

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION**

IN RE: SALVADORE HERRERA, Debtor

No. 5:15-bk-70926

Ch. 7

LIBERTY FRUIT COMPANY, INC.

PLAINTIFF

v.

5:15-ap-7060

SALVADORE HERRERA

DEFENDANT

ORDER

The plaintiff, Liberty Fruit Company, Inc. [Liberty Fruit] filed its complaint to determine the dischargeability of a debt on June 17, 2015, and the debtor answered the complaint on July 14, 2015. In its complaint, Liberty Fruit alleges that the debtor was engaged in the business of buying and selling wholesale quantities of perishable agricultural commodities and was subject to the Perishable Agricultural Commodities Act [PACA], 7 U.S.C.

§ 499(a) - 499(q). Liberty Fruit alleges that it became a beneficiary of the PACA trust when the debtor failed to pay for produce the debtor received from Liberty Fruit. Because it had not been paid, Liberty Food filed a complaint in the United States District Court for the District of Kansas alleging that the debtor had defaulted on its obligations under PACA by failing to preserve trust assets to pay for the produce the debtor received. The debtor failed to respond to the federal district court lawsuit and a default judgment was entered in favor of Liberty Food. The debtor subsequently filed his bankruptcy case in this Court on April 8, 2015. Liberty Fruit timely filed its complaint objecting to the discharge of its debt pursuant to 11 U.S.C. § 523(a)(4).

Presently before the Court is the *Plaintiff's Motion For Summary Judgment* that was filed by Liberty Fruit on September 29, 2015. Included with the motion were a brief in support of the motion and a *Statement of Undisputed Facts in Support of Plaintiff's Motion For Summary Judgment*. Although the parties requested a continuance of the trial of Liberty Fruit's complaint, they did not request an extension of time to respond to the motion for

summary judgment. This Court's General Order No. 37 allows a non-moving party 28 days to respond to a motion for summary judgment and file a "separate and concise statement of the material facts as to which it contends a genuine dispute exists to be tried." Material facts set forth by the moving party that are not controverted by the non-moving party shall be deemed admitted and "any facts alleged to be undisputed in the moving party's motion and supporting affidavits may be taken as true." Because more than 28 days have passed and the debtor did not respond to the motion or statement of undisputed facts, the Court finds that the motion for summary judgment is ripe for determination and that the relevant facts set forth by Liberty Fruit in its statement of undisputed facts are deemed admitted and taken as true.

Jurisdiction

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

Summary Judgment

Federal Rule of Bankruptcy Procedure 7056 provides that Federal Rule of Civil Procedure 56 applies in adversary proceedings. Rule 56 states that summary judgment shall be rendered "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(a). The burden is on the moving party to establish the absence of a genuine issue of material fact and that it is entitled to judgment as a matter of law. *Canal Ins. Co. v. ML & S Trucking, Inc.*, No. 2:10-CV-02041, 2011 WL 2666824, at *1 (W.D. Ark. July 6, 2011) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87, (1986); *Nat'l Bank of Commerce of El Dorado, Ark. v. Dow Chem. Co.*, 165 F.3d 602 (8th Cir.1999)); *see also Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986) (citing to former Fed. R. Civ. P. 56(c)). The burden then shifts to the non-moving party who must show "that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot

produce admissible evidence to support the fact.” Fed. R. Civ. P. 56(c)(1)(B). If the non-moving party fails to address the movant’s assertion of fact, the court may consider the fact undisputed. Fed. R. Civ. P. 56(e)(2).

When ruling on a summary judgment motion, the Court must view the facts in the light most favorable to the non-moving party and allow that party the benefit of all reasonable inferences to be drawn from the evidence. *Canada v. Union Electric Co.*, 135 F.3d 1211, 1212-13 (8th Cir. 1997); *Ferguson v. Cape Girardeau Cty.*, 88 F.3d 647, 650 (8th Cir. 1996).

Preclusive Effect of Default Judgment

As a preliminary matter, the Court wants to address the preclusive effect of a default judgment in this court when the judgment was obtained in another federal court. Liberty Fruit alleges in its complaint that the United States District Court for the District of Kansas has entered a default judgment against Salvadore Herrera and others for failure to retain PACA trust assets and make payment to Liberty Fruit as required under the PACA statutes. As such, Liberty Fruit argues that the default judgment is entitled to preclusive effect in this Court and that the debtor’s “adjudicated failure to abide by his fiduciary obligations under PACA . . . amounts to a defalcation of the PACA Trust assets.” [Doc. 1 Complaint ¶¶ 28, 29] In his answer, the debtor admits he failed to appear in the Kansas lawsuit and that a default judgment was entered against him. However, he also states that “no issues were tried whatsoever in the Kansas City lawsuit and that the default judgment obtained in that suit is not entitled to preclusive effect in this matter.” [Doc. 5 Answer ¶ 8]

