).

SUMMARY AND CONCLUSION

In order to prevail on a claim of nondischargeability under 11 U.S.C. § 523(a)(4), Plaintiff must prove that Debtor owed it a fiduciary duty and that a defalcation in the performance of that duty occurred. Because these issues arise upon Plaintiff's Motion for Summary Judgment, the Court must be satisfied that no genuine issue of material fact exists regarding the proof of either element.

In its attempt to prove the existence of a fiduciary duty, Plaintiff proceeds under the theory that a PACA trust exists between itself and Debtor. In order to prove the existence of the trust and the right to claim its benefits, Plaintiff must prove (1) that seed corn is a "perishable agricultural commodity"; (2) that Debtor is a "commission merchant, dealer, or broker"; and (3) that Plaintiff timely perfected its interest in the trust. Plaintiff has failed to establish that no genuine issue of material fact exists regarding any one of these elements.

The evidence presented so far is insufficient to satisfactorily determine whether seed corn is a perishable agricultural commodity. Genuine issues of fact exist regarding the processing of seed corn as well as its nature relative to freshly harvested field corn. Plaintiff has also failed to prove that the circumstances warrant piercing the corporate veil of Agra Seeds, Inc. Whether Debtor is a "dealer" under PACA cannot be determined until these issues are resolved. At this point, it is unclear whether PACA applies to Debtor at all.

Even if Plaintiff had proven the first two elements of its fiduciary duty theory, its failure to include an allegation that it perfected its interests in the PACA trust is fatal. Unless Plaintiff actually gave the notice required by 7 U.S.C. § 499e(c)(3), it can enjoy no right to trust benefits. Plaintiff will be given a brief period of time to amend its complaint to allege that it complied with PACA's notice requirements. In doing so, however, it must also assert that it is doing so in good faith and that it has a factual basis for doing so.

WHEREFORE, genuine issues of material fact remain regarding the existence of a fiduciary duty under 7 U.S.C. § 499e(c)(2) and 11 U.S.C. § 523(a)(4).

FURTHER, Plaintiff's Motion for Summary Judgment is DENIED.

FURTHER, Plaintiff will be granted leave to amend its Complaint until March 27, 2000, provided it can allege a good faith basis to support its assertion that the notice requirement of 7 U.S.C. § 499e(c)(3) has been met. If no such allegation is timely made, Defendant is granted permission to file a Motion for Summary Judgment challenging Plaintiff's claim.

SO ORDERED this 14th day of March, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge