COMPOSITE EXHIBIT D
BANKRUPTCY COURT CASES

Walls v. Centurion Asset Management, Inc. (In re Bolze), 2009 WL 2232802 (Bankr. E.D. Tenn. 2009).

Not Reported in B.R., 2009 WL 2232802 (Bkrtcy.E.D.Tenn.)
(Cite as: 2009 WL 2232802 (Bkrtcy.E.D.Tenn.))

United States Bankruptcy Court,
E.D. Tennessee.
In re Dennis BOLZE d/b/a Centurion Asset Management d/b/a Advanced Trading Services, Debtor
G. Wayne Walls, Trustee, Plaintiff
v.
Centurion Asset Management, Inc. and Advanced Trading Services, Inc., Defendants.
Bankruptcy No. 09-30075.
Adversary No. 09-3035.

July 23, 2009.

West KeySummary
Bankruptcy 51 2084.10

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51k2084 Transfer and Consolidation of Cases
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A Chapter 7 trustee established that two corporations were the alter-egos of a debtor and that the assets and liabilities of those corporations should be substantively consolidated with those of the debtor. The debtor interchangeably used his name individually on applications and other documents as the owner of assets titled to both corporations and commingled his personal funds with those of the corporations. There was also evidence that the debtor used those commingled funds to pay personal bills and make personal investments and that the debtor used his personal residence as the business address for both corporations and conducted all business from that address.

Bailey & Bailey, PLLC, Robert M. Bailey, Esq., Knoxville, TN, for Plaintiff, G. Wayne Walls, Trustee.

Centurion Asset Management, Inc., Gatlinburg, TN, pro se.

Advanced Trading Services, Inc., Gatlinburg, TN, pro se.

MEMORANDUM ON REQUEST TO ENTER DEFAULT

RICHARD STAIR, JR., Bankruptcy Judge.

***1** This adversary proceeding is before the court on the Complaint for Substantive Consolidation of Non-Debtor Entities (Complaint) filed by the Plaintiff, G. Wayne Walls, Trustee, on March 26, 2009, seeking to substantively consolidate the assets and liabilities of the Defendants, Centurion Asset Management, Inc. and Advanced Trading Services, Inc., with the Chapter 7 bankruptcy estate of the Debtor, Dennis Bolze. The Defendants did not file responsive pleadings or otherwise appear, and on May 7, 2009, the Plaintiff filed a Request to Enter Default (Motion for Default Judgment), which the court set for an evidentiary hearing by an Order entered on May 12, 2009.

The evidentiary hearing on the Motion for Default Judgment was held on July 6, 2009, and, again, neither of the Defendants appeared. The record before the court consists of the testimony of the Plaintiff and thirty-four exhibits introduced into evidence, including declarations executed under penalty of perjury by Michael Tallarico, a senior Futures Trading Investigator with the Commodity Futures Trading Commission, and Michael Potter, a former employee of Nevada Corporate Headquarters, Inc.

Succinctly stated, the Plaintiff's action is grounded upon his contention that the Debtor "was engaged in a Ponzi scheme and was using the [Defendants] as conduit entities to transfer money to himself and to

investors." COMPL. at ¶ 9.

This is a core proceeding. 28 U.S.C. § 157(b)(2)(A), (O) (2006).

I

On November 1, 2001, the Debtor, Dennis Bolze, incorporated Advanced Trading Services, Inc. under the laws of the State of Nevada utilizing the services of a company known as Nevada Corporate Headquarters, Inc., which served as the Incorporator and Registered Agent domiciled in the State of Nevada.[FN1] *See* COLL. EX.. 1. Michael Potter, a former employee of the Incorporator, was listed as a Director, as well as President, Secretary, and Treasurer in the incorporation documents filed with the State of Nevada; however, he was a temporary officer and not involved in the company's business transactions or day-to-day operations.[FN2] *See* COLL. EX.. 1; EX. 9 (POTTER DECL.) at ¶¶ 2, 4. Instead, Advanced Trading Services, Inc.'s business affairs were controlled exclusively by the Debtor, who consistently held himself out as the owner and vice president of the company and was custodian of the stock ledger, as per the Stock Ledger Statement dated November 12, 2001. *See* COLL. EX.. 1; COLL. EX.. 16; COLL. EX.. 17. Advanced Trading Services, Inc. did not operate out of a physical office in Nevada; instead, it was operated by the Debtor from his residences first at 1656 Cardinal Drive, Gatlinburg, Tennessee, and, more recently, at 935 Campbell Lead Road, Gatlinburg, Tennessee (Campbell Lead Road Property). Advanced Trading Services, Inc. did not file any federal tax returns under its tax identification number, nor did it register in any capacity with the Commodity Futures Trading Commission. *See* EX. 4; EX. 6 (TALLARICO DECL.) at ¶ 11.

***2** Similarly, the Debtor incorporated Centurion Asset Management, Inc., also as a Nevada corporation, on February 13, 2003, with Nevada Corporate Headquarters, Inc. as Incorporator and once again listed Mr. Potter as a temporary officer and director even though he was not involved in the business transactions of the company. *See* COLL. EX.. 2; EX. 9 (POTTER DECL.) at ¶¶ 2, 5-6, 12. The Debtor conducted all business affairs of Centurion Asset Management, Inc., which did not have a physical office in Nevada and, as with Advanced Trading Services, Inc., operated solely from the Debtor's residential addresses. Through a Resolution of the Board of Directors on March 21, 2003, executed by Mr. Potter, the Debtor, who held the stock ledger of the corporation, was appointed President, Secretary, Treasurer, and Director of Centurion Asset Management, Inc., and Mr. Potter executed a Resignation of Officers. *See* COLL. EX.. 2. Centurion Asset Management, Inc. did not file any federal tax returns under its tax identification number, nor did it register in any capacity with the Commodity Futures Trading Commission. *See* EX. 4; EX. 6 (TALLARICO DECL.) at ¶ 11.[FN3]

An action was brought in the United States District Court for the Eastern District of Tennessee against the Debtor, Centurion Asset Management, Inc., and Advanced Trading Services, Inc. by the Commodity Futures Trading Commission on March 3, 2009, Civil Action No. 3:09-CV-88, alleging violations of the Commodity Exchange Act, fraud, failure to register as a commodity pool operator, failure to register as an associated person of a commodity pool operator, and for unjust enrichment. *See* EX. 4; EX. 5. In its Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties Under the Commodity Exchange Act, the Commodity Futures Trading Commission sought the following relief: (1) a permanent injunction against the Debtor, Centurion Asset Management, Inc., and Advanced Trading Services, Inc. from further violations of the Commodity Exchange Act and from engaging in any activity related to trading any commodity; (2) a restraining order preventing the defendants from disposing in any way of their books and records; (3) an order granting the Commodity Futures Trading Commission access to the defendants' books and records, ordering an accounting of all accounts associated with the defendants, requiring disgorgement of all benefits received by the defendants, requiring the defendants to pay restitution to the pool participants, and rescinding all contracts between the defendants and any investors; and (4) assessment of civil damages and all costs. *See* EX. 4. The court takes judicial notice, pursuant to Rule 201 of the Federal Rules of Evidence, that a Restraining Order was issued in this action by the district court on March 4, 2009, which was extended for ten days by an Order entered on March 17, 2009. On April 1, 2009, the district court entered an Order of Preliminary Injunction and Other Ancillary Relief Against Centurion Asset Management, Inc. and Advanced Trading Services, Inc. The Preliminary Injunction remains in effect.

***3** The Involuntary Petition commencing the Debtor's Chapter 7 bankruptcy case was filed on January 9, 2009, by Bill Allen, II, Ray Whaley, and Donnie Lay (Petitioning Creditors), and the Order for Relief was entered by default on February 5, 2009. The Plaintiff was appointed trustee pursuant to an Order entered on January 15, 2009, granting the Motion to Appoint Interim Trustee filed by the Petitioning Creditors on January 12, 2009, and has continued to serve in that capacity subsequent to the entry of the Order for Relief. The Trustee filed the Complaint initiating this adversary proceeding on March 26, 2009, seeking an order finding that Centurion Asset Management, Inc. and Advanced Trading Services, Inc. are alter egos and instrumentalities of the Debtor, that any and all assets of those corporations should be considered consolidated with all assets and liabilities of the Debtor in his bankruptcy case, and that the involuntary bankruptcy case commenced on January 9, 2009, and subsequent Order for Relief entered on February 5, 2009, also be considered to have been entered against Centurion Asset Management, Inc. and Advanced Trading Services, Inc. As discussed, the Defendants have not appeared, and on May 7, 2009, the Plaintiff filed the pending Motion for Default Judgment.

II

"Substantive consolidation in bankruptcy is a process by which the assets and liabilities of different entities are consolidated and treated as a single entity. The consolidated assets create a single fund from which all of the claims against the consolidated debtors are satisfied." *Bli Farms v. GreenStone Farm Credit Servs., FCLA (In re Bli Farms)*, 312 B.R. 606, 620 (E.D.Mich.2004). "Substantive consolidation is employed in cases where the interrelationships of the debtors are hopelessly obscured and the time and expenses necessary to attempt to unscramble them is so substantial as to threaten the realization of any net assets for all of the creditors." *First Nat'l Bank v. Raforth (In re Baker & Getty Fin. Servs.)*, 974 F.2d 712, 720 (6th Cir.1992). "It treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors [and non-debtors] morph to claims against the consolidated survivor." *In re Owens Corning*, 419 F.3d 195, 205, 208 n. 13 (3d Cir.2005). Bankruptcy courts have the authority to substantively consolidate assets of a debtor with those of a non-debtor corporation under 11 U.S.C. § 105(a) (2006), to be used sparingly and when equity demands. *Simon v. New Ctr. Hosp. (In re New Ctr. Hosp.)*, 187 B.R. 560, 567 (E.D.Mich.2005).

"Implicit in [the] decision [to substantively consolidate] is the conclusion that the benefit-protection of the possible realization of any recovery for the majority of unsecured creditors-outweighs the potential harm to any particular creditor." *In re Am. HomePatient, Inc.*, 298 B.R. 152, 165-66 (Bankr.M.D.Tenn.2003). In order to substantively consolidate entities, the proponent must demonstrate that "(i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." *Owens Corning*, 419 F.3d at 211. The court's analysis is highly fact-specific, and "[a] determination of whether the corporations in question are alter egos of one another is critical[.]" *New Ctr. Hosp.*, 187 B.R. at 568.

***4** In Tennessee, there is a presumption that corporations are distinct legal entities, wholly separate from their officers, directors, and shareholders. *Schlater v. Haynie*, 833 S.W.2d 919, 925 (Tenn.Ct.App.1991). However, "[i]n an appropriate case and in furtherance of the ends of justice, the separate identity of the corporation may be discarded and the individual or individuals owning all its stock and assets will be treated as identical to the corporation." *VP Bldgs., Inc. v. Polygon Group, Inc.*, 2002 WL 15634, at *4, 2002 Tenn.App. LEXIS 11, at *11 (Tenn.Ct.App. Jan.8, 2002). The corporate veil will be pierced, and the corporate entity will be disregarded upon a showing that the corporation is a "sham" or "dummy" organization, or such action is necessary to accomplish justice. *Muroll Gesellschaft M.B.H. v. Tenn. Tape, Inc.*, 908 S.W.2d 211, 213 (Tenn.Ct.App.1995). This principle is to be applied with "great caution and not precipitately" in light of the assumption of corporate separateness, and the party seeking to pierce the corporate veil bears the burden of proof in order to justify such action, and "usually a combination of factors is present in a particular case and is relied upon to resolve the issue ." *Schlater*, 833 S.W.2d at 925.

These factors include

> (1) whether there was a failure to collect paid in capital; (2) whether the corporation was grossly undercapitalized; (3) the nonissuance of stock certificates; (4) the sole ownership of stock by one individual; (5) the use of the same office or business location; (6) the employment of the same employees or attorneys; (7) the use of the corporation as an instrumentality or business conduit for an individual or another corporation; (8) the diversion of corporate assets by or to a stockholder or other entity to the detriment of creditors, or the manipulation of assets and liabilities in another; (9) the use of the corporation as a subterfuge in illegal transactions; (10) the formation and use of the corporation to transfer to it the existing liability of another person or entity; (11) the failure to maintain arms length relationships among entities.

Fed. Deposit Ins. Corp. v. Allen, 584 F.Supp. 386, 397 (E.D.Tenn.1984) (citations omitted).

The Plaintiff contends and the court agrees that through the following actions, as evidenced by documentation contained in Collective Exhibits 18, 19, 20, 23, 24, 26, 27, and 28, the Debtor operated both Advanced Trading Services, Inc. and Centurion Asset Management, Inc. as his alter-egos by: (1) interchangeably using his name individually on applications and other documents as the owner of assets titled to both corporations; (2) commingling his personal funds with those of the two corporations, using the commingled funds to pay personal bills and make personal investments in Trading Rooms Technologies, Inc., Urban Classic Cabinetry & Design, Inc., Spirit Developers, LLC, and Smoky Mountain Estates Properties, Inc., among others; (3) using his personal residence as the business address for both corporations and conducting all business from that address; (4) using Centurion Asset Management, Inc. as an instrumentality to further his illegal Ponzi scheme; [FN4] and (5) failing to keep separate the business transactions and dealings of both companies with his own and those of Spirit Developers, LLC and Smoky Mountain Estates Properties, Inc.

