No. 22-502

In the
Supreme Court of the United States

SPRING VALLEY PRODUCE, INC.,
PRODUCE EXCHANGE CO., INC.,
FRESH DIRECT, INC., AND
S. ROZA & COMPANY, INC.,

Petitioners,

v.

NATHAN AARON FORREST AND
MARSHA WEIDMAN FORREST,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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INTRODUCTION

As explained in the petition, there is a split among appellate courts over the test for assessing a technical trust, and a direct conflict between the Eleventh Circuit's opinion below and numerous district and bankruptcy courts on the specific question of whether claims arising under PACA trusts are non-dischargeable pursuant to Bankruptcy Code (11 U.S.C. § 523(a)(4)). Petition for Certiorari ("Pet.") 11-12 (citing cases).

Respondents deny the existence of a circuit split, focusing on the lack of circuit-level decisions specifically addressing PACA. They attempt to distinguish the other appellate cases addressing when technical trusts are dischargeable, and argue that even the more general decisions do not hold that nonsegregated statutory trusts may never be technical trusts. Brief for the Respondents in Opposition ("Opp.") 12.

But the appellate courts disagree about the requirements of a technical trust. The Sixth and Seventh Circuits, and the Ninth and Tenth Circuit Bankruptcy Appellate Panels ("BAPs"), hold that trust statutes similar in all material respects to PACA establish a technical trust even when the statute permits co-mingling of funds.

Respondents also understate the confusion and division among district courts and bankruptcy courts throughout the country: A wide range of courts hold that PACA trust claims are non-dischargeable under Section 523(a)(4), while other courts agree with the Eleventh Circuit's position in this case. Respondents argue that the conflict will eventually resolve itself, but it has already existed for some three decades.

Finally, Respondents understate the importance of uniformly applying bankruptcy laws throughout the nation. That is especially true when, as here, the Bankruptcy Code provision at issue intersects with another federal law. This Court's review is warranted.

ARGUMENT

I. Appellate Courts Apply Markedly Different Standards to Assess Technical Trusts.

The circuit courts have applied different and conflicting tests to assess whether a trust is non-dischargeable under Section 523(a)(4). Pet. 11-12 (citing cases).

1. Respondents make much of the fact that the Eleventh Circuit said a nonsegregated statutory trust could in some circumstances qualify as a technical trust. But the Eleventh Circuit placed overwhelming weight on that factor, discounting all the other factors traditionally indicating a technical trust.

The court below noted that PACA trusts have many attributes of a technical trust including the duty to maintain accurate records of all PACA covered transactions. Pet. App. 63a-64a. The court further acknowledged that the majority view is that these duties are enough to establish the existence of a technical trust. *Id.* at 64a. But the court observed that segregation of trust funds "has been long-recognized as a requirement for non-PACA commercial cases or for other statutory trusts." *Id.* The segregation of funds, according to the Eleventh Circuit, is nearly a requirement for technical trusts—and in this the Eleventh Circuit parted ways with the Sixth and Seventh Circuits, and Ninth and Tenth Circuit BAPs.

2. Respondents are wrong that this disagreement is over application of the test to various facts, rather than over the test itself. The circuits apply markedly different analyses, and that difference is outcome-determinative.

For instance, the statute at issue in *Stoughton Lumber Co. v. Sveum*, 787 F.3d 1174 (7th Cir. 2015) (Posner, J.) is indistinguishable in all material respects from the PACA statute in this case. In *Stoughton Lumber*, the Seventh Circuit considered a Wisconsin statute that creates a trust for any funds given to a contractor. The statute provides that

> "all moneys paid to any prime contractor or subcontractor by any owner for improvements, constitute a trust fund only in the hands of the prime contractor or subcontractor to the amount of all claims due or to become due or owing from the prime contractor or subcontractor for labor, services, materials, plans, and specifications used for the improvements, until all the claims have been paid."

Id. at 1176 (quoting Wis. Stat. § 779.02(5)). This sets up a parallel structure to the trust established under PACA, which creates a trust for any agricultural goods or proceeds held by merchants. 7 U.S.C. § 499e(c)(2). Like the statute at issue in *Stoughton*, PACA makes it unlawful to use trust assets for non-trust purposes so long as growers are unpaid. 7 U.S.C. § 499b(3), (4).