The debtor is correct. The doctrine of collateral estoppel precludes a court from conducting further proceedings on issues that have been litigated and ruled upon previously. *Fischer v. Scarborough (In re Scarborough)*, 171 F.3d 638, 641 (8th Cir. 1999). However, if the issue before the court was not actually litigated in the prior federal court action, the doctrine of collateral estoppel is not applicable. The general federal rule concerning default judgments that were obtained in *federal court* follows the Restatement (Second) of Judgments:

“[o]rdinarily a default judgment will not support the application of collateral estoppel because ‘[i]n the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated.’” *In re Bush*, 62 F.3d 1319, 1323 (11th Cir. 1995) (quoting Restatement (Second) of Judgments § 27 cmt. e (1982)); *see also In re Gottheiner*, 703 F.2d 1136, 1140 (9th Cir. 1983).¹ The federal rule pertaining to federal default judgments differs from state default judgments. In determining whether a *state court* judgment is entitled to preclusive effect, the court must look to the substantive law of the forum state in applying collateral estoppel. *In re Scarborough*, 171 F.3d at 641. Had the Kansas City lawsuit been tried in state court, the result may be different.² Because the default judgment was entered in federal court without the issues being actually litigated, the Court finds that Liberty Fruit’s default judgment is not entitled to preclusive effect in this Court.

Statement of Undisputed Facts

As stated earlier, Liberty Fruit filed its statement of undisputed facts to which the debtor did not respond. Without regarding the statements that relate specifically to the district court complaint and that court’s judgment against the debtor, the Court deems the following statements by Liberty Fruit true and admits them for the purpose of Liberty Fruit’s motion for summary judgment:

¹ Collateral estoppel consists of four elements: “(1) the issue sought to be precluded is identical to the issue previously decided; (2) the prior action resulted in a final adjudication on the merits; (3) the party sought to be estopped was either a party or in privity with a party to the prior action; and (4) the party sought to be estopped was given a full and fair opportunity to be heard on the issue in the prior action.” *Canady v. Allstate Ins. Co.*, 282 F.3d 1005, 1016 (8th Cir. 2002) (quoting *Wellons, Inc. v. T.E. Ibberson Co.*, 869 F.2d 1166, 1168 (8th Cir.1989)). The Court is only concerned about the fourth element in this instance: whether the debtor was given a full and fair opportunity to be heard in the prior action.

² Under Kansas law, the state in which Liberty Fruit is located, the judgment may have a preclusive effect because a party may not collaterally attack a default judgment. *Banister v. Carnes*, 675 P.2d 906 (Kan. Ct. App. 1983). However, under Missouri law, the state in which Liberty Fruit was incorporated, a default judgment has no preclusive effect because it is not a judgment on the merits. *Bi-State Dev. Agency v. Whelan Sec. Co.*, 679 S.W.2d 332 (Mo. Co. App. 1984).

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2. Plaintiff Liberty Fruit Company, Inc. is a Missouri corporation with its principal place of business located at 1247 Argentine Boulevard, Kansas City, Kansas 66105.

3. Plaintiff is engaged in the business of buying and selling wholesale quantities of perishable agricultural commodities (hereafter "Produce") in interstate commerce and was at all times pertinent hereto a dealer subject to and licensed under the provisions of the Perishable Agricultural Commodities Act, 1930, 7 U.S.C.A. § 499a-499(q) (hereafter "PACA").

4. Plaintiff is a creditor, supplier and seller of Produce, as those terms are defined in PACA and within the meaning of 7 U.S.C. § 499e(c).

5. Defendant Salvadore Herrera was an officer and director of Jalisco Foods, Inc. (hereafter "Jalisco"), an Arkansas corporation that was a dealer and commission merchant buying Produce as a licensed dealer under and subject to PACA.

6. Defendant Herrera controlled or was in a position to control the day to day operations of Jalisco, and at all times pertinent herein was a person in control of and responsibly connected to Jalisco and the PACA assets within the meaning of 7 U.S.C. § 499a(b)(9).

7. Plaintiff sold and delivered Produce in interstate commerce to Jalisco and Defendant from July 6, 2010 through February 3, 2011.

8. The Produce was sold on credit, and despite demand, Jalisco and Defendant failed to pay Plaintiff a total of \$23,542.30 for Produce received by Jalisco and Defendant.

9. As a result of the delivery of Produce to Jalisco and Defendant, Plaintiff became a beneficiary of the PACA trust in the amount of \$23,542.30 pursuant to 7 U.S.C. § 499e(c).

10. The PACA trust consisted of all of the Produce or Produce-related assets of Jalisco, including all funds commingled with funds from other sources and all assets procured by such funds, in the possession of Jalisco since the creation of the PACA trust.

11. Plaintiff gave written notice of its intent to preserve the trust benefits through each of its invoices in the manner required by law.

12. Despite notice and demand, Jalisco and Defendant failed to pay Plaintiff as required by PACA.

13. Jalisco's failure, refusal and inability to pay Plaintiff indicated dissipation of trust assets and failure to maintain sufficient assets in the statutory trust.

...