***5** At trial, the Plaintiff testified that in his investigation, he has been unable to fully separate the assets and liabilities of the Debtor from those of Advanced Trading Services, Inc. and Centurion Asset Management, Inc. The record reflects that these difficulties arise due to the continued overlapping and blending of these companies' financial transactions with the financial transactions of the Debtor, as well as the commingling of monies received from and by both corporations. As proof that the assets of the Debtor, Advanced Trading Services, Inc., and Centurion Asset Management, Inc. have been commingled, the Plaintiff subpoenaed and analyzed bank records from the following three accounts with Bank of America, summarizing the activity in and out of those accounts from January 2007 to January 2009:(1) account ending in 2127 in the name of Advanced Trading Services, Inc. (ATS BOA Account 2127); (2) account ending in 6196 in the name of Advanced Trading Services, Inc. (ATS BOA Account 6196); and (3) account ending in 1687 in the name of Centurion Asset Management, Inc. (CAM BOA Account). COLL. EX. 18; COLL. EX.. 19; COLL. EX.. 20. The Plaintiff additionally received records from BankEast for an account in the name of Advanced Trading Services, Inc. ending in 2726 for October 9, 2008, through December 15, 2008 (ATS BankEast Account). COLL. EX. 21.

As established by the Plaintiff's proof, the bulk of the money paid into the ATS BOA Account 2127 was received through 125 transfers, totaling $4,484,300.00, from the CAM BOA Account, which included funds sent in by investors. COLL. EX. 18. Monies were also transferred into this account from Advanced Trading Services, Inc. as follows: four transfers totaling $5,228.00 from the ATS BOA Account 6196, and ten transfers totaling $1,001,000.00 from other nondescript Advanced Trading Services, Inc. bank accounts. COLL. EX. 18. Additionally, three transfers totaling $158,000.00 were received from personal accounts the Debtor maintained in his name with Tennessee State Bank and First Tennessee Bank, one transfer of $45,000.00 was received from an account with First Tennessee Bank in Kathleen Bolze's name, and ten transfers totaling $279,760.00 held in a Man Financial account located in First Tennessee Bank were credited to the ATS BOA Account 2127. COLL. EX. 18.

The summary of outgoing payments from the commingled funds contained in the ATS BOA Account 2127 establishes that seventy-one transfers, totaling $892,000.00, were made directly to the Debtor and Kathleen Bolze, and an additional 136 transfers, to-

taling $237,764.27, were paid to Greg Kauffman, the Debtor's step-son, and Angela and Valerie Kauffman, the Debtor's step-daughters. COLL. EX. 18. An additional thirty-eight transfers totaling $566,547.37, thirty-three transfers totaling $651,790.00, and one transfer of $100,000.00 were made to Spirit Developers, LLC, Trading Room Technologies, and Urban Classic Cabinetry, respectively, three companies in which the Debtor was investing personally. COLL. EX. 18. Also paid from the ATS BOA Account 2127 were four transfers totaling $68,000.00 to Robert Warren, a Centurion Asset Management, Inc. investor, who had requested his money be returned. COLL. EX. 18.

***6** With respect to the ATS BOA Account 6196, the Plaintiff established that there were fifty-five transfers to this account, totaling $536,314.00, from the ATS BOA Account 2127 and eighteen transfers, totaling $277,500.00, from the CAM BOA Account. COLL. EX. 19. Several credit cards were paid out of this ATS BOA Account 6196, and while the Plaintiff was unable to determine if they were personal or business bank cards, the records indicate the following payments: (1) eighteen payments totaling $35,162.09 to check card ending in 2802; (2) twenty-one payments totaling $27,784.53 were made to a check card ending in 7634; (3) sixteen payments totaling $30,756.46 were made to a check card ending in 5768; and (4) twenty-four payments totaling $39,215.43 to a check card ending in 1771. COLL. EX. 19. Additionally, one transfer of $125,000.00 was made to Smoky Mountain Estates Properties, another company in which the Debtor invested personally,[FN5] and one personal donation in the amount of $25,000.00 was made to the University of Tennessee.[FN6] COLL. EX.. 19. The Plaintiff also testified to his belief that this account funded much of the construction work for the Debtor's Campbell Lead Road Property.

Similarly, with respect to the CAM BOA Account, the Plaintiff established that approximately $8,044,355.00 was received from investors, while an additional $1,820,050.00 was received through thirty-nine transfers from ATS BOA Account 2127, and $231,600.00 was received from eight transfers from the ATS BOA Account 6196. COLL. EX. 20. Out of this account, approximately $6,540,883.00 was paid to investors. The Plaintiff testified that he discovered through his investigation that if there were insufficient funds to cover payments to investors from the CAM BOA Account, funds were then transferred from the two Advanced Trading Services, Inc. accounts. COLL. EX. 20. Additional payments made out of the CAM BOA Account include 124 transfers totaling $4,472,300.00 to ATS BOA Account 2127, eighteen transfers totaling $277,500.00 to ATS BOA Account 6196, and $6,500.00 to an account in the name of Advanced Trading Services, Inc. with Citizens National Bank. COLL. EX. 20. Finally, one payment of $2,388.00 was made to the Debtor personally. COLL. EX. 20.[FN7]

Similarly, the summary for the ATS BankEast Account, which was funded through a loan in the amount of $198,905.00 to Advanced Trading Services, Inc., evidences one transfer to the ATS BOA Account 2127 of $5,000.00 and one transfer to the CAM BOA Account of $10,000.00. COLL. EX. 21. The bulk of the funds paid out of this account, $112,400.00, were paid to Spirit Developers and represented a personal investment of the Debtor, who also received $1,100.00 from this transaction. COLL. EX. 21. The remaining funds, less $3,600.00 to "cash," were paid to contractors for various property investments. COLL. EX. 21.

With respect to the Debtor's personal accounts, Mrs. Bolze, at the Plaintiff's request, provided copies of statements and cancelled checks from January 21, 2005, through November 2008, for the account she and the Debtor maintained at Mountain National Bank, account 3417 (Personal Bank Account), reflecting that Advanced Trading Services, Inc. provided the primary source of incoming deposits during this period, totaling $1,326,900.00 from its accounts at Bank of America. COLL. EX. 23. Additionally, $296,310.62 received from the refinance of real property located at 442 P.A. Proffitt Road, in Gatlinburg, Tennessee (Proffitt Road Property), which was titled in the name of Advanced Trading Services, Inc., was deposited into another personal bank account held by the Debtor and Mrs. Bolze at Tennessee State Bank. COLL. EX. 25. As evidenced by these cumulative records, the funds of Advanced Trading Services, Inc. and Centurion Asset Management, Inc. were routinely commingled, along with funds from the Debtor's and Mrs. Bolze's personal accounts, and the Debtor used funds from both companies to pay personal bills and fund his personal investments.

***7** In addition to the commingling of funds between himself, Advanced Trading Services, Inc., and Centurion Asset Management, Inc., the Debtor consistently failed to distinguish whether assets were owned by him personally or by Advanced Trading Services, Inc. and failed to keep the business entities themselves separate from himself and each other, as established, first, by the fact that the offices for Centurion Asset Management, Inc. and Advanced Trading Services, Inc. were located at the Debtor's residence, the Campbell Lead Road Property, which is also the address for the registered agent for Spirit Developers, LLC. *See* EX. 27. In addition, the Plaintiff established that the Debtor held himself out as the owner of property which was actually owned by one of the corporate entities.

Pursuant to a subpoena, the Plaintiff, in addition to bank account records, also received from BankEast documents which it received from the Debtor during the application process for the loan which funded the ATS BankEast Account and for which the stock of Advanced Trading Services, Inc. was pledged as collateral. *See* COLL. EX.. 22. Included among these documents, as material to the issue before the court, are the following (1) Profit & Loss Statements of Advanced Trading Services, Inc. for 2007 and 2008; (2) prepared but not filed Form 1040 U.S. Individual Income Tax Returns for 2006 and 2007 for the Debtor and Kathleen Bolze; (3) personal financial statements for the Debtor and Mrs. Bolze dated September 2008; and (4) a partnership income return for Spirit Developers, LLC for 2007. COLL. EX. 22. As reflected in the Profit & Loss Statement dated January through December 2007, Advanced Trading Services, Inc. received income in the amount of $246,125.50 from Centurion Asset Management, Inc., and in the Profit & Loss Statement dated January through July 2008, it received income of $77,529.53 from Centurion Asset Management, Inc., although the Plaintiff testified that he was unable to determine what type of income Advanced Trading Services, Inc. ever received from Centurion Asset Management, Inc. since none of the trading was done in the name of Centurion Asset Management, Inc.[FN8] COLL. EX.. 22.

In connection with obtaining the loan from BankEast, the Debtor and Mrs. Bolze also submitted a Personal Financial Statement dated September 10, 2008, disclosing their ownership interest in Advanced Trading Services, Inc., with each listed as owning a 50% interest valued, collectively, at $10,800,000.00. The Debtor did not disclose any interest in Centurion Asset Management, Inc. within this document. COLL. EX. 22. The September 10, 2008 Personal Financial Statement also represents that the Debtor holds 3,870 shares of stock in Mountain National Bank valued at $77,600.00; however, during his investigation, the Plaintiff contacted Mountain National Bank and determined that there were no stock certificates issued in the Debtor's name, although there were 3,619 shares of stock issued in the name of Advanced Trading Company. *See* COLL. EX.. 22; COLL. EX.. 23. This misrepresentation of the stock ownership was also contained in a Personal Financial Statement dated July 5, 2007, submitted to Tennessee State Bank for a loan made to Advanced Trading Services, Inc. in the amount of $150,000.00 for the purchase of the Proffitt Road Property, in which the Debtor represented that he held ownership of 14,000 shares of stock in Mountain National Bank valued at $410,000.00.[FN9] COLL. EX.. 24. Finally, the 2007 federal tax return for Spirit Developers, LLC, likewise submitted in connection with the BankEast loan, indicates on Schedule K-1 that Advanced Trading Services, Inc. was a 60% partner, a statement which is once again inconsistent with the July 5, 2007 Personal Financial Statement listing the Debtor individually as a 50% partner in Spirit Developers, LLC. *Compare* COLL. EX.. 22 *with* COLL. EX.. 24.

***8** The fact that the Debtor's and Defendants' financial and business affairs were interchangeable is also established by the fact that the Debtor obligated Advanced Trading Services, Inc. for liabilities of Centurion Asset Management, Inc., as evidenced by a Secured Promissory Note dated December 15, 2008, in the amount of $472,570.00 to Jerard and Carol Muszik, which is secured by a Deed of Trust pledging the Campbell Lead Road Property and the Proffitt Road Property as collateral.[FN10] EX. 30

The Plaintiff also introduced into the record insurance binders dated July 26, 2007, and March 17, 2008, which were issued by Atchley-Cox-McCrosky Insurance for the Campbell Lead Road Property and incorporated additional liability insurance for the Proffitt Road Property. *See* COLL. EX.. 24. Both of these properties are titled to Advanced Trading Services, Inc., and yet, the insurance policies were to be

issued in the names of the Debtor and Mrs. Bolze, individually. COLL. EX. 24. Similarly, the Debtor completed the Application for Service/Delivery for gas service on the Campbell Lead Road Property with Thompson Gas in his own name rather than that of Advanced Trading Services, Inc. and maintained a contract with ADT Security Services, Inc., in the name Dennis Bolze "dba Centurion Asset Management." EX. 29; EX. 35.

Based upon the evidence, the Plaintiff has established that Advanced Trading Services, Inc. and Centurion Asset Management, Inc. are alter-egos of the Debtor. Moreover, the Plaintiff has proved that the Debtor used both corporations as subterfuges for advancing his Ponzi scheme. The record reflects that the Debtor directed investors to send their investments by either check or wire transfer to the Bank of America account in the name of Centurion Asset Management, Inc. *See, e.g.*, EX. 8 (WHALEY DECL. at EX. 1); EX. 10 (GALYON DECL. at EX. 1); EX. 11 (CASON DECL. at COLL. EX.. 4). There was, however, no trading account established with the Commodity Futures Trading Commission in the name of Centurion Asset Management, Inc., although two trading accounts were established through Man Securities, Inc. in the name of Advanced Trading Service, Inc. by the Debtor, its Vice President. *See* EX. 6 (TALLARICO DECL.) at ¶¶ 5 -6; COLL. EX.. 16; COLL. EX.. 17. In these documents, it was represented by a letter signed on May 15, 2005, by the Debtor and Kathleen Bolze to Man Securities, Inc., that "[a]ll funds deposited in the trading account represent proprietary funds of the Corporation and do not represent the interest of any other individuals or companies, and that the sole business of the Corporation is running trading seminars[,]" and that Advanced Trading Services, Inc. "does not hold itself out as engaging in the business of investing capital contributions from other participants in the security markets." COLL. EX. 17. Nevertheless, monies received by Centurion Asset Management, Inc. were invested in these accounts, and more than $800,000.00 was lost. EX. 6 (TALLARICO DECL.) at ¶¶ 5-6.

***9** Based upon the foregoing, the court has no difficulty in piercing the corporate veil under Tennessee law and additionally finds that the Plaintiff has proved the necessary elements to pierce the corporate veil under Nevada law as well, which similarly provides that "the equitable remedy of 'piercing the corporate veil' may be available to a plaintiff in circumstances where it appears that the corporation is acting as the alter ego of a controlling individual." *LFC Mktg. Group, Inc. v. Loomis*, 116 Nev. 896, 8 P.3d 841, 845 (Nev.2000). "While the classic alter ego situation involves a creditor reaching the personal assets of a controlling individual to satisfy a corporation's debt, the 'reverse' piercing situation involves a creditor reaching the assets of a corporation to satisfy the debt of a corporate insider based on a showing that the corporate entity is really the alter ego of the individual." *Loomis*, 8 P.3d at 846.

> There are three general requirements for application of the alter ego doctrine: (1) the corporation must be influenced and governed by the person asserted to be the alter ego; (2) there must be such unity of interest and ownership that one is inseparable from the other; and (3) the facts must be such that adherence to the corporate fiction of a separate entity would, under the circumstances, sanction fraud or promote injustice. It is not necessary that the plaintiff prove actual fraud. It is enough if the recognition of the two entities as separate would result in an injustice.
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> ....
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> In determining whether a unity of interest exists between the individual and the corporation, courts have looked to factors like co-mingling of funds, undercapitalization, unauthorized diversion of funds, treatment of corporate assets as the individual's own, and failure to observe corporate formalities. These factors may indicate the existence of an alter ego relationship, but are not conclusive. There is no litmus test for determining when the corporate fiction should be disregarded; the result depends on the circumstances of each case.

