NOTES ON

DEBTOR/CREDITOR

RELATIONS

April 2010

Food Fight

Under the Perishable Agricultural Commodities Act ("PACA"), anyone who sells a perishable agricultural product must hold the sale proceeds in trust for payment of the supplier of the product. If the proceeds are used for anything else, everything purchased with the proceeds will become part of the trust. The trust extends to the proceeds of the proceeds *ad infinitum*.

Robinson Farms was a produce distributor that financed its operations through a line of credit with AgriCap. In order to secure the advances made to Robinson Farms, AgriCap perfected a security interest in all of Robinson Farms' inventory and receivables.

After Robinson Farms filed a Chapter 11 case, two of its suppliers sued AgriCap to recover the monies that Robinson Farms had paid to AgriCap from the proceeds of the sale of the produce. The federal appeals court in Richmond sided with the produce suppliers, holding that the trust created by PACA gave the suppliers a claim that was superior to all other creditors, even secured claim creditors.
Nickey Gregory Co. v. AgriCap, LLC, 2010 U.S. App. LEXIS 4587 (4th Cir. Mar. 4, 2010).

Assisting a Fraudulent Transfer

If an insolvent corporation sells its property for less than reasonably equivalent value, the corporation's trustee in a subsequent bankruptcy can reverse the sale, as a constructively fraudulent transfer, and recover the property or its value from the purchaser.

Last year, a trustee attempted to recover under the legal theory of aiding and abetting the transfer from an attorney and a notary that closed a sale. This theory generally allows an injured party to recover from someone who assists the primary wrongdoer.

A New York bankruptcy judge rejected the trustee's claims, explaining that only parties that had come into possession of the property or benefited from the transfer could be liable. Incidental participants, such as attorneys, brokers, lenders, etc., could not be liable as aiders and abettors.
Mendelsohn v. Paragon Mortgage Bankers Corp. (In re Parker), 399 B.R. 577 (Bankr. E.D.N.Y. 2009).

Discharging Tax Debts

Mrs.Ciotti filed federal and Maryland income tax returns timely for 1992 to 1996. In 1998, the IRS made adjustments to those returns which significantly increased the income. Mrs. Ciotti was required to report this adjustment to the Maryland taxing authorities, but did not do so. However, the IRS reported the income to the state, and Maryland assessed an additional $500,000 in taxes, penalties and interest.

In 2007, Mrs. Ciotti filed a Chapter 7 bankruptcy case, seeking to discharge this old tax debt. However, taxes "with respect to which a return, or equivalent report or notice, if required, … was not filed or given" are not discharged. The court determined that the IRS notice to Maryland did not satisfy Mrs. Ciotti's obligation to report the income, preventing the discharge of the Maryland taxes.
Maryland v. Ciotti, 421 B.R. 202 (D. Md. 2009).

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This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.

Prepared by James C. Olson, Attorney and Counselor at Law

One Corporate Center Suite 400 10451 Mill Run Circle Owings Mills, MD 21117 410-356-8852 Fax 410-356-8804 jolson@jamesolsonattorney.com