Like PACA, "[s]egregation of the trust funds was not required either by the statute or … the case law." *Stoughton Lumber*, 787 F.3d at 1176. The debtor was "therefore free to commingle the funds with other

moneys." *Id.* This is directly in line with PACA's status as a non-segregated trust.

Respondents attempt to distinguish *Stoughton Lumber* and most of the other cases cited in the petition by asserting that PACA allows debtors to use trust assets for other purposes, while the other statutes do not. But PACA does not permit a debtor to consume trust assets for non-trust purposes while growers are unpaid. It is "unlawful" to discard, dump, or destroy any produce without reasonable cause, "to fail or refuse truly and correctly to account and make full payment promptly" or "to fail to maintain the trust" in any way. 7 U.S.C. § 499b(3), (4). The buyer who "in any way encumber[s] the funds or *render[s] them less freely available* to PACA creditors" is in breach of the buyer's fiduciary duty as trustee. *Coosemans Specialties, Inc. v. Gargiulo*, 485 F.3d 701, 706 (2d Cir. 2007) (emphasis added; citation omitted).

Even though the Wisconsin statute tracked PACA, the Seventh Circuit ruled opposite to the Eleventh Circuit, holding that a nonsegregated statutory trust qualifies as a technical trust under Section 523(a)(4) and thus is excepted from discharge. Had the matter under appeal been heard by the Seventh Circuit rather than the Eleventh, Petitioners' claim would have been held non-dischargeable.

The statute under consideration by the Sixth Circuit in *Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249 (6th Cir. 1982) likewise mirrors PACA for all essential elements. The statute at issue, Mich. Comp. Laws §§ 570.151-.153, imposes a trust on funds received by a building contractor for the "benefit of the person making the payment, contractors,

laborers, subcontractors or materialmen." *Id.* § 570.151. Similarly, PACA provides that when a merchant receives agricultural commodities, it does so in trust for the benefit of the seller. The Michigan statute, like PACA, does not prescribe any procedure for handling trust funds. Instead, like PACA, it provides a separate legal remedy for violating the trust. *Id.* § 570.152 (providing for imprisonment or fines for violations).

The Michigan statute does not require the segregation of funds received in trust, yet the Sixth Circuit nonetheless held that claims arising under the act are non-dischargeable. *Carlisle*, 691 F.2d at 252-53. As the court explained, "[t]hat the statute does not mandate any particular form or procedures in handling trust funds [does not] undercut[] the validity of the trust…. The fact that the trustee is afforded some measure of discretion in handling trust funds does not defeat the trust under [predecessor to Section 523(a)(4)]." *Id.* Without any segregation requirement, the Sixth Circuit would likely find PACA trust claims non-dischargeable as well.

In *Woodworking Enterprises, Inc. v. Baird (In re Baird)*, 114 B.R. 198 (B.A.P. 9th Cir. 1990), the Ninth Circuit Bankruptcy Appellate Panel considered the non-dischargeability of claims arising under an Arizona statute, Ariz. Rev. Stat. §§ 33-981 to 33-1008. That statute imposes a trust on monies paid to a contractor "as payment for labor, professional services, materials, machinery, fixtures or tools." *Id.* § 33-1005. Like PACA, the Arizona statute does not require the segregation of trust funds, but the *Baird* court still held that claims arising under the statute are non-dischargeable under 11 U.S.C. § 523(a)(4). As

the court reasoned, a technical trust does not require "the fund holder to maintain the separate identity of any trust res, does not require the segregation of funds and does not impose bookkeeping obligations." 114 B.R. at 203. Because *Baird*, as in the Sixth and Seventh Circuits, does not condition the non-dischargeability of trust fund claims on the segregation of trust assets, it too would likely hold the PACA trust fund claims are non-dischargeable.