Polaris Indus. Corp. v. Kaplan, 103 Nev. 598, 747 P.2d 884, 886-87 (Nev.1987) (internal citations omitted).

In summary, the Plaintiff's Motion for Default Judgment shall be granted, and the assets and liabilities of the Defendants, Advanced Trading Services, Inc. and Centurion Asset Management, Inc., shall be substantively consolidated with those of the Debtor, effective January 9, 2009, the date the Involuntary Petition was

filed against Dennis Bolze.

An order consistent with this Memorandum will be entered.

FN1. Under Nevada law, every company registered with the Nevada Secretary of State is required to have a registered agent domiciled within the State of Nevada. Nevada Corporate Headquarters, Inc. provided registered agent service and offered a "nominee service" for the administrative convenience of its customers, which provided for the submission of a temporary nominee's name on the List of Officers and Directors submitted to the Nevada Secretary of State. The nominee would serve for a brief period of time, thirty to forty-five days, to provide the company's shareholders time to select a permanent board of directors, after which the board would select permanent officers of the company. *See* EX. 9 (POTTER DECL.) at ¶¶ 3, 4.

FN2. *See supra* n. 1.

FN3. The Debtor was also involved in the incorporation of Trading Rooms Technologies, Inc., in the State of Nevada on December 30, 2005, once more through Nevada Corporate Headquarters, Inc. *See* COLL. EX.. 3. As with Advanced Trading Services, Inc. and Centurion Asset Management, Inc., the Debtor held himself out as having an ownership interest in Trading Rooms Technologies, Inc. *See, e.g.*, COLL. EX.. 24.

FN4. A Criminal Complaint was issued against the Debtor out of the United States District Court for the Eastern District of Tennessee on March 3, 2009, charging the Debtor with wire fraud and money laundering. *See* EX. 13. The six-page Affidavit of Special Agent Kevin McCord signed by Kevin McCord, a Special Agent with the Criminal Investigations Division of the Internal Revenue Service, also dated March 3, 2009, details the charges against the Debtor giving rise to the issuance of the Criminal Complaint, including investment fraud schemes. EX. 13. The Debtor, who remains in the custody of the United States Marshal, was indicted on July 21, 2009, under counts alleging wire fraud and money laundering.

FN5. As evidenced by the Minutes of Meeting dated November 8, 2006, for Smoky Mountain Estate Properties, Inc., the Debtor was added as a "stockholder and associate" with a twenty-five percent share. COLL. EX. 22. As payment for his "initial investment," the Debtor tendered a check to Smoky Mountain Estate Properties, Inc. in the amount of $50,000.00, which was paid from the ATS BOA Account 2127 on October 27, 2006. COLL. EX. 22.

FN6. The Plaintiff testified that the University of Tennessee has returned $187,000.00 in donations made by the Debtor.

FN7. As testified to by the Plaintiff, it also appears that the Debtor was making payments to Denys Dobbie and his wife, Mary Elizabeth Bryant, for Mr. Dobbie's assistance in locating additional investors. Mr. Dobbie received thirty-seven payments totaling $228,532.24 from ATS BOA Account 2127 and fourteen payments totaling $90,951.00 from the CAM BOA Account, while Ms. Bryant received seventeen payments totaling $30,810.00 and eight payments totaling $19,716.59 from those same accounts, respectively. COLL. EX. 18; COLL. EX.. 20.

FN8. The Plaintiff also testified that both Profit & Loss Statements fraudulently reflect that the Advanced Trading Services, Inc. Trading Accounts produced income of $1,452,853.21 and $1,064,069.70, respectively. *See* COLL. EX.. 22.

FN9. The July 5, 2007 Personal Financial Statement also references that the Debtor held a 50% ownership in Trading Rooms Technologies, which was receiving payment from the ATS BOA Account 2127. *Compare* COLL. EX.. 24 *with* COLL. EX.. 18.

FN10. The Debtor also executed this Secured Promissory Note, making himself per-

sonally liable.

Bkrtcy.E.D.Tenn.,2009.
In re Bolze
Not Reported in B.R., 2009 WL 2232802 (Bkrtcy.E.D.Tenn.)

END OF DOCUMENT

In re Alico Mining, Inc., 278 B.R. 586 (Bankr. M.D. Fla. 2002).

278 B.R. 586, 15 Fla. L. Weekly Fed. B 182
(Cite as: 278 B.R. 586)

C

United States Bankruptcy Court,
M.D. Florida,
Fort Myers Division.
In re ALICO MINING, INC., a Florida Corporation, Debtor.
No. 01-18572-9P1.

Feb. 28, 2002.

Creditor brought motion for substantive consolidation of estates of Chapter 11 corporate debtor and corporate nondebtor. The Bankruptcy Court, Alexander L. Paskay, J., held that court had jurisdiction to substantively consolidate estate of debtor with estate of nondebtor.

Ordered accordingly.

West Headnotes

[1] Bankruptcy 51 2163

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2163 k. Evidence. Most Cited Cases
Excerpts from unidentified depositions, apparently taken in connection with some state court litigations, and other unauthenticated documents, were not acceptable as competent evidence for use in motion hearing.

[2] Bankruptcy 51 2085

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2085 k. Reorganization Cases. Most Cited Cases
Court had jurisdiction to substantively consolidate estate of Chapter 11 corporate debtor with estate of corporate nondebtor. Bankr.Code, 11 U.S.C.A. § 105(a).

[3] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases

Bankruptcy 51 2125

51 Bankruptcy
51II Courts; Proceedings in General
51II(A) In General
51k2124 Power and Authority
51k2125 k. Equitable Powers and Principles. Most Cited Cases
Although the Bankruptcy Code does not specifically authorize consolidation of separate estates, a court may order consolidation by virtue of its general equitable powers. Bankr.Code, 11 U.S.C.A. § 105(a).

[4] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Orders of "substantive consolidation" combine the assets and liabilities of separate and distinct, but related, legal entities into a single pool and treat them as a single entity; this enables a bankruptcy court to disregard separate corporate entities and to pierce their corporate veils in order to reach assets for the satisfaction of debts of a related corporation. Bankr.Code, 11 U.S.C.A. § 105(a).

[5] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General

51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases

Bankruptcy 51 2281

51 Bankruptcy
51III The Case
51III(D) Involuntary Cases
51k2281 k. In General. Most Cited Cases
Substantive consolidation is a remedy entirely independent of, and inconsistent with the involuntary petition remedy, and thus, is an alternative means to bring nondebtor's assets into a debtor's estate. Bankr.Code, 11 U.S.C.A. § 105(a).

[6] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases
Substantive consolidation may be based on a finding that it would be more equitable to all parties to allow consolidation under circumstances of the case, by showing that the affairs of the entities are inextricably intertwined or that creditors dealt with them as a single economic unit; it does not require a finding of fraud or an intent to hinder and delay creditors. Bankr.Code, 11 U.S.C.A. § 105(a).

[7] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases

Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Before ordering consolidation, a bankruptcy court must conduct a searching inquiry to ensure that consolidation yields benefits that would offset the harm it inflicts on objecting parties; moreover, the proponent must show substantial identity between the entities to be consolidated, and that consolidation is necessary to avoid some harm or to realize some benefit. Bankr.Code, 11 U.S.C.A. § 105(a).

[8] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases

Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Once the proponent has made the required prima facie showing that the estates of a debtor and a nondebtor should be consolidated, the burden shifts to the objecting party to show (1) that it has relied on separate credit of one of the entities to be consolidated; and (2) that it will be prejudiced by consolidation. Bankr.Code, 11 U.S.C.A. § 105(a).

[9] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases

278 B.R. 586, 15 Fla. L. Weekly Fed. B 182
(Cite as: 278 B.R. 586)

When considering whether the proponent of a motion seeking substantive consolidation has made the required prima facie showing, the factors to consider are as follows: (1) presence or absence of consolidated financial statements for entities whose estates are to be consolidated; (2) unity of interest and ownership; (3) existence of parent and intercorporate guarantees on loans; (4) degree of difficulty in segregating and ascertaining individual assets and liability; (5) existence of transfers of assets without formal observance of corporate formalities; (6) commingling of assets and business functions; and (7) profitability of consolidation at single physical location. Bankr.Code, 11 U.S.C.A. § 105(a).
***587** James T. Demarest,George Vega, Jr., Naples, FL, for debtor.

Asher Rabinowitz, Tampa, FL, for movant.

Jeffrey S. Kannensohn, Naples, FL, Jeffrey W. Leasure, Ft. Myers, FL, for Alico Investments, Inc.

Nancy G. Farage, Tampa, FL, for Jonbo Corporation.

Louis D. D'Agostino, Naples, FL, for B & D Estero.

ORDER ON MOTION FOR SUBSTANTIVE CONSOLIDATION

ALEXANDER L. PASKAY, Bankruptcy Judge.

This is a Chapter 11 case and the particular matter under consideration is Motion for Substantive Consolidation, filed on December 18, 2001, by Michael J. Volpe (Volpe) as Trustee of the CMM No. 1400 Trust, u/a/d July 18, 2000 (Trust). The unusual aspect of this Motion is that unlike such motions that generally involve an attempt to consolidate the estates of two debtors, in this instance, the Motion seeks a substantive consolidation of the estate of Alico Mining, Inc. (Debtor) with the estate of Florida Earth Mining and Materials, Inc. (Florida Earth), a nondebtor.

In support of the Motion, Volpe contends that the Trust is a secured creditor of the Debtor; that both the Debtor and Florida Earth are controlled and dominated by Robert S. Hardy (Bob Hardy); that the Debtor is merely an alter ego of Florida Earth; and that Bob Hardy determines what to do with the funds generated under an agreement for purchase of mining rights between the Debtor and Florida Earth. The agreement was signed by Bob Hardy, as president of Florida Earth and Paul Hardy, his son, as the president of the Debtor. Volpe further contends that when Volpe requested that Florida Earth sign loan documents between the Trust and the Debtor pursuant to which the Trust had loaned the Debtor the sum of $2,250,000, Bob Hardy admitted that "the relationship between Alico Mining and Florida Earth Mining and materials, which we are operating and consider for our agreements with Trust to be one entity."

[1] The Motion filed by Volpe is accompanied by 26 attachments most of which are excerpts from unidentified depositions apparently taken in connection with some state court litigations and other unauthenticated documents, all of which, of course, are not acceptable as competent evidence in their present form.

In response to the Motion, on February 20, 2002, the Debtor filed its Objection to ***588** Motion for Substantive Consolidation and a shareholder, Marion Hardy, filed her Objection to Motion for Substantive Consolidation on February 19, 2002. In the Objections, the Debtor and shareholder assert that this Court does not have jurisdiction to consider substantive consolidation between a debtor and nondebtor and that the debtor and nondebtor should not be consolidated. The later assertion is not presently before this Court.

[2] At the outset, it is important to point out the precise issue before this Court, which is whether or not a bankruptcy court has jurisdiction to **substantively consolidate** the estate of a debtor with the estate of a **nondebtor**; and not whether the two estates should be **substantively consolidated**. At the duly scheduled hearing, this Court indicated that before an evidentiary hearing is scheduled, it would be appropriate to consider the threshold issue, that is the jurisdiction of this Court to subject an entity to this jurisdiction, which would be tantamount to force an entity to become an involuntary chapter 11 debtor without obtaining an entry for order for relief in an involuntary case commenced by creditors of the **nondebtor** entity pursuant to 11 U.S.C. § 303. It is clear that this can only be accomplished by destroying the independent legal existence of the **nondebtor** entity by removing its corporate shield and establishing with competent evidence that, as in this case, the Debtor is nothing more than the **alter ego** of Florida Earth.

While this Court expressed initial misgivings as to this Court's power to accept this somewhat unorthodox approach suggested by counsel for Volpe, research indicates that there is substantial authority to support this Court's power to grant the relief sought by Volpe if Volpe is able to present competent and persuasive evidence to warrant a granting of his Motion on an alter ego theory.

[3] It is generally recognized that although the Bankruptcy Code does not specifically authorize consolidation of separate estates, the court may order consolidation by virtue of its general equitable powers. *In re Auto-Train Corporation*, 810 F.2d 270 (D.C.Cir.1987); *In re Continental Vending Machine Corp.*, 517 F.2d 997 (2d Cir.1975), *cert. denied*, 424 U.S. 913, 96 S.Ct. 1111, 47 L.Ed.2d 317 (1976). This authority is expressed in Section 105(a) of the Bankruptcy Code, which authorizes courts to issue any order necessary or appropriate to carry out the provisions of Title 11. *In re Bonham*, 229 F.3d 750 (9th Cir.2000).

[4][5][6] Orders of "substantive consolidation" combine the assets and liabilities of separate and distinct, but related, legal entities into a single pool and treat them as a single entity. This enables a bankruptcy court to disregard separate corporate entities and to pierce their corporate veils in order to reach assets for the satisfaction of debts of a related corporation. *See Bonham, supra* at 764. Substantive consolidation is a remedy entirely independent of, and inconsistent with the involuntary petition remedy, and thus, is an alternative means to bring nondebtor's assets into a debtor's estate. *In re Munford, Inc.*, 115 B.R. 390 (Bankr.N.D.Ga.1990). Substantive consolidation may be based on a finding that it would be more equitable to all parties to allow consolidation under circumstances of the case, by showing that the affairs of the entities are inextricably intertwined or that creditors dealt with them as a single economic unit. It does not require a finding of fraud or an intent to hinder and delay creditors. *Munford, supra. See also, In re Reider*, 31 F.3d 1102 (11th Cir.1994).

