



Signed July 07, 2006.

Ronald B. King

Ronald B. King
 United States Bankruptcy Judge

**IN THE UNITED STATES BANKRUPTCY COURT
 FOR THE WESTERN DISTRICT OF TEXAS
 SAN ANTONIO DIVISION**

IN RE:

**MIKE J. HERMES, JR. AND
 ERIN A. HERMES,**

DEBTORS

CASE NO. 03-51055-RBK

CHAPTER 7

**SUN PACIFIC MARKETING
 COOPERATIVE, INC.**

VS.

ADVERSARY NO. 03-5085-RBK

**MIKE J. HERMES, JR. AND
 ERIN A. HERMES**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This adversary proceeding was filed to declare an unpaid debt for the sale of produce nondischargeable. The Court previously issued an Opinion (Court document #42) ruling the debt to be nondischargeable as to Mike J. Hermes, Jr. and denying all relief as to Erin A. Hermes. A subsequent appeal of the former ruling resulted in remand. *In re Hermes*, 2005 WL 1593441 (W.D.

Tex. July 7, 2005). On remand, the Court hereby makes the following Findings of Fact and Conclusions of Law pursuant to FED. R. BANK. P. 7052 and 9014:

FINDINGS OF FACT

1. Sun Pacific Marketing Cooperative, Inc. (“Sun Pacific”) is a seller of agricultural products, including produce.

2. Mike J. Hermes (“Hermes”) was president, secretary, and treasurer of Farm to Market Produce, Inc. (“FMI”).

3. Together with his wife, Erin A. Hermes, Hermes owned fifty percent of FMI.

4. Between June 22, 2002 and July 7, 2002, Sun Pacific sold perishable agricultural commodities to FMI. Sun Pacific delivered these commodities to FMI, and FMI accepted delivery. FMI subsequently resold these commodities.

5. Sun Pacific sent invoices to FMI for the commodities it sold, each of which bore the following language referencing the Perishable Agricultural Commodities Act (“PACA”):

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.

6. Sun Pacific’s invoices were received by the office of Sol Schwartz, a public accounting firm, on behalf of FMI.

7. Hermes saw Sun Pacific’s invoices and acknowledged that they contained PACA language.

8. Hermes stated that FMI did not have cash on hand to pay Sun Pacific when their invoices became due.

9. Hermes stated that Sun Pacific was never advised that their payment was contingent upon FMI receiving payment from its Mexican produce customer.

10. Despite receiving Sun Pacific's invoices, FMI never paid for the produce.

11. On February 24, 2003, Hermes and his wife filed for Chapter 7 bankruptcy in Case Number 03-51055.

12. On May 16, 2003, Sun Pacific initiated this adversary proceeding with a Complaint to Determine Dischargeability against Hermes in the amount of \$109,663.87, asserting that its sale of tomatoes to FMI gave rise to a PACA trust and that Hermes should be held liable for defalcation while acting in a fiduciary capacity.¹

CONCLUSIONS OF LAW

1. This Court has jurisdiction and venue of this proceeding pursuant to 28 U.S.C. §§ 157(a) and 1334 and the Standing Orders of Reference of the District Court. This matter is a core proceeding. 28 U.S.C. § 157(b)(2)(B).

2. Venue is proper in this Court under 28 U.S.C. §§ 1408 and 1409.

3. PACA creates a trust consisting of the perishable commodities or the proceeds of those commodities for the benefit of the unpaid seller. 7 U.S.C. § 499e(c)(2). The trust *res* consists of the produce delivered to the buyer, products made from that produce, and the proceeds from the sale of such produce. *Red's Market v. Cape Canaveral Cruise Line, Inc.*, 181 F.Supp.2d 1339,

¹Sun Pacific also asserted this claim against Hermes's wife, Erin Hermes. This Court's November 22, 2004 Opinion denied all relief against Mrs. Hermes who was not an FMI officer or director and had no knowledge of FMI's business affairs.

1343 (M.D. Fla. 2002). A PACA trust is a floating trust which attaches to the buyer's entire produce inventory and its proceeds. *In re Fresh Approach, Inc.*, 51 B.R. 412, 422 (Bankr. N.D. Tex. 1985).

The buyer bears the burden of showing which, if any, of these assets are not a part of the trust *res*.

Id.

4. A seller's interest in a PACA trust must be properly perfected or it will be lost. 7 U.S.C. § 499e(c)(3). A seller may use ordinary and usual billing or invoice statements to provide notice to the buyer of its intent to preserve PACA trust benefits. 7 U.S.C. § 499e(3)(4). The Court concludes that the notice Sun Pacific included in each of its invoices to FMI met this requirement, perfecting its interest in the produce and creating a PACA trust for its benefit. FMI became the trustee of that PACA trust.