Lastly, in *Employers Workers' Compensation Ass'n v. Kelley (In re Kelley)*, 215 B.R. 468 (B.A.P. 10th Cir. 1997), the Tenth Circuit Bankruptcy Appellate Panel considered the non-dischargeability of claims arising under an Oklahoma statute, Okla. Stat. tit. 36, §§ 1441-53. That statute provides that insurance premiums received by an administrator for an insurer are held by that administrator in a fiduciary capacity. *Id.* § 1445(A). Although the statute requires that premiums received by an administrator must be promptly deposited into a general fiduciary bank account, the primary trust-like duty under the statute appears to be its bookkeeping requirements, requiring accurate and complete records. *Id.* § 1445(B).

While the Eleventh Circuit recognized Petitioners' position as PACA trustee imposed on them a similar duty to maintain records of PACA trust related transactions and that this duty was trust-like, it nonetheless declined to hold PACA trust claims non-dischargeable in the absence of a segregation requirement. Pet. App. 27a ("SVP is correct that the duty to keep accurate records is a typical trust-like duty."). The differing approaches taken in the Tenth Circuit and by the Eleventh render PACA trust claims dischargeable in the latter court but not the former.

II. The Eleventh Circuit Split from Numerous Decisions in Holding That Claims Arising under PACA Trusts Are Non-Dischargeable.

Respondents argue that resolution of this conflict should be indefinitely deferred for further percolation because the specific application of PACA has yet to be answered by other circuit courts. Opp. 2. But this ignores important and related considerations.

1. First, Respondents are only partially correct that the Eleventh Circuit is the first appellate court to apply Section 523(a)(4) to a PACA trust. As provided in 28 U.S.C. § 158, district courts and BAPs sit as appellate courts in bankruptcy appeals. The Respondents dismiss the opinions of district courts, but those courts sit as courts of appeal, often giving the last word on a matter. And no authority supports Respondents' contention that opinions of BAPs should not be considered when assessing appellate decisions. In 28 U.S.C. § 158(b), Congress created the BAPs as adjuncts of the circuit courts.

While it is true that the Ninth Circuit is not bound by decisions of the BAP, the Ninth Circuit has observed that BAP decisions should be binding on all bankruptcy courts within the circuit; otherwise, the purpose for establishing the panel—to provide a uniform body of bankruptcy law within the circuit—would be frustrated. *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 472 (9th Cir. 1990) ("'In order to achieve this desired uniformity, the decisions of the BAP must be binding on all of the bankruptcy courts from which review may be sought, *i.e.*, each district in the Ninth Circuit.'") (citation omitted). As a result,

the decision in *Baird* that stands in direct conflict with the Eleventh Circuit's decision below is binding on all bankruptcy courts of the Ninth Circuit absent a district court or court of appeals decision to the contrary.

2. More broadly, the conflict at the district court and bankruptcy court level—and now the circuit court level—has persisted without resolution for some thirty years. *See Nuchief Sales, Inc. v. Harper (In re Harper)*, 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993) (holding in 1993 that PACA trusts satisfy the technical trust requirements of Section 523(a)(4)).

For instance, in *N.P. Deoudes, Inc. v. Snyder (In re Snyder)*, 184 B.R. 473, 475 (D. Md. 1995), the Maryland District Court held that PACA trust claims are non-dischargeable under Section 523(a)(4). To establish the existence of a technical trust and a showing of fiduciary capacity, the court articulated the following rule: The " 'statute must define the trust res, spell out the trustee's fiduciary duties and impose a trust prior to and without reference to the wrong which created the debt.' " *Id.* (quoting *Baird*, 114 B.R. at 202). The court concluded that PACA trusts satisfy each of these elements and that segregation of funds is not a necessary element. *Id.*

Absent resolution of the conflict, the potential non-dischargeability of PACA related debts will continue to be decided based on nothing more than accidents of geographic location. Such a state undermines Congress's constitutional mandate to promulgate uniform bankruptcy laws. It is more so true here as the issue at hand implicates two federal statutes.

III. Respondents Ignore the Importance of Establishing a Uniform Federal Rule for the Dischargeability of PACA Trust Debts in Bankruptcy.

Respondents argue that the existence of other remedies available to PACA trust claimants somehow undermines the importance of the uniform application of Section 523(a)(4). Opp. 20-21.

First, Respondents suggest that the priority of PACA trust claims in bankruptcy often results in substantial if not full payment of those claims with small amounts of those claims being subject to potential discharge. Opp. 20. Thus, they imply, Section 523(a)(4) is redundant. But Respondents offer no basis for their opinion that PACA trust claims are typically or largely satisfied in bankruptcy, an opinion that is contradicted by Petitioners' unpaid $261,504.15 claim in this case. Pet. App. 3a.