***589** [7][8] Before ordering consolidation however, a bankruptcy court must conduct a searching inquiry to ensure that consolidation yields benefits that would offset the harm it inflicts on objecting parties. Moreover, the proponent must show substantial identity between the entities to be consolidated, and that consolidation is necessary to avoid some harm or to realize some benefit. *Auto-Train, supra* at 276; *In re Snider Bros., Inc.*, 18 B.R. 230 (Bankr.D.Mass.1982). Once the proponent has made the required prima facie showing, the burden shifts on the objecting party to show (1) that it has relied on separate credit of one of the entities to be consolidated; and (2) that it will be prejudiced by consolidation. *In re Optical Technologies, Inc.*, 221 B.R. 909 (Bankr.M.D.Fla.1998).

[9] Factors to consider whether the proponent has made the required prima facie showing are as follows: (1) presence or absence of consolidated financial statements for entities whose estates are to be consolidated; (2) unity of interest and ownership; (3) existence of parent and intercorporate guarantees on loans; (4) degree of difficulty in segregating and ascertaining individual assets and liability; (5) existence of transfers of assets without formal observance of corporate formalities; (6) commingling of assets and business functions; and (7) profitability of consolidation at single physical location. *Optical Technologies, supra* at 913.

Based on the foregoing, this Court is satisfied that it is appropriate to schedule a final evidentiary hearing in order give Volpe an opportunity to present competent evidence in support of his Motion. Therefore, this Court has determined, that as to the threshold issue of whether or not this Court has jurisdiction to consolidate a debtor and a nondebtor entity, it does have jurisdiction to consider the request of consolidation in this Motion.

Accordingly it is,

ORDERED, ADJUDGED AND DECREED that the Clerk shall schedule a pre-trial conference to be held on March 21, 2002, beginning at 10:30 a.m. at the United States Bankruptcy Courthouse, Fort Myers, Federal Building and Federal Courthouse, Room 4-117, Courtroom D, 2110 First Street, Fort Myers, Florida, in order to prepare the issues for trial.

Bkrtcy.M.D.Fla.,2002.
In re Alico Mining, Inc.
278 B.R. 586, 15 Fla. L. Weekly Fed. B 182

END OF DOCUMENT

In re Bonham, 226 B.R. 56 (Bankr. D. Alaska 1998).

226 B.R. 56
(Cite as: 226 B.R. 56)

H

United States Bankruptcy Court,
D. Alaska.

In re RaeJean BONHAM, aka Jean Bonham, aka Jeannie Bonham, dba World Plus, Debtor.
Bankruptcy No. F95-00897-HAR.

April 10, 1998.

Chapter 7 trustee moved to substantively consolidate debtor's estate with those of her closely held corporations. The Bankruptcy Court, Herbert A. Ross, J., held that: (1) trustee could seek consolidation by way of motion, and did not have to commence adversary proceeding or file involuntary petitions against corporations; (2) debtor's estate would be substantively consolidated with estates of her closely held corporations, in order to enable trustee to pursue avoidance claims against investors who received avoidable transfers in connection with Ponzi investment scheme that corporations had been used to further; and (3) consolidation would be nunc pro tunc to date that involuntary petition was filed against debtor.

Motion granted.

West Headnotes

[1] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Bankruptcy court has authority to grant substantive consolidation of separate bankruptcy estates into a single estate. Bankr.Code, 11 U.S.C.A. § 105(a).

[2] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Substantive consolidation of estates involves the pooling of assets and liabilities of two or more related entities, whose liabilities are then satisfied from common pool of assets created by consolidation. Bankr.Code, 11 U.S.C.A. § 105(a).

[3] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases
Substantive consolidation should not be used as mere device of convenience, in order to overcome accounting difficulties or the like, where consolidation would unfairly impair vested rights of some creditors. Bankr.Code, 11 U.S.C.A. § 105(a).

[4] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Substantive consolidation should be used sparingly. Bankr.Code, 11 U.S.C.A. § 105(a).

[5] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases
In general, prior to ordering that estates be substantively consolidated, bankruptcy court should be convinced that injustice will occur absent consolidation. Bankr.Code, 11 U.S.C.A. § 105(a).

[6] Bankruptcy 51 2084.1

51 Bankruptcy

51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Not all classes of creditors have to be treated equally once estates of separate debtor entities are substantively consolidated, and the rights of class of creditors of one of the entities can be protected from inequities that might otherwise result from the substantive consolidation. Bankr.Code, 11 U.S.C.A. § 105(a).

[7] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Whether to allow substantive consolidation is decision which is driven by facts of case. Bankr.Code, 11 U.S.C.A. § 105(a).

[8] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Substantive consolidation should be distinguished from state law "alter ego" remedies; while substantive consolidation, like these alter ego remedies, ignores artificial legal structures, it does not seek to hold shareholders liable for acts of their incorporated entity, but looks only to combined assets of consolidated entities for satisfaction of all claims against the collective group. Bankr.Code, 11 U.S.C.A. § 105(a).

[9] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Law of substantive consolidation is not state "alter ego" law; it is federal bankruptcy law. Bankr.Code, 11 U.S.C.A. § 105(a).

[10] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
Consolidating a non-debtor's estate with case of existing debtor is much more sensitive matter than consolidating estates of existing debtors; if substantive consolidation is to be applied cautiously in case of existing debtors, even more care should be taken with respect to consolidating non-debtors. Bankr.Code, 11 U.S.C.A. § 105(a).

[11] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In General. Most Cited Cases
While consolidating a non-debtor's estate with case of existing debtor is much more sensitive matter than consolidating estates of existing debtors, there are cases in which substantive consolidation of non-debtors is appropriate procedure and/or remedy under given facts. Bankr.Code, 11 U.S.C.A. § 105(a).

[12] Bankruptcy 51 2156

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2156 k. Nature and Form; Adversary Proceedings. Most Cited Cases
Chapter 7 trustee could move for order substantively consolidating debtor's estate with those of closely held corporations that she allegedly used to operate Ponzi scheme; trustee did not have to proceed by way of adversary proceeding or by filing involuntary petitions against corporations. Bankr.Code, 11 U.S.C.A. § 105(a).

[13] Bankruptcy 51 2084.10

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.10 k. Particular Cases. Most Cited Cases
Chapter 7 debtor's estate would be substantively consoli-

dated with estates of her closely held corporations, in order to enable trustee to pursue avoidance claims against investors who received avoidable transfers in connection with Ponzi investment scheme that corporations had been used to further, where debtor had observed few corporate formalities but had freely transferred funds between corporations and used corporate funds to pay her personal expenses in manner which had resulted in hopeless entanglement of debtor's and her corporations' affairs, where corporations had been used for fraudulent purpose, and where investors had dealt solely with debtor and did not appear to have relied on any particular corporate entity, but rather on the exorbitant returns that were promised on their investment contracts. Bankr.Code, 11 U.S.C.A. § 105(a).

[14] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases

Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Simplistically, parties seeking to substantively consolidate estates must first make their case for substantive consolidation, e.g., by showing why consolidation is fair or just, due to intermingling of assets, alter ego behavior, fraud, or the like. Bankr.Code, 11 U.S.C.A. § 105(a).

[15] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases

Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Once parties seeking to substantively consolidate estates have made case for substantive consolidation, burden then shifts to opposing parties to show why consolidation should be denied, e.g., because of parties' reliance on entities' separateness, due to unfair dilution of recovery that would result if consolidation occurred, or for some other reason. Bankr.Code, 11 U.S.C.A. § 105(a).

[16] Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Substantive consolidation of Chapter 7 debtor's estate with those of her closely held corporations would be nunc pro tunc to date that involuntary petition was filed against debtor, in order to enable trustee to pursue avoidance claims, to fullest extent possible, against investors who received avoidable transfers in connection with Ponzi investment scheme that corporations had been used to further, where investors had dealt solely with debtor and did not appear to have relied on any particular corporate entity, but rather on the exorbitant returns that were promised on their investment contracts. Bankr.Code, 11 U.S.C.A. § 105(a).

[17] Bankruptcy 51 2084.15

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.15 k. Proceedings; Evidence. Most Cited Cases
Important factor in fixing appropriate date for substantive consolidation of Chapter 7 debtor's estate with estates of her closely held corporations, to enable trustee to pursue avoidance claims against all of the investors who received avoidable transfers in connection with Ponzi investment scheme that corporations had been used to further, was whether investors relied on apparent separateness of debtor and her corporations. Bankr.Code, 11 U.S.C.A. §

226 B.R. 56
(Cite as: 226 B.R. 56)

105(a).
***58** RaeJean Bonham, Fairbanks, AK, Debtor, Pro se.

Cabot Christianson, Gary Spraker, Bundy & Christianson, Anchorage, AK, James DeWitt, for trustee.

Larry D. Compton, Anchorage, AK, trustee.

John Burns, David G. Parry, Birch, Horton, Bittner & Cherot, Fairbanks, AK, Rebecca Copeland, Koval & Featherly, Anchorage, AK, for Joint Defense Committee.

Brad E. Ambarian, Lane, Powell, Spears, Lubersky, Anchorage, AK, Grant E. Courtney, Lane, Powell, Spears, Lubersky, Seattle, WA, Ronald Goss, Shulkin Hutton, Inc., Seattle, WA, for Various Defendants.

Gerald K. Smith, Randolph J. Haines, Lewis & Roca, Phoenix, AZ, for Defendants.

Kenneth Wooten, Fairbanks, AK, Creditor, Pro se.

MEMORANDUM DECISION FOR ALLOWANCE OF SUBSTANTIVE CONSOLIDATION

HERBERT A. ROSS, Bankruptcy Judge.

Table of Contents **Page**

***59** 1. *INTRODUCTION*-Larry Compton, the chapter 7 trustee, filed a motion to consolidate the estate of the individual debtor, RaeJean Bonham, with the estates of two non-debtors, World Plus, Inc. (WPI) and Atlantic Pacific Funding Corp. (APFC), two corporations closely held by Bonham.

The trustee asks that consolidation be effective as of December 19, 1995, the date that the involuntary bankruptcy proceeding was commenced against Ms. Bonham. The trustee seeks to fix that date for avoidance proceedings with respect to any transfers made by Bonham, WPI, and APFC.

There are no assets in these estates of significant value, except the avoidance recoveries. Ms. Bonham operated a Ponzi scheme through investment contracts issued in the name of WPI and APFC in the four or five years before December 19, 1995. If consolidation is not permitted, the creditors of Bonham, WPI and APFC, totaling over $50 million dollars in claims filed in this bankruptcy (the largest percentage coming from losses related to the investment contracts) will recover nothing.

There has been vigorous opposition to consolidation from the targets of the avoidance actions filed by the trustee. Appendix A is a table setting out the voluminous pleadings on this issue.

The trustee has filed over 600 adversary proceedings seeking avoidance of payments by WPI and APFC to investment contract participants. If the consolidation is denied, most or all of these avoidance actions will fail and the creditors will receive nothing.

Whether or not to allow substantive consolidation is generally a fact-driven decision. For that reason, the facts the court relies on are extensively set forth in Part 2 of this *Memorandum Decision.* The case law uniformly holds that substantive consolidation should be sparingly used, with an eye to possible negative effects on creditors. Yet, there are cases where substantive consolidation is justly applied.

The bar is set even higher with respect to the substantive consolidation of non-debtors. Nonetheless, this is an appropriate case to invoke the doctrine. In balancing the interests of the parties, I find that they favor granting the substantive consolidation of the WPI and APFC estates with the estate of RaeJean Bonham.

The procedure to raise the issue has been fair. The effective date of the substantive ***60** consolidation of this case with the estates of WPI and APFC shall be December 19, 1995.

2. *FACTS* [FN1]-

FN1. I have largely adopted the findings of fact proposed by the trustee. I am aware of the caution that a trial court should not blindly rubber stamp the findings proposed by the prevailing

party. *Hagans v. Andrus*, 651 F.2d 622, 626 (9th Cir.1981), *cert den* 454 U.S. 859, 102 S.Ct. 313, 70 L.Ed.2d 157. In this case, however, the facts involve a great deal of financial analysis and the inferences that are drawn from them. These are not easily stated in general terms. Accordingly, I have adapted and used the trustee's proposed findings which sets this material out extensively. Before doing so, I have checked the record for accuracy. *See*, *Photo Electronics Corp. v. England*, 581 F.2d 772, 776-777 (9th Cir.1978).

I have reviewed the parties' evidentiary submissions, and I have sat through the involuntary trial and many other proceedings involving RaeJean Bonham. I believe the trustee's proposed findings fairly state the facts.

Because the issue of substantive consolidation is so fact intensive, I have set the facts forth in Part 2 of this *Memorandum Decision* extensively.

2.1. *Procedural Background*-

2.1.1. On December 19, 1995, an involuntary chapter 7 petition was filed by various creditors against RaeJean Bonham, aka Jean Bonham, aka Jeannie Bonham, dba World Plus.

2.1.2. On December 20, 1995, a hearing was held on the motion of the petitioning creditors to appoint an interim trustee. Larry Compton was appointed the interim trustee during this involuntary chapter 7 proceeding. [*See, Order*, Docket Entry 5].

2.1.3. The debtor, RaeJean Bonham, initially contested the involuntary chapter 7. However, at a hearing on January 8, 1996, she agreed to the petition and the appointment of a chapter 11 trustee, and converted the case to chapter 11. On January 9, 1996, the court entered an *Order For Relief And Voluntarily Conversion To A Chapter 11 Case* (Docket Entry 38, filed January 9, 1996).

2.1.4. RaeJean Bonham filed a voluntary chapter 11 petition on January 5, 1996, Case No. F96-00013-HAR, listing as debtors herself, APFC, and WPI. The petition states in Bonham's handwriting: “This is an individual filing-these are names of corporations in which debtor was a former shareholder. RSB.” No activity had taken place in that case, and no schedules, statements or lists had been filed. At the hearing on January 8, 1996, the court indicated that it would dismiss the voluntary case, F96-00013-HAR, and an *Order Dismissing Voluntary Petition* was entered (Docket Entry 5, filed January 9, 1996). There was no notice to interested parties of the intent to dismiss, except to those appearing at the hearing.