20. As evidenced by Plaintiff's Proof of claim as Claim No. 2 in Case No. 5:15-bk-70926, as the date of the order for relief therein, there was due and owing to Plaintiff the amount of \$66,508.61 with interest continuing to accrue thereafter.³

Section 523(a)(4)

Section 523(a)(4) states that a discharge does not operate against any debt incurred as a result of "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Only the "defalcation in a fiduciary capacity" portion of § 523(a)(4) is applicable in the current adversary proceeding.⁴ Hence, Liberty Fruit must prove by a preponderance of the evidence that (1) a fiduciary relationship existed between Liberty Fruit and the debtor and (2) the debtor committed defalcation in the course of that fiduciary relationship. *See Jafarpour v. Shahrokhi (In re Shahrokhi)*, 266 B.R. 702, 707 (B.A.P. 8th Cir 2001) (citing numerous cases).

The determination of a fiduciary relationship under § 523(a)(4) is a question of federal law, not state law. *In re Cochran*, 124 F.3d at 984. The federal law relating to § 523(a)(4) is clear and well established: "[t]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." *Id.* (quoting *Lewis v. Scott*, 97 F.3d 1182, 1185 (9th Cir. 1996)); *see also Barclays Am./Bus. Credit, Inc. v. Long (In re Long)*, 774 F.2d 875, 878 (8th Cir. 1985)

³ Although the parties' material fact acknowledges a debt of \$66,508.61, they do not identify who specifically owes the debt.

⁴ Liberty Fruit did not allege either embezzlement or larceny in its complaint.

(citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934)). A technical trust is a trust imposed by statute or common law. *Reshetar Sys. Inc. v. Thompson (In re Thompson)*, 458 B.R. 504, 509 (B.A.P. 8th Cir. 2011). With regard to PACA, a fiduciary relationship arises under a technical trust that is imposed by the PACA statutes. Specifically,

[p]erishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, *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. § 499e(c)(2) (emphasis added).

The parties' statement of undisputed facts establishes the fiduciary relationship that arises under PACA between Liberty Fruit and the debtor. Liberty Fruit was "at all times pertinent hereto a dealer subject to and licensed under the provisions of the Perishable Agricultural Commodities Act, 1930, 7 U.S.C.A. § 499a-499(q)" and a "creditor, supplier and seller of Produce, as those terms are defined in PACA and within the meaning of 7 U.S.C. § 499e(c)." The debtor was "an officer and director of Jalisco Foods, Inc. (hereafter "Jalisco"), an Arkansas corporation that was a dealer and commission merchant buying Produce as a licensed dealer under and subject to PACA." And, finally, the debtor "controlled or was in a position to control the day to day operations of Jalisco, and at all times pertinent herein was a person in control of and responsibly connected to Jalisco and the PACA assets within the meaning of 7 U.S.C. § 499a(b)(9)." Because Liberty Foods "gave written notice of its intent to preserve the trust benefits through each of its invoices in the manner required by law," when the debtor failed to pay Liberty Foods a total of \$23,542.30 for produce that was received by the debtor and Jalisco Foods, Inc., Liberty Food "became a beneficiary of the PACA trust in the amount of \$23,542.30 pursuant to 7 U.S.C. § 499e(c)."

Having satisfied the first required element—that a fiduciary relationship existed between

Liberty Fruit and the debtor—the Court will address the second element—that the debtor committed defalcation in the course of that fiduciary relationship. Defalcation is defined as the “misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds.” *Tudor Oaks Ltd. P’ship v. Cochrane (In re Cochrane)*, 124 F.3d 978, 984 (8th Cir. 1997) (quoting *Lewis v. Scott*, 97 F.3d 1182, 1186 (9th Cir. 1996)). Most circuit courts recognize that an individual officer or director of a corporation may be held individually liable for breaching PACA’s fiduciary duties. *Weis-Buy Servs., Inc. v. Paglia*, 411 F.3d 415, 421 (3d Cir. 2005) (citing cases in support from the 5th Cir., 7th Cir. and 9th Cir. Courts of Appeal). Again, according to the parties’ statement of undisputed facts, the debtor “was an officer and director of Jalisco Foods, Inc.” and “at all times pertinent herein was a person in control of and responsibly connected to Jalisco and the PACA assets within the meaning of 7 U.S.C. § 499a(b)(9).” Further, “Jalisco’s failure, refusal and inability to pay Plaintiff indicated dissipation of trust assets and failure to maintain sufficient assets in the statutory trust.” The Court finds that the dissipation of trust assets and failure to maintain sufficient assets in the statutory trust amounts to a defalcation in the course of the debtor’s and Liberty Fruit’s fiduciary relationship.

Having satisfied both elements under § 523(a)(4), the Court grants Liberty Foods motion for summary judgment as a matter of law. To the extent there is a debt based on either Liberty Food’s Proof of Claim in the amount of \$66,508.61, which the parties acknowledge in their statement of undisputed facts, or the debtor’s Schedule F, which recognizes an undisputed claim in the amount of \$40,262.21, that debt is excepted from discharge in the debtor’s bankruptcy case.

IT IS SO ORDERED.

cc: Kyle T. Unser
R. Jeff Conner