5. A PACA trustee must maintain "trust assets in a manner that such assets are freely available to satisfy outstanding obligations" to sellers of produce. 7 C.F.R. § 46.46(d)(1). "Any act or omission inconsistent with this responsibility, including dissipation of trust assets, is unlawful" and violates PACA. *Id.* "Dissipation" is defined as "any act or failure to act which could result in the diversion of trust assets or which could prejudice or impair the ability of unpaid suppliers, sellers, or agents to recover money owed in connection with produce transactions." 7 C.F.R. § 46.46(a)(2). Relinquishing control over agricultural commodities without securing payment for those commodities is a dissipation of trust assets regardless of any attempt by the buyer to collect payment of that produce. *Bronia v. Ho*, 873 F.Supp. 854, 861 (S.D.N.Y. 1995). The Court concludes that FMI's resale of the Sun Pacific produce to a Mexican buyer without properly securing payment therefore amounted to a dissipation of Sun Pacific's PACA assets. The fact that FMI never received payment from its buyer in the subsequent resale of Sun Pacific's deliveries is immaterial.

6. Waiver of PACA protection only occurs by a written agreement to extend payment. The Court finds that any communications from Sun Pacific to FMI requesting payment for past due amounts were merely evidence of Sun Pacific's attempts to collect the debt and concludes that this did not constitute any form of waiver.

7. Where the trustee of a PACA trust is a corporation with insufficient assets to cover liability for a breach of its fiduciary responsibilities, its fiduciary responsibility and attendant personal liability can be extended to a person who is in a position to control the PACA trust assets and who has breached the fiduciary duty to preserve those assets. *Golman-Hayden Co., Inc. v. Fresh Source Produce Inc.*, 217 F.3d 348, 350 (5th Cir. 2000), citing *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 283 (9th Cir. 1997). The Court concludes that FMI did not have sufficient assets to pay Sun Pacific. The Court further concludes that, by virtue of his ownership stake and his authority as president, secretary, and treasurer, Hermes was in a position to control Sun Pacific's PACA trust assets.

8. In pertinent part, 11 U.S.C. § 523(a)(4) states:

(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—

(4) for fraud or defalcation while acting in a fiduciary capacity . . .

11 U.S.C. § 523(a)(4) (2005).

9. Fiduciary capacity under § 523(a)(4) only applies to technical, express, or statutory trusts. *Tom Lange Co. v. Stout (In re Stout)*, 123 B.R. 412, 414 (Bankr. W.D. Okla. 1990). PACA trusts are statutory trusts in that they have an identifiable *res*, they impose fiduciary duties on the buyer, and they arise without any wrongdoing by the trustee. *N.P. Deoudes, Inc. v. Snyder (In re*

Snyder), 184 B.R. 473, 475 (D. Md. 1995); *see also Stout*, 123 B.R. at 415. The Court concludes that fiduciary responsibility under a PACA trust is subject to § 523(a)(4).

10. With respect to possible defalcation under § 523(a)(4), the Fifth Circuit requires a finding of willful neglect or recklessness with regard to a fiduciary duty. *In re Schwager*, 121 F.3d 171, 185 (5th Cir. 1997); *In re Wang*, 247 B.R. 211, 218 (Bankr. E.D. Tex. 2000). Willfulness is an objective measure of what a reasonable person in the debtor's position knew or reasonably should have known. *In re Felt*, 255 F.3d 220, 226 (5th Cir. 2001), *citing Roy v. Gravel*, 143 B.R. 825, 828 (W.D. La. 1992), *aff'd*, 983 F.2d 1062 (5th Cir. 1993). The objective standard charges the debtor with knowledge of the law without regard to an analysis of his actual intent or motive. *Id.*

11. Hermes saw Sun Pacific's invoices and acknowledged their PACA notice statements. Hermes was aware that FMI did not have the means to pay Sun Pacific when their invoices became due. Hermes never advised Sun Pacific that their payment would be contingent upon FMI's receipt of payment from their Mexican customer. This Court finds that Hermes had actual knowledge of FMI's obligation to Sun Pacific and that this obligation was subject to PACA. Thus, the Court concludes that Hermes willfully neglected his responsibility to Sun Pacific and that Hermes's actions amount to defalcation while acting in a fiduciary capacity pursuant to § 523(a)(4).

12. Any Finding of Fact which should more appropriately be characterized as a Conclusion of Law shall be considered a Conclusion of Law herein. Similarly, any Conclusion of Law which should more appropriately be characterized as a Finding of Fact shall be considered as a Finding of Fact herein.

An order will be entered contemporaneously herewith.

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