2.1.5. The chapter 11 trustee, Larry Compton, investigated the operations of the debtor-in-possession, and concluded that he could not continue the business. Among other things, the purported business (selling tickets procured with frequent flyer mileage, which the debtor or her related companies purchased from third parties) appeared to conflict with an injunction that had been entered against RaeJean Bonham and World Plus, Inc. in the United States District Court for the Northern District of Georgia, *Delta Air Lines, Inc. v. Robert Y. Seward, et al.*, Case No. 93-CV-1036-HTW. The debtor acquired funds with the promise of exorbitant interest rates for the alleged purpose of purchasing frequent flyer mileage to conduct the ticket sales business. The trustee shortly concluded that the ticket sales business was a front for a Ponzi investment scheme. After hearing testimony on January 29, 1996, the court converted the chapter 11 case to chapter 7 (Docket Entry 147, filed January 30, 1996). Larry Compton was appointed chapter 7 trustee (Docket Entry 143, filed January 29, 1996).

2.1.6. There have been approximately 1,111 proofs of claim filed for over $53 million. Most of these claims, to the exclusion of the Delta Air Lines settlement (Docket Entry 1364, filed August 26, 1997), and a handful of others, arise from the investment operations of the debtor or her related corporations, WPI or APFC.

2.1.7. Minimal net proceeds are expected from the liquidation of personal assets of the ***61** debtor. Therefore, there are virtually no assets in this case except the potentiality of the trustee recovering on fraudulent transfers or preference actions. The trustee has commenced approximately 613 adversary proceedings to recover fraudulent and preferential transfers from investors of the debtor, WPI or APFC.

2.2. *Background Of World Plus and World Plus, Inc*.-

2.2.1. RaeJean Bonham operated a proprietorship known as “World Plus” before April 1991. The stated purpose of the business was to purchase frequent flyer miles available from various airlines and use them to acquire tickets,

which she then sold to the public. Sometime prior to 1989, World Plus began issuing short term investment contracts for returns of 50% within 60 to 90 working days. World Plus later offered investment contracts returning 50% for 6 to 8 months, and contracts for 20% over 6 months. Beginning in June 1995, World Plus began issuing contracts for 50% interest for periods as short as 10 days. (*See, Affidavit of Larry D. Compton* [*"Compton Affidavit"*], Exhibit 35).

2.2.2. RaeJean Bonham incorporated World Plus, Inc. (WPI) on April 22, 1991. (*See, Compton Affidavit,* Exhibit 8).

2.2.3. Bonham was the incorporator of WPI, its registered agent and sole director. The only other officer of WPI was Bonham's husband, Steve Bonham, who was listed as vice president. (*See, Compton Affidavit,* Exhibit 9). Steve Bonham denies he was significantly involved in the affairs of WPI, and claims that his wife, RaeJean, ran the business.

2.2.4. RaeJean Bonham is the sole shareholder of WPI, but WPI never issued stock certificates or recorded ownership in any stock register for WPI.

2.2.5. There is no evidence of WPI holding any shareholder meetings, and there are no minutes of director meetings.

2.2.6. WPI never filed any income tax returns with the Internal Revenue Service or the State of Alaska.

2.2.7. There are no financial statements for WPI. Larry Compton is a licensed certified public accountant and panel trustee in Alaska. As such, he has a great deal of forensic accounting experience in investigating the financial records of debtors and testing them for fraud. In this case, Mr. Compton, after diligent inquiries, has been unable to locate income statements, balance sheets, cash journals, and the normal accounting records one would expect in a business that handled as much cash as debtor, WPI, and APFC.

2.2.8. WPI was involuntarily dissolved by the State of Alaska on September 18, 1995. (*See, Compton Affidavit,* Exhibit 10).

2.3. *Background of Atlantic Pacific Funding Corp.*-

2.3.1. RaeJean Bonham began to issue investment contracts under the name of APFC in the fall of 1992. The bulk of APFC investment contracts were issued in 1993 and 1994. These investment contracts were purportedly for the purpose of purchasing frequent flyer miles from third parties for resale through her ostensible business. The first investment contract by APFC, which the trustee has located to date, was issued on October 30, 1992, to Jack C. Melior for 50% return in 6 months. (*See, Compton Affidavit,* Exhibit 36).

2.3.2. When Ms. Bonham first began to issue investment contracts under the name of APFC, she does not appear to have been shareholder, officer, director, or otherwise an agent of APFC, a Nevada corporation. Her husband, Steve, denies he had any significant role in the operation of APFC, and claims that his wife, RaeJean, ran the business.

2.3.3. On September 21, 1992, Irma D. Butler, a customer service coordinator for Laughlin Associates, Inc., incorporated APFC in Nevada.

2.3.4. On February 19, 1993, Bonham signed a Nevada Headquarters Program or Contract Office Service Package with Laughlin***62** Associates to provide corporate services and a Nevada base. (*See, Compton Affidavit,* Exhibit 13). As part of the corporate profile of APFC, Bonham instructed Laughlin to take daily phone messages, stating that Bonham was currently "out of the office" and inform Bonham of the phone calls so she could return them from her Fairbanks office. Bonham also completed a Mail Forwarding Service Agreement and Application For Delivery of Mail Through Agent, instructing Laughlin to forward her mail to a Fairbanks post office box. On this agreement, Bonham described APFC's business as "travel." (*See, Compton Affidavit,* Exhibit 14).

2.3.5. On February 24, 1993, Bonham opened Account No. 25101940 in the name of RaeJean S. Bonham, dba Atlantic Pacific Funding Corporation, with First National Bank of Anchorage (the FNBA Account). The initial deposit was a check in the amount of $5,000 drawn on WPI's Key Bank Account No. 125200879. (*See, Compton Affidavit,* Exhibit 12).

2.3.6. On March 19, 1993, Bonham signed an Application for Business License for Carson City, Nevada on behalf of APFC. RaeJean Bonham is shown as the president, and the nature of business is noted as "travel." (*See, Compton Affidavit,* Exhibit 15).

2.3.7. On March 22, 1993, George Johnson signed a bill of sale on APFC letterhead acknowledging receipt of $1,000 from APFC for payment "in full for the purchase of this corporation from RaeJean Bonham." (*See, Compton Affidavit,* Exhibit 16).

2.3.8. On May 6, 1993, Carson City, Nevada issued a business license effective through December 31, 1993. The licensee was stated as: "Bonham, RaeJean S. Atlantic Pacific Funding, Inc." (*See, Compton Affidavit,* Exhibit 17).

2.3.9. On or about September 15, 1993, the State of Nevada requested a List of Officers, Directors, and Agent for APFC. Laughlin Associates, Inc. is shown as the corporation's duly appointed resident agent. Charles Ferrara was listed as the president, secretary, and treasurer of APFC. (*See, Compton Affidavit,* Exhibit 18).

2.3.10. On October 1, 1993, Bonham signed a Consent to Action Without a Meeting of the Shareholders of Atlantic Pacific Funding, Inc., by which Charles Ferrara was removed as director and she was named director of APFC. Bonham used preprinted forms supplied by Laughlin Associates. The accompanying Acceptance of Office is signed by Bonham and dated February 14, 1994. (*See, Compton Affidavit,* Exhibit 21).

2.3.11. In February 1994, Bonham completed a subsequent List of Officers, Directors, and Agent, identifying herself as the president, secretary, treasurer, and sole director of APFC. (*See, Compton Affidavit,* Exhibit 19). Bonham submitted another List of Officers, Directors, and Agent for APFC in August 1994, identifying herself as president, secretary and treasurer, but did not disclose the directors of the corporation. The address of the corporation is that of Laughlin Associates at 2533 N. Carson, # 1185, Carson City, NV 89706. (*See, Compton Affidavit,* Exhibit 20).

2.3.12. The debtor's files also contain Minutes of Annual Meeting of Board of Directors of APFC, and Minutes of Annual Meeting of Stockholders of APFC, both reflecting that they were held on September 24, 1994. (*See, Compton Affidavit,* Exhibit 22).

2.3.13. No stock certificates appear to have been issued or logged onto a stock ledger reflecting Bonham's ownership of the stock of APFC.

2.3.14. The trustee has located no documentation regarding capitalization of the corporation or its asset base.

2.3.15. APFC never filed an income tax return with the IRS or the State of Alaska.

2.3.16. No financial statements for APFC have been located despite the trustee's diligent search and requests for production of information and records from RaeJean Bonham.

***63** 2.3.17. APFC never registered to do business in Alaska.

2.3.18. Bonham sent a letter dated February 9, 1994, on APFC letterhead to WPI and APFC investors. This letter stated that WPI and APFC were registered only in the states of Alaska and Nevada. She admonished her investors not to tell anyone, including financial institutions, about her investment program. (*See, Compton Affidavit,* Exhibit 23). Some of the investors have denied seeing this letter.

2.3.19. APFC had no employees.

2.3.20. APFC had no business other than the issuance of investment contracts, collecting invested funds, and paying investors of APFC and WPI. APFC was no longer a viable Nevada corporation after October 1, 1995. (*See, Compton Affidavit,* Exhibit 71).

2.4. *Business of Selling Airline Tickets Procured With Frequent Flyer Miles*-

2.4.1. WPI and World Plus, the proprietorship operated by RaeJean Bonham prior to the incorporation of WPI, sold frequent flyer tickets to the general public. RaeJean Bonham testified in various proceedings before this court that she purchased large blocks of frequent flyer miles from large corporations, some of them Fortune 500 corporations. The trustee, Larry Compton, has found no proof of such purchases, and no inventory of miles. There are no records regarding the procurement and disposition of any such miles. The court finds that Bonham's testimony in this respect was false.

2.4.2. Bonham appears to have purchased some frequent flyer miles from various brokerage firms dealing in frequent flyer mileage. After making an airline reservation,

an employee of WPI would receive payment from the customer and would order a frequent flyer ticket from a broker. The broker would procure the ticket from an individual frequent flyer member. The broker would take 50% of the ticket price at the time of the order, and receive the balance upon delivery of the ticket.

2.4.3. Since 1991, the largest part of WPI tickets were with Delta Air Lines and, in 1994, Bonham estimated that 90% of the reservations were placed with Delta Air Lines.

2.4.4. The trustee has located limited records purporting to detail the sales of frequent flyer tickets for 1991, 1992 and 1994 (including January 1995). This information included the sales price of each ticket and the cost of the ticket recorded on a monthly basis. The trustee has not found similar information for any other year. The debtor's records show that in 1991 and 1992, World Plus/WPI sold approximately 100 tickets a month, but by 1994, the number had fallen to approximately 50 tickets per month with a gross profit of approximately $5,000-$6,000 per month. The sales of tickets for this period, according to the debtor's records, were as follows:

1991

Date-1991	No. of Tickets	Amount Sold	Cost of Goods	Gross Profit	Profit per Ticket
January 1991	120	$64,830	$55,660	$9,170	$76
February 1991	75	$43,872	$36,100	$7,772	$105
March 1991	146	$83,520	$68,600	$14,920	$102
April 1991	65	$35,002	$30,415	$4,587	$71
May 1991	67	$36,270	$37,706	($1,436)	$0
June 1991	136	$70,920	$61,825	$9,095	$67
July 1991	80	$39,829	$35,655	$4,174	$52
August 1991	91	$49,815	$41,100	$8,715	$96
September 1991	48	$27,974	$22,295	$5,679	$118
October 1991	69	$39,255	$31,055	$8,200	$119

November 1991	112	$59,808	$50,712	$9,096	$81
December 1991	245	$129,900	$110,710	$19,190	$78
TOTAL	**1254**	**$680,995**	**$581,833**	**$99,162**	**$79**

1992

Date - 1992	No. of Tickets	Amount Sold	Cost of Goods	Gross Profit	Profit per Ticket
January 1992	113	$63,976	$53,289	$10,687	$95
February 1992	71	$39,819	$32,030	$7,789	$110
March 1992	92	$50,805	$42,250	$8,555	$93
April 1992	114	$61,889	$53,205	$8,684	$76
May 1992	74	$40,502	$34,280	$6,222	$84
June 1992	153	$78,023	$67,335	$10,688	$70
July 1992	147	$78,310	$67,305	$11,005	$75
August 1992	123	$64,452	$55,879	$8,573	$70
September 1992	76	$40,405	$34,746	$5,659	$75
October 1992	93	$50,395	$41,750	$8,645	$93
November 1992	148	$77,055	$66,938	$10,117	$68

December 1992	271	$141,045	$121,623	$19,422	$72
TOTAL	**1,475**	**$786,676**	**$670,630**	**$116,046**	**$79**

1994

Date - 1994 (incl.01/95)	No. of Tickets	Amount Sold	Cost of Goods	Gross Profit	Profit per Ticket
January 1994	48	$26,320	$21,290	$5,030	$105
February 1994	41	$24,168	$18,810	$5,358	$131
March 1994	50	$34,870	$28,307	$6,563	$131
April 1994	23	$32,140	$25,790	$6,350	$233
May 1994	45	$25,295	$21,030	$4,265	$95
June 1994	129	$65,615	$53,595	$12,020	$93
July 1994	94	$53,094	$44,280	$8,814	$94
August 1994	82	$46,615	$38,755	$7,860	$96
September 1994	57	$32,640	$26,720	$5,920	$104
October 1994	52	$31,100	$25,820	$5,280	$102
November 1994	51	$28,847	$24,484	$4,363	$86
December 1994	95	$53,240	$48,678	$4,562	$48

January 1995	17	$9,590	$8,388	$1,202	$71
TOTAL	**784**	**$463,533**	**$385,947**	**$77,586**	**$99**

***65** *(See,* Exhibit 33 to the *Compton Affidavit, Docket Entry 732,* and Exhibit 84 to the *Supplemental Affidavit of Larry D. Compton [Supplemental Affidavit], Docket Entry 1281).*

2.4.5. The gross profit figures shown in ¶ 2.4.4, are prior to the deduction of overhead expenses such as rent, employee salaries, insurance, etc.

2.4.6. Other than the ticket information described in ¶ 2.4.4, the investor information described in ¶ 2.7.3, and check registers, there are no ledgers, financial statements, or accounting information for Bonham, World Plus, WPI, or APFC. In addition, the debtor has not cooperated with the trustee's investigation and her answers to the trustee's questions have been inconsistent, evasive, and not credible. She has frustrated the trustee's efforts to reconstruct her business activities. The trustee has attempted to reconstruct the debtor's financial records based on the canceled checks issued by World Plus, WPI, and APFC, and the monthly bank statements for those entities obtained from the relevant financial institutions under subpoena, or from federal agencies that have subpoenaed the debtor's records. Using available check registers, trustee's counsel has created a Quicken database detailing the debtor's deposits, payments, and transfers to the extent possible. The database has substantially complete deposit and payment detail for non-cash items for the years 1990 and 1992-1995.

2.4.7. The trustee has attempted to analyze all cash deposits which he located in the records of debtor, WPI and APFC, and has identified approximately $2.4 million of such deposits. Even assuming that these are all ticket revenues and were added to the gross profits shown in ¶ 2.4.4, there would probably have been a profit in 1992 and 1995, but still a loss in 1990, 1993, and 1994.

***66** 2.4.8. The ticket sales business did not generate sufficient revenue to cover the debt service on the investment contracts. That debt service was covered by procuring subsequent investment contracts, the proceeds of which were used to pay the obligations on prior investment contracts.

2.5. *Delta Air Lines Suit*-A complaint was filed in *Delta Air Lines, Inc. v. Robert Y. Seward, et al.,* Case No. 93-CV-1036-HTW, in the United States District Court for the Northern District of Georgia in early May 1993. On May 13, 1993, the Georgia District Court entered a preliminary injunction prohibiting the defendant ticket suppliers from selling frequent flyer tickets on Delta Air Lines. An amended complaint was filed on September 13, 1993, adding WPI, RaeJean Bonham, Steven Bonham, and other defendants. That complaint alleged, among other things, that Bonham's ticket brokering defrauded Delta and tortiously interfered with Delta's business relations. On or about January 30, 1995, the Georgia District Court granted Delta's motion for partial summary judgment determining Bonham's and the other defendants' liability to Delta. On September 29, 1995, the Georgia District Court entered a permanent injunction prohibiting the defendant ticket suppliers from selling frequent flyer tickets on Delta Air Lines to, among others, World Plus.

2.6. *Investment Contract Business (The Ponzi Scheme)*-

2.6.1. Throughout Ms. Bonham's operation of the business, as an individual, as WPI, and as APFC, investment contracts were offered to investors with very high rates of return for relatively short periods. For example, a number of the contracts were for 50% return on investments within 60 to 90 days, although they varied to as low as 20% to 50% for a period of 6 to 8 months.

2.6.2. As the investment business got in trouble due to the pyramid nature of its capital needs, WPI offered as high as 50% on a contract for as short as 10 days.

2.6.3. Bonham, WPI, and APFC dealt with investors who were located in 42 separate states. These 1,000 + investors had over 6,000 investment contracts, of which over 2,000 separate contracts were issued in 1995.

2.6.4. The trustee's investigation has shown that WPI and APFC (and perhaps to a small extent, Bonham, as a sole proprietor in 1991) had the following investment contract obligations outstanding at the end of each calendar year:

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Year	Contract Obligations as of 12/31	Number of Contracts as of 12/31	Number of Tickets Needed to Sell at $550 per ticket
1991	$1,447,500	109	2,631
1992	$1,330,000	85	2,418
1993	$21,440,000	1030	38,981
1994	$25,637,000	1263	46,612
1995	$22,363,468	1144	40,660

(*See, Supplemental Affidavit*, Exhibit 88).

Assuming a ticket was sold to a buyer for $550 per ticket, all of which was applied to revenue, the last column indicates how many tickets would have been required to be sold to cover the principal amount of the contracts issued, without even considering the exorbitant interest promised. Bonham and the corporations' actual ticket activity, as reflected in ¶ 2.4.4, was not even close to the actual number of tickets needed.

2.7. *Relationships Between World Plus, Inc. and Atlantic Pacific Funding Corp.*-

2.7.1. The trustee has determined that WPI routinely transferred investment funds ***67** to APFC. For the years ending December 31, 1993, 1994, and 1995, WPI directly transferred the following amounts to APFC's FNBA account:

Payor	Payee	Period	Amount
WPI	Atlantic Pacific	2/23/93-12/31/93	$197,000
WPI	Atlantic Pacific	1/1/94-12/31/94	$1,436,500
WPI	Atlantic Pacific	1/1/95-12/31/95	$2,200,000
TOTAL			**$3,833,500**

(*See, Compton Affidavit,* Exhibit 37).

2.7.2. Bonham did not formally notify investors who had dealt with her individually, that she had incorporated WPI in April 1991, and that they were now investing in a corporation that had never been capitalized. Thus, investors with contracts issued by World Plus prior to April 1991, held contracts against a sole proprietorship. Yet, if they rolled the contract over after April 1991, the new contract was with a new entity, WPI.

2.7.3. The overwhelming majority of the investors with multiple investments after 1992, indiscriminately received contracts from both WPI and APFC. Bonham never made any distinction as to which entity would issue the investment contract. The sole records of investments maintained by Bonham were index cards on the individual investor. Even those index cards do not reference which entity issued which contract. (*See, Supplemental Affidavit,* Exhibit 103).

2.7.4. Nor did the fact that an investor paid money to WPI ensure that WPI would issue the investment contract (or that payment to APFC would result in an investment contract from APFC). To further complicate matters, on maturity APFC often paid the obligations of WPI, and if the investor rolled all or part of the investment contract into a new contract, it was not necessarily issued by the same corporation.

2.8. *Bank Accounts*-

2.8.1. Bonham, WPI and APFC held and operated several bank accounts for the years 1989-1995. The trustee has discovered the following accounts:

Bank Name and Account Number	**Key Bank Account No. 075019140**	**Key Bank Account No. 070013071 00**	**First Natl Bank of Anch. Acct No. 2510 1940**	**Merrill Lynch CMA Account No. 28H-07015**	**Denali State Bank Account No. 102-8281**
Name on Account (per bank statement)	Steve or RaeJean Bonham	World Plus until 6/91; thereafter, World Plus, Inc.	Until 11/93: RaeJean Bonham, dba Atlantic Pacific Funding Corp. After 11/93: Atlantic Pacific Funding Corp. [bank statements for all years sent to Fairbanks address]	World Plus, Inc.	World Plus, Inc., dba Atlantic Pacific Funding, Inc.
Account name on checks	Steve or RaeJean Bonham, dba S & S	World Plus until 12/91; thereafter,	Atlantic Pacific Funding Corp. [until 11/93: Fair-	World Plus, Inc., dba Atlantic Pacific	World Plus, Inc.

	Services	World Plus, Inc.	banks address; thereafter, Nevada address]		
Date Opened	12/8/87	1/11/88	2/26/93	10/4/95	8/9/95
Date Closed	11/95	8/10/95	10/20/95	12/29/95	10/9/95

***68** 2.8.2. The checks used for WPI's Key Bank Account No. 07001307100, show that the account was originally a business account in the name of "World Plus-RaeJean Bonham." (*See, Compton Affidavit,* Exhibit 82).

2.8.3. Bonham opened Account No. 2510 194 0 at First National Bank of Anchorage on February 26, 1993, in the name of RaeJean Bonham, dba Atlantic Pacific Funding Corporation. Bonham opened the account with a $5,000 deposit from WPI. At the time Bonham opened the FNBA account, APFC operated as the "dba" of RaeJean Bonham, and was funded in large part by investments payable to WPI. In November 1993, the bank statements were changed to read "Atlantic Pacific Funding Corporation."

2.8.4. The trustee's investigation indicates that the debtor's records show that WPI transferred approximately $3.8 million to APFC. These records also reflect over $700,000 in transfers from APFC to WPI. There are no records setting forth the relationship between the corporations. There are no records reflecting or recording the transfer of funds between the corporations, or giving any basis for the transfers. (*See, Compton Affidavit,* Exhibit 37).

2.8.5. Bonham directly and frequently deposited funds from WPI investments into APFC's bank account. Bonham would take checks made payable to WPI and endorse the check for deposit in APFC's FNBA account. Other times, Bonham would simply line out "WPI" as payee and write "Atlantic Pacific." (*See, Compton Affidavit,* Exhibits 38 and 40).

2.8.6. By at least March 1995, Bonham had created deposit stamps that read:

FOR DEPOSIT ONLY ATLANTIC PACIFIC FUNDING CORP. DBA ATLANTIC PACIFIC CORP., WORLD PLUS, INC.

FOR DEPOSIT ONLY ATLANTIC PACIFIC FUNDING CORP. DBA ATLANTIC PACIFIC FUNDING WORLD PLUS

(*See, Compton Affidavit,* Exhibit 41).

2.8.7. In August 1995, Bonham opened Account No. 102-8281 with Denali State Bank. The name on the account according to the bank statements was "WORLD PLUS INC DBA ATLANTIC PACIFIC FUNDING." Investment checks were endorsed with a deposit stamp that read: "WORLD PLUS INC. dba ATLANTIC PACIFIC FUNDING." (*See, Compton Affidavit,* Exhibits 42 and 43).

2.8.8. In October 1995, Bonham opened a cash management account in Juneau with Merrill Lynch Pierce Fenner & Smith, Account No. 28H-07015. Bonham requested that the account be set up as "WORLD PLUS INC. DBA ATLANTIC PACIFIC FUNDING CORP." Merrill Lynch refused and required Bonham to choose one name or the other. Bonham opened the account in the name of WPI. However, her checks on the account still read: "WORLD PLUS INC. DBA ATLANTIC PACIFIC FUNDING CORP." (*See, Compton Affidavit,* Exhibits 44 and 45).

2.8.9. Bonham also began to deposit investment funds into the joint account with her husband Steve Bonham, Key Bank Account No. 075019140. In the months of September and October 1995, Bonham deposited a total of $502,185 into this account. For the two months prior to September, she had deposited a total of $10,088.91. The money did not stay in the account for long, as by the end of October 1995, the account had a negative balance of

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$3,651.64.

Key Bank Account No. 075019140	**July 1995**	August 1995	**September 1995**	October 1995
Deposits	$1,379.91	$8,709.00	$193,108.05	$309,076.95
Withdrawals	$0.00	$0.00	$56,000.00	$42,025.00
Checks Paid	$479.76	$8,321.45	$135,029.99	$270,703.59
Deposits less Withdrawals and Checks Paid	$900.15	$387.55	$2,078.01	($3,651.64)

***69** (*See, Compton Affidavit,* Exhibit 46).

2.8.10. At about the same time, Bonham began to transfer investment income from one investor directly to another investor in satisfaction of a prior investment contract. Bonham would endorse the check to another investor or add his or her name as an additional payee. To date, the trustee has discovered approximately 10 lateral transfers in the amount of $20,000. (*See, Compton Affidavit,* Exhibit 70).

2.8.11. At the time of the petition date, the only account that was still open was the Cash Management Account with Merrill Lynch Pierce Fenner & Smith.

2.8.12. The debtor's use of WPI and APFC bank accounts as well as her own in such an indiscriminate and arbitrary fashion, has completely intermingled and confused the true financial receipts and disbursements of each entity. Given the debtor's lack of cooperation and apparent untrustworthy testimony in various proceedings before this court, it is unlikely that the trustee could ever, at any reasonable cost, sort out the true nature of the financial operations and structure of the three parties (Bonham, WPI, and APFC). The debtor has not only been untruthful in this court, but in previous securities investigations by the State of Idaho and the State of Alaska.

2.9. *The State of Alaska Securities Investigation-*

2.9.1. On September 4, 1992, Ed Watkins, Alaska Securities Examiner, spoke to RaeJean Bonham who told him that she had no idea the investment contracts might be a security. Bonham represented to Watkins that there would be no new investment sales and no rollovers would occur until the matter was resolved. (*See, Compton Affidavit,* Exhibit 47).

2.9.2. Despite her assurances to the State of Alaska, Bonham continued to issue investment contracts. Counsel for the trustee has identified over 90 additional investment contracts signed with WPI during the period of the State of Alaska's investigation, September 1992-March 1993.

2.9.3. Bonham wrote a letter to the "Investors of World Plus, Inc." dated September 28, 1992. Specifically, Bonham informed her investors:

> It has come to my attention once again that a few investors have been violating the understood agreement that this a confidential program and is not to be discussed with anyone. It is extremely important to observe this

rule in the program and not give out any information to family members, friends or financial institutions.

(*See, Compton Affidavit,* Exhibit 49). Some investors deny receiving this letter.

2.9.4. On November 17, 1992, Richard Hompesch, WPI's Alaska counsel, wrote to Ed Watkins about the WPI investigation, enclosing a list of active investors showing the date they first became involved and total invested. (*See, Compton Affidavit,* Exhibit 50).

***70** 2.9.5. Hompesch wrote Watkins on February 9, 1993, about the WPI investments in response to Watkins' stated concerns over the investment program. In his letter, Hompesch enclosed a list of investors and the investment balances. (*See, Compton Affidavit,* Exhibit 51).

2.9.6. Hompesch wrote another letter to Watkins on February 26, 1993, in which he attached a revised list of investors showing 17 contracts coming due in March 1993, for a total of $280,000. (*See, Compton Affidavit,* Exhibit 53). Hompesch also provided a schedule of contracts that had been paid since September 1992, which indicated $285,000 had been paid to 21 investors.

2.9.7. In March 1993, Hompesch submitted to the Alaska Department of Commerce & Economic Development (the DCED), WPI's application to offer exempt securities. (*See, Compton Affidavit,* Exhibit 54). In his letter, Hompesch stated that all of the outstanding contracts would be paid on or before March 12, 1993. *Id.* In reality, WPI and APFC, who had just begun issuing investment contracts, had over $2 million in outstanding contracts as of March 31, 1993. (*See, Supplemental Affidavit,* Exhibit 89).

2.9.8. Hompesch stated: "Assuming that all prior sales have been resolved to your satisfaction and that all investors are paid in full, World Plus, Inc. would like to begin selling new contracts on March 15, 1993, totaling approximately $300,000." (*See, Compton Affidavit,* Exhibit 54). Hompesch enclosed a *Notice of Exempt Offering* for WPI to raise up to $500,000 through contracts bearing 20% interest which would be limited to no more than 25 Alaska residents. *Id.*

2.9.9. On May 24, 1994, Hompesch wrote to Lawrence Carroll, Senior Securities Examiner for the State of Alaska DCED, to renew the *Notice of Exempt Offering,* and stated that there were no outstanding investment contracts. (*See, Supplemental Affidavit,* Exhibit 90).

2.9.10. Attached to the letter is Bonham's affidavit stating that "[a]t this time, World Plus, Inc. and Atlantic Pacific Funding Corporation have paid in full all contracts previously issued by the corporations. At this time, there are no outstanding or unpaid contracts to any investors." *Id.* This affidavit was incorrect. In fact, during the period from March 15, 1993, through May 24, 1994, WPI and APFC issued over 2,000 investment contracts in the principal amount of $45,710,000. (*See, Supplemental Affidavit,* Exhibit 91). A review of Exhibit 91 demonstrates that many of the investment contracts for this period were issued by APFC in an effort to circumvent the State of Alaska's registration requirements.

2.9.11. The DCED renewed WPI's exempt status to permit it to issue investment contracts at 20% per annum, to 15 or fewer Alaska residents, the total investment not to exceed $250,000. However, the DCED did require WPI to report the status of its investments every three months.

2.9.12. On September 8, 1994, Hompesch disclosed $220,000 in investments with 14 investors. (*See, Supplemental Affidavit,* Exhibit 93). Additionally, Hompesch informed the DCED that APFC had issued no new investment contracts. In reality, for the period of June 10, 1994, through September 8, 1994, WPI and APFC issued over 500 new investment contracts having a face amount of $11,765,000. (*See, Supplemental Affidavit,* Exhibit 94).

2.9.13. On December 12, 1994, Hompesch made his second disclosure to the DCED concerning the status of WPI's and APFC's investment program. (*See, Supplemental Affidavit,* Exhibit 95). Hompesch wrote that the only new investor since the September report was Ray Patterson, and that the only other change was a reduction in Arlyss Borjesson's investment from $15,000 to $5,000. Again, Hompesch stated that APFC "sold no contracts."

2.9.14. In fact, during this period WPI and APFC issued over 600 new contracts totaling $14,254,000 in principal, according to the debtor's records. (*See, Supplemental Affidavit,* Exhibit 96).

2.9.15. In his report for the first quarter of 1995, Hompesch informed the DCED that "neither Alaska Pacific Funding nor World Plus, Inc. has made any sales nor has had ***71** any investment change since our last report on December 12, 1994." (*See, Supplemental Affidavit,* Exhibit 97).

2.9.16. However, since December 12, 1994, WPI and APFC had, in fact, issued over 650 new contracts worth $14,458,000 in principal. (*See, Supplemental Affidavit,* Exhibit 98).

2.9.17. On June 14, 1995, Hompesch again informed the DCED that neither WPI nor APFC had made any new investments, and that no changes had occurred since the March 1995, report. (*See, Supplemental Affidavit,* Exhibit 99).

2.9.18. Actually, during this period WPI issued over 800 new investment contracts with a principal value of $16,177,000. (*See, Supplemental Affidavit,* Exhibit 100).

2.9.19. On September 13, 1995, Hompesch filed his last report with the DCED detailing 11 investors with $18,000 invested with WPI. (*See, Supplemental Affidavit,* Exhibit 101).

2.9.20. That report was also materially deceptive, as from June 15, 1995, through September 13, 1995, WPI issued over 750 contracts totaling $15,636,231 in principal. (*See, Supplemental Affidavit,* Exhibit 102). Some of these contracts were for two to three months. These contracts did not state the interest rate on the face of the contract, but did state the total amount due from WPI upon maturity. The trustee has calculated that the investment contracts maturing in two to three months returned 50% interest.

2.9.21. Through a series of falsehoods, directly and through her attorney, Bonham intentionally mislead the State of Alaska for over three years, during which time she issued tens of millions of dollars in investment contracts. Bonham used WPI and APFC to perpetuate her fraud, and these single-owner corporations should not be recognized as valid entities in order to shelter them, or their owner, from liability.

2.10. *The State of Idaho Securities Investigation-*

2.10.1. On November 17, 1993, James Burns, Securities Investigator, Idaho Department of Finance, wrote to Rae-Jean Bonham requesting information regarding solicitation of investments in Idaho. (*See, Compton Affidavit,* Exhibit 56). Bonham responded to the request for information on December 21, 1993, on APFC letterhead with a Nevada address, sending names of Idaho investors in WPI and APFC. (*See, Compton Affidavit,* Exhibit 57). She explained her business as buying large blocks of frequent flyer miles. She also explained that all lenders were Alaska residents when they first invested, but some later moved to Idaho. *Id.* The investors she identified were: Robert Beeson (c/o Chuck Joy), John Davidson, Howard Hall, Sherman Hart (c/o John Hart), Betty Jordan, Al Knapp, Donna Kreiensieck, and Niki LeClair. Bonham convinced her Idaho investors to write letters of support for APFC. (*See, Compton Affidavit,* Exhibit 58).

2.10.2. On January 20, 1994, Bonham, on APFC letterhead, responded to Burns' request for information on the investment contracts. She again stated that she never solicited investments in Idaho. Rather, according to her, people contacted her to invest, to see if there was an "open slot." To explain her business, she wrote:

> Atlantic Pacific Funding Corporation is my company I use to buy blocks of airline miles from large corporations at a cheaper price and WPI is my travel company which sells airline tickets to the public. We sell those tickets at a much higher price than what we purchased them for, enabling us to pay the interest to my investors.

(*See, Compton Affidavit,* Exhibit 59).

2.10.3 James Burns wrote to Bonham on February 3, 1994, informing her that the Nevada Corporations Department records showed someone else as the president, secretary and treasurer. (*See, Compton Affidavit,* Exhibit 60).

2.10.4. On February 16, 1994, Cumer Green, Bonham's Idaho counsel, wrote to James Burns, enclosing a recent filing in Nevada to revise the officers and directors to show Bonham as the president, treasurer, and secretary, as well as sole shareholder. The only other officer was Steve Bonham, her husband. Green explained that there was an oversight and Bonham's omission from the biennial report was just a housekeeping***72** item that needed to be done. (*See, Compton Affidavit,* Exhibit 61).

2.10.5. Approximately a week later, Ed Watkins, Alaska DCED, wrote to Bonham's Alaska counsel, Daniel Winfree, of Winfree & Hompesch, to inform Bonham that WPI's exemption from registration for WPI would not be renewed unless the Idaho securities investigation was resolved. (*See, Compton Affidavit,* Exhibit 62).

2.10.6. The State of Idaho concluded its investigation on April 5, 1994, when the Idaho Securities Bureau (Department of Finance) issued its *Agreement and Order* against RaeJean Bonham, WPI and APFC regarding the sales of unregistered securities by unlicensed sales persons and disclosure violations per the settlement agreement. (*See, Compton Affidavit,* Exhibit 73).

2.10.7. As part of the *Agreement and Order*, Bonham on behalf of herself personally, WPI, and APFC promised not to offer or issue any new investment contracts to Idaho residents unless she qualified the securities with the Idaho Department of Finance. *Id.* at ¶ 4. Bonham also promised to pay $2,500 as a fine to the State of Idaho.

2.10.8. After the conclusion of the Idaho investigation, Hompesch wrote to Lawrence Carroll regarding WPI's *Notice of Exempt Offering.* (*See, Compton Affidavit,* Exhibit 63). Hompesch enclosed a proposed *Notice of Exempt Offering*, a copy of the *Agreement and Order* of the Idaho investigation, and an affidavit from Bonham stating that all outstanding investors had been paid in full and there were no outstanding contracts. *Id.* Lawrence P. Carroll responded to Hompesch's letter on June 6, 1994. (*See, Compton Affidavit,* Exhibit 64). Under the agreement for WPI and APFC to offer exempt securities, WPI and APFC were required to file a report on September 15, 1994, and every three months thereafter. Additionally, Carroll wrote, *Id.*:

> Please understand that we are concerned that the limitations imposed by the Statutes are observed, and that there be no commingling of funds from other entities or other jurisdictions.
>
> Please note, as well, that the exemption at AS 45.55.140(b)(5)(B) is limited to Alaska residents only.

2.10.9. Hompesch acknowledged and accepted the State of Alaska's conditions by letter on June 16, 1994. (*See, Compton Affidavit,* Exhibit 65). Again, this did not deter Bonham, as she continued to bring in new investors through both APFC and WPI.

2.10.10. Bonham, through either WPI or APFC, issued approximately 80 investment contracts to Idaho residents after the *Agreement and Order.* (*See, Supplemental Affidavit,* Exhibit 92). Neither she, WPI, nor APFC ever paid the $2,500 fine.

2.10.11. Through another separate series of falsehoods, directly and through counsel, Bonham lied and defrauded the State of Idaho, all the while continuing her Ponzi scheme. Bonham used WPI and APFC to perpetuate this fraud and these single-owner corporations should not be recognized as valid entities in order to shelter them, or their owner, from liability.

2.11. *Transfers For Personal Benefit-*

2.11.1. Through various individual adversary proceedings during the course of this bankruptcy, the court has determined that RaeJean Bonham has used proceeds from WPI to finance her personal credit cards, housing, food, travel, and entertainment. Although WPI was a Sub S corporation, there is no indication that RaeJean Bonham properly accounted for withdrawals from WPI as salary or dividends, but rather used the corporation to pay her personal expenses.

2.11.2. The trustee has established in other proceedings that WPI or World Plus transferred approximately $200,000 to S & S Services, the proprietorship of RaeJean Bonham's husband, Steven Bonham. (*See, Compton Affidavit,* Exhibit 66 at ¶ 37).

2.11.3. The trustee has also established by his affidavit and in other proceedings before this court the following direct payments to Bonham's personal creditors by World Plus or WPI:

Date	**Amount**	**Item**
Since January, 1990	$11,652.60	GMAC - Automobile payments
Since January,	$6,573.	Saupe Enter-

1990	67	prises - Heating Oil
Since January, 1990	$8,306.07	GVEA - Utility bills
Since January, 1990	$24,651.00	Mortgage payments on the Bonham's personal residence
	$26,843.00	Life insurance premiums for policies on the lives of Steve & RaeJean Bonham
TOTAL	**$78,026.34**	

***73** (*See, Compton Affidavit,* Exhibit 66 at ¶¶ 40-44)

2.11.4. World Plus or WPI made the following payments to purchase personal goods or equipment for RaeJean or Steve Bonham or on their behalf:

Date	**Ck #**	**Amount**	**Payee**	**Item**
Sept. 7, 1990	2723	$24,000.00	Mike Gutman	Case 580D Backhoe
June 3, 1991	3530	$19,000.00	WJR, Ltd.	Case 580D Backhoe
Feb. 19, 1992	4556	$7,000.00	Gail McQuade	1992 Harley Davidson motorcycle
Jan. 14, 1993	5548	$3,000.00	Craig Taylor Equip. Co.	Melroe 853 Bobcat Loader
Jan. 18, 1993	5563	$22,130.00	Craig Taylor Equip. Co.	Melroe 853 Bobcat Loader
Dec. 14, 1994	7262	$15,408.45	Farthest North Harley	1995 Harley Davidson Motorcycle

TOTAL	**$90,538.45**

(*See, Compton Affidavit,* Exhibit 66 at ¶¶ 10-29).

2.11.5. World Plus purchased or supplied money for the partial purchase price of motor vehicles for Bonham's children, Stephanie and Steven Shane Bonham. WPI paid monthly stipends to Stephanie Bonham while she attended college. World Plus occasionally paid Stephanie's rent and tuition, and paid for vacations. (*See, Compton Affidavit,* Exhibit 66).

2.12. *Benefits vs. Burdens of Consolidation; Reliance of the Investors on WPI or APFC-*

2.12.1. Investors in World Plus, WPI and APFC have claims against RaeJean Bonham for unpaid amounts due under the investment contracts, given her violations of Alaska and federal laws regulating the sale of securities. APFC appears to have no, or minimal, creditors as it ceased to issue investment contracts in 1994, though Bonham continued to use the corporation to hide investment funds and make payments to WPI investors until the fall of 1995.

2.12.2. WPI and APFC are dissolved and defunct corporations. There are no meaningful assets for the creditors of WPI or APFC to recover outside of bankruptcy. Consolidation will not diminish any recovery by a creditor of WPI or APFC. Nor, will consolidation diminish the recovery of the creditors of RaeJean Bonham, given the lack of corporate independence.

2.12.3. Creditors of the corporations will recover little, or nothing, absent substantive consolidation of WPI and APFC with the Bonham estate *nunc pro tunc* as of December 19, 1995, the date of the involuntary petition against RaeJean Bonham.

2.12.4. The parties objecting to substantive consolidation are all defendants in the adversary proceedings brought by the trustee. They have filed a number of declarations stating that each of them relied on the separate credit of the corporations, WPI and ***74** APFC, and that they did not rely on the credit of RaeJean Bonham. These declarations are identified on the following table:

Attorney Name	**Docket Entries**	**Notes**
GOERIG, George	1285-1300	Declarant states that they *knew* that other investors had contacted state agencies and alleges only dealt with WPI or APFC, and Bonham only as agent.
ROSIE, John (*Pro Se*)	1284	Alleges only dealt with WPI or APFC, and Bonham only as agent.
BURNS, John	1268, 1275	Alleges only dealt with WPI or APFC, and Bonham only as agent.
MACDONALD, Michael	1282	Alleges only dealt with WPI or APFC, and Bonham only as agent.

DAVISON, Bruce	1280	Alleges only dealt with WPI or APFC, and Bonham only as agent.
AMBARIAN, Brad	1179-1203 1277-1278	Declarant states that they *knew* that other investors had contacted state agencies and alleges only dealt with WPI or APFC, and Bonham only as agent.
COPELAND, Rebecca	1235-1264	Alleges only dealt with WPI or APFC, and Bonham only as agent.

Some of the declarations (e.g., those filed by George Goerig's and Brad Ambarian's clients) indicate that the declarant "knew other investors had contacted the Alaska state agency which regulated securities and that agency had represented that WPI or APFC were in compliance with relevant laws of Alaska, including those governing corporations and the issuance of securities." None of the declarations give any detail about the specific financial information relied on. All are conclusionary, boilerplate statements that the investors relied on WPI and APFC, and only dealt with RaeJean Bonham as agent of the corporation. None had any financial information about WPI and APFC.

2.12.5. Those investors with investments prior to WPI's incorporation on April 22, 1991, held claims against Bonham personally, and their declarations directly contradict their testimony. Even after Bonham began operating though WPI and APFC, she was the only one who dealt or negotiated with investors to sell investment contracts and the only one who issued them either in her own name or on behalf of WPI and APFC.

2.12.6. Declarants also blur the line between WPI and APFC. Given the debtor's indiscriminate use of the corporations, it is impossible to separate the assets and liabilities of Bonham, WPI and APFC. It is implausible to believe that investors relied on the separate credit of one corporation as opposed to the other, given the degree to which the corporations were intertwined and dominated by Bonham.

2.12.7. None of the declarants state that he or she reviewed any financial statement or other accounting before investing. It is uncontroverted that the corporations never issued***75** a financial statement and never filed corporate tax returns.

2.12.8. The declarants do not reference any specific facts in support of their statements that they relied on the separate credit of WPI and APFC. RaeJean Bonham has testified that she personally handled each investment; no other party for WPI and APFC was involved. She used the corporate identities indiscriminately and often interchangeably. The self-serving statements of the investors' personal beliefs are not credible evidence that they relied on the credit of one or the other corporate entities as opposed to RaeJean Bonham.

3. *ISSUES*- The principal issues are:

- Does the bankruptcy court have authority to substantively consolidate the estates of non-debtors?

- Is substantive consolidation with the non-debtor corporations, WPI and APFC, appropriate in this case?

- What is the proper procedure for determining if there should be substantive consolidation with non-debtors? Is an adversary proceeding required? Are separate voluntary petitions required?

- If the cases are substantively consolidated, should it be ordered *nunc pro tunc* to the date of filing the involuntary case against RaeJean Bonham for preference purposes?

4. *LEGAL ANALYSIS*- **Part 4.1** of this *Memorandum Decision* is introductory, spelling out some of the basics.

In **Part 4.2**, I discuss the distinction between the federal bankruptcy concept of substantive consolidation and the state law theories of *alter ego,* corporate veil piercing and reverse piercing.

I have included a long section, about 33 pages in **Parts 4.3, 4.4 and 4.5** of this *Memorandum Decision* to review the case law of substantive consolidation: (a) pre-Code, (b) after the 1978 Bankruptcy Code became effective, and (c) relating specifically to non-debtor consolidation. In these sections, I do not attempt to any great degree to reflect on how these cases relate to the Bonham, WPI and APFC facts.

Rather, in **Part 4.6** (relating to procedure), **Part 4.7** (discussing the merits of substantive consolidation in this case), and **Part 4.8** (discussing the *nunc pro tunc* or effective date issue), I will attempt to relate the law to the specific case before the court.

4.1. *A Bankruptcy Court Has Authority to Order Substantive Consolidation of Entities (Usually All of Them Debtors) in an Appropriate Case*- Substantive consolidation has long been part of the fabric of bankruptcy law. 2 *Collier on Bankruptcy*, ¶ 105.04[2], fn18 (Matthew Bender 15th ed rev 1998):

> *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941). In *Sampsell*, the Court upheld the bankruptcy referee's consolidation of the estate of the individual debtor with the assets of a nondebtor corporation which was wholly owned by the debtor and his family. In upholding consolidation, the Court noted that the "power of the bankruptcy court to subordinate claims or to adjudicate equities arising out of the relationship between the several creditors is complete." 313 U.S. 215, 219, 61 S.Ct. 904, 907, 85 L.Ed. 1293, 1298.

Sampsell involves the merger of the assets and claims of separate estates (including the estate of a non-debtor).

The source of the authority to substantively consolidate has been found in the general equitable powers of the court, now embodied in 11 U.S.C.A. § 105(a). *Sampsell* ; *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2nd Cir.1988); *Matter of Munford*, 115 B.R. 390, 397 (Bankr.N.D.Ga.1990).

[1] Thus, in general, there is little doubt that a bankruptcy court has authority to grant substantive consolidation of separate bankruptcy estates into one estate. Also, in what appears to be a slight majority of the cases which have decided the issue, courts have held that the estate of a non-debtor can be consolidated into that of a debtor under the appropriate circumstances.

[2] "[Substantive consolidation] involves the pooling of the assets and liabilities of two or more related entities; the liabilities of the entities involved are then satisfied from the common pool of assets created by consolidation."***76** *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245, 248 (11th Cir.1991). There are winners and losers in the process. The creditors of the poorer estates may benefit from the pooling of assets of a more solvent estate, and those from the more financially solvent estates will be diluted. *Flora Mir Candy Corp. v. R.S. Dickson & Co.*, 432 F.2d 1060, 1062-63 (2nd Cir.1970).

[3][4][5] Substantive consolidation should not be used as a mere device of convenience, e.g., to overcome accounting difficulties, where it would unfairly impair the vested rights of some of the creditors. *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2nd Cir.1988); *Flora Mir Candy Corp.*, 432 F.2d at 1062. Because of the possibility for such inequities, it should be used sparingly. *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2d Cir.1966); *Matter of New Center Hospital*, 187 B.R. 560, 567 (E.D.Mich.1995). In general, a court should be convinced that injustice would occur absent consolidation. *See*, *In re Snider Bros., Inc.*, 18 B.R. 230, 235 (Bankr.D.Mass.1982), analyzing *Soviero v. Franklin Nat'l Bank*, 328 F.2d 446 (2d Cir.1964).

[6] However, the rights of a class of creditors of one of the entities can be protected, even though the cases are substantively consolidated. Not all classes of creditors have to be treated equally. For example, the security interest of a creditor in the assets of one of the entities may be protected so the interest is not diluted (nor improved) by the consolidation. *In re Continental Vending Machine Corp.*, 517 F.2d 997, 1001 (2nd Cir.1975); *In re Tureaud*, 45 B.R. 658 (Bankr.N.D.Okla.1985), *affd* 59 B.R. 973 (1986).

The only sections of the 1978 Bankruptcy Code which even mention substantive consolidation are 11 U.S.C.A. § 302(b), involving the joint cases of spouses, and § 1123(a)(5)(C), stating that a chapter 11 plan may provide for the consolidation or merger of a debtor with one or more persons.

FRBP 1015(b) allows the court to order joint administration of certain related debtors, but the Advisory Notes make it clear that substantive consolidation is neither authorized or prohibited by the rule. Thus, the doctrine of substantive consolidation has been shaped by the case law as I have outlined in Parts 4.3, 4.4, and 4.5 of this *Memorandum Decision.*

[7] After reading many of these cases, I tend to agree with the court that said precedent alone is of limited value because of the diversity of factual patterns. *In re Reider*, 31 F.3d 1102, 1108 (11th Cir.1994). The results in the cases are fact driven.

[8] 4.2. *Substantive Consolidation Should be Distinguished from State Law Alter Ego Remedies*- The parties opposing substantive consolidation have all been sued by the trustee to recover funds on various avoidance theories. They are defendants in the *Bonham Recovery Actions* (the *BRA*), the lead case for case management purposes under complex litigation procedures. Among the defenses they have raised is that the trustee is attempting to enforce an *alter ego* remedy which is not a prerogative of the bankruptcy trustee. They argue that the right to pursue this remedy belongs to the individual creditors of WPI and APFC, corporations which RaeJean Bonham used to obtain a large part of the investments she received before she was shut down in late 1995. In other words, they say the trustee has no standing to pursue avoidance claims.

Some of these defendants cite *Williams v. California 1st Bank*, 859 F.2d 664 (9th Cir.1988), *In re Ozark Restaurant Equipment Co., Inc.*, 816 F.2d 1222 (8th Cir.1987), *cert den* 484 U.S. 848, 108 S.Ct. 147, 98 L.Ed.2d 102 (1987); and *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972), as dispositive because the trustee has no authority to assert a creditor's individual rights against WPI and APFC under Alaska law. They cite *Croxton v. Crowley Maritime Corp.*, 817 P.2d 460, 466 (Alaska 1991), for the proposition that Alaska has rejected reverse piercing of a corporate entity. *See,* Docket Entry 1105, *Supplemental Memorandum in Opposition to Trustee's Motion For Substantive Consolidation Re: Alter Ego Issues* (filed by Randolph Haines for various defendants).

***77** Others make similar arguments. *See,* Docket Entry 1108, *Joinder and Supplement to "Response and Objection to Trustee's Motion for Substantive Consolidation"* (filed by Brad Ambarian for various defendants). They cite *Norman v. Nichiro Gyogyo Kaisha, Ltd.*, 645 P.2d 191, 196 (Alaska 1982); *Arctic Contractors, Inc. v. State of Alaska*, 573 P.2d 1385, 1386 (Alaska 1978); *Martin v. Maldonado*, 572 P.2d 763, 773 (Alaska 1977).

The trustee need not dispute these cases because they do not address the federal bankruptcy law concept of substantive consolidation, and deal only with the state law regarding *alter ego*, piercing and reverse piercing of corporate entities.

The difference between corporate veil piercing and the bankruptcy concept of substantive consolidation is succinctly stated by J. Stephen Gilbert, Note: *Substantive Consolidation in Bankruptcy: A Primer*, 43 Vand L Rev 207, 218 and fn 77-81:

> 2. Misplaced Analogy to Corporate Law
>
> The factors evaluated on a motion for substantive consolidation appear similar to an analysis of piercing the corporate veil. Like piercing the corporate veil, substantive consolidation ignores artificial structures legally defining the consolidated entities. Ultimately, however, such an analogy is misplaced because the corporate law doctrine of limited liability is not involved. Rather, substantive consolidation is more like the corporate law notion of enterprise liability because substantive consolidation does not seek to hold shareholders liable for the acts of their incorporated entity. [FN79] Substantive consolidation more closely resembles the bankruptcy rule of subordination because competition for the consolidated assets is between creditors alone. Thus, substantive consolidation ignores artificial legal structures but looks only to the combined assets of the consolidated entities for satisfaction of all claims against the collective group. [footnotes omitted]

See, In re Creditors Service Corp., 195 B.R. 680, 689 (Bankr.S.D.Ohio 1996); *In re Kroh*, 117 B.R. 499, 501-2 (W.D.Mo.1989) ("The result [the bankruptcy judge] reaches may be close to the practice forbidden in *Ozark Restaurant*, but it is distinctly different."); *In re DRW Property Co. 82*, 54 B.R. 489, 496, fn. 2 (Bankr.N.D.Tex.1985).

[9] The law of substantive consolidation is federal bankruptcy law. In some cases, an *alter ego* analysis is involved in determining if entities should be consolidated. The use of an *alter ego* analysis does not, however, deprive the bankruptcy court of jurisdiction to consider sub-

stantive consolidation.

4.3. *Early Development of the Case Law of Substantive Consolidation*- The law of substantive consolidation has been developed over the course of almost 60 years in a number of circuit and lower court cases. In this Part 4.3 of this *Memorandum Decision*, I will discuss some of the pre-Code cases. Many, but not all, of these pre-Code cases involve the consolidation of the estates of entities that were already debtors. Some of the most important ones involve the substantive consolidation of non-debtors.

In Part 4.4, I will review some of the circuit cases and key lower court cases decided after the 1978 Bankruptcy Code.

After that, in Part 4.5, I will focus on the case law under the 1978 Bankruptcy Code involving the consolidation of non-debtor entities with existing bankruptcy debtor estates. These are mostly lower court opinions.

Here is a thumbnail sketch of some of the key concepts which arise from the seminal pre-Code cases. Substantive consolidation was fashioned as a device to combat the commission of fraud upon creditors which might go uncorrected in its absence. *See, e.g., Sampsell v. Imperial Paper*, in which consolidation was used to thwart a non-debtor from walking away with the assets which rightfully should have belonged to a bankrupt corporation, but were obtained through fraudulent transfers by insiders.

Substantive consolidation was also used as a practical device where the identity of assets and liabilities of separate entities were badly intermingled by poorly kept accounting records, disregard of corporate formalities, and sloppy business procedures in general. The accounting cost of untangling these estates ***78** might well eat up the amount available for creditors, so consolidation was a practical way to maximize the recovery for the creditors.

There is, however, a need to balance these worthy goals of overcoming fraud or maximizing the recovery where the entities are hopelessly entangled, so that they do not overshadow or defeat the vested rights of innocent creditors.

Circuit Judge Friendly of the 2nd Circuit took a conservative approach, giving more deference to the secured creditors (or, those with guaranties, for example) than the general body of unsecured creditors, even though the bottom line for the total recovery might be less. This is discussed in the *Kheel* and *Flora Mir Candy Corp.* cases reviewed later in this Part 4.3.

Over time, the circuit courts and some lower courts have developed some tests or guidelines to determine if substantive consolidation is appropriate in a given case. These tests vary slightly, but it is fair to say the decision in a given case is heavily dependent on the facts of the individual case. Some of the tests are discussed in Part 4.4.

Here are the earlier cases. As they are reviewed, many