Beating the Ostrich Defense:

Silent Partner with Head in the Sand Held Liable in PACA Lawsuit.

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If you are a produce supplier who properly preserved your rights and faced with an insolvent corporate buyer, PACA can help you hold those directing the corporate buyer individually liable. The corporate principals can be reached because they have *personal fiduciary obligations* as trustees of the PACA trust. This is more than just "piercing the corporate veil". A corporation can only act through its principals, and if the corporation acted in breach of the PACA trust, then those in a *position* to control the corporation's actions will be liable. Thus, even a silent partner who was in a position to act can be liable, even if somebody else dissipated the PACA trust assets. The "ostrich defense" is typically insufficient to protect the corporate principals.

A good example of this recently came out of the United States District Court for the Western District of Pennsylvania in the matter of Weis-Buy Services, Inc., et al. v. Ralph Paglia, Jr., et al., 00-121 Erie, (WDPA, March 11, 2004). In Paglia, a 25% partial owner of the corporate buyer, United Fruit and Produce Company ("United Fruit"), claimed he was relegated to minimal involvement and did not order products or disburse corporate funds.[1] Additionally he claimed he did not make payments to himself or anyone else out of PACA trust assets and did nothing to dissipate the trust assets. He based this on his alleged inability to control United Fruit's operation or any trust assets and the dominance of the other owners. All of United Fruit's actions were blamed on the majority owner.

Nevertheless, the Paglia Court found the partial owner liable.[2] The Court followed the legal standard that an individual in a position to control the PACA trust assets has breached a fiduciary duty if he does not preserve the assets for the trust beneficiaries and is personally liable. Courts from coast to coast have followed this standard. [3]

Even if the partial owner's allegations of non-involvement were taken at face value, the Court noted United Fruit had a stamp with the partial owner's signature and used the stamp on company checks in order to make the checks valid, even after the partial owner left his job with United Fruit. The partial owner admitted he never demanded the return of the stamp, thereby allowing his signature to be used on company checks, a requirement for the checks to be honored by United Fruit's bank, which distributed funds to non-produce creditors. Not only did the partial owner get hit with a judgment, he will most likely not be able to get rid of it in a Chapter 7 bankruptcy since, under the Bankruptcy Rules, a judgment based on a defalcation or breach of a fiduciary duty is traditionally not dischargeable.

Clearly, the Court's ruling is a boon for unpaid produce sellers who sell to insolvent buyers. Owners, officers and directors involved in a produce company cannot bury their heads in the sand like an ostrich, ignore financial troubles, blame others and expect to escape liability when their company collapses. Not only does the unpaid supplier have even more incentive to pursue the deadbeat buyer, once the message gets out, the principals controlling a produce company will have a strong incentive to use extra care in maintaining their company's financial integrity. Such an arrangement can only benefit and insure the well being of the whole produce industry.

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1 The director discussed herein is not the title defendant Ralph Paglia, against whom a Default Judgment was previously entered.

2 *** Update *** The Court's ruling was reversed on appeal on other grounds. Specifically, the Plaintiff waited too long to bring suit against the individual defendants.

3 See Golman-Hayden Co, Inc. v. Fresh Source Produce, Inc., 217 F.3d 348, 351 (5th Cir. 2000); Hiller Cranberry Products, Inc. v. Koplovsky, 165 F.3d 1, 8-9 (1st Cir. 1999); Sunkist Growers, Inc. v. Fisher, 104 F.3d 280, 283 (9th Cir. 1997); Shepard v. K.B. Fruit & Vegetable, Inc., 868 F.Supp. 703, 706 (E.D. Pa. 1994); Morris Okun, Inc. v. Harry Zimmerman, Inc., 814 F.Supp. 346, 348 (SDNY, 1993).

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