And even if Respondents were correct on this score, the general need for the uniform application of the Bankruptcy Code would remain. Congress enacted Section 523(a)(4), and it should be enforced uniformly throughout the country.

Second, Respondents suggest that the ability of PACA sellers to obtain district court orders requiring segregation of PACA trust funds and enjoining depletion of those funds alleviates the need for the fiduciary capacity exception. Opp. 20-21. Respondents, however, cite no authority, and can make no persuasive argument, for the proposition that a creditor's pre-petition, non-bankruptcy remedies should limit the scope of available remedies under the Bankruptcy Code. Nor do Respondents explain why the

availability of pre-bankruptcy remedies decreases the importance of uniformity. Moreover, as a practical matter, the initiation of an action seeking segregation and other injunctive relief does not affect a PACA dealer's ability to petition for an order of relief under the Bankruptcy Code. At that point, continuation of the district court PACA action would be immediately stayed. *See* 11 U.S.C. § 362(a)(1).

IV. This Case Is a Good Vehicle for Review.

Respondents make a few brief attempts to suggest this case is not a good vehicle to address the question presented.

First, they point out that the lower courts assumed without deciding that Respondents were personally liable. But personal liability under PACA is a common and well-supported legal principle. As the Second Circuit has explained, "[a]n individual who is in a position to control the assets of the PACA trust and fails to preserve them, may be held personally liable to the trust beneficiaries for breach of fiduciary duty." *Coosemans Specialties*, 485 F.3d at 705-06; *see also, e.g.*, *Patterson Frozen Foods, Inc. v. Crown Foods Int'l, Inc.*, 307 F.3d 666, 669 (7th Cir. 2002) (PACA allows "recovery against both the corporation and its controlling officers"); *Weis-Buy Servs., Inc. v. Paglia*, 411 F.3d 415, 420-21 (3d Cir. 2005). District courts within the Eleventh Circuit routinely observe this rule. *E.g.*, *Gulf Coast Produce, Inc. v. Am. Growers, Inc.*, 2008 WL 660100, at *3 (S.D. Fla. Mar. 7, 2008); *Harvest Food Grp., Inc. v. Newport Int'l of Tierra Verde, Inc.*, 2008 WL 4927006, at *3 (S.D. Fla. Nov. 17, 2008).

Indeed, other than cursorily claiming that personal liability "is far from unassailable" (Opp. 21),

Respondents make no attempt to dispute this assumption. It would be rare for a district court to certify for interlocutory review—and the court of appeals to accept—a decision that turned on an irrelevant question. And, of course, the courts below dismissed Petitioners' claim based on the question presented.

Second, Respondents take issue with two paragraphs in the petition discussing *Begier v. IRS*, 496 U.S. 53 (1990). Opp. 22. That discussion was presented in the context of explaining why the Eleventh Circuit's decision is wrong, and Respondents make no attempt to dispute the analysis. The fact that the Eleventh Circuit's decision is wrong for multiple reasons should make review more compelling, not less.

Finally, Respondents attempt to refocus the question presented to argue that this case is a suboptimal vehicle. The issue raised by the petition is whether a debtor in bankruptcy may discharge liability for unlawfully violating a nonsegregated statutory trust. Pet. i. Respondents attempt to rephrase the question presented as whether a PACA trust allows trust property to be held in a single account rather than separate accounts for each trust beneficiary. This is not Petitioners' position. Rather, Petitioners argue that a statutory trust that permits the comingling of any trust assets with non-trust assets may still be a technical trust so that any claims arising under that trust are non-dischargeable under Section 523(a)(4).

*   *   *

In sum, neither statute at issue here—the PACA trust provisions and the fiduciary capacity exception to discharge under the Bankruptcy Code—is of recent vintage. Though the issue under consideration is

longstanding, it has yet to be resolved. This Court's review is warranted.

CONCLUSION

For the foregoing reasons and those stated in the petition for a writ of certiorari, the petition should be granted.

Respectfully submitted,

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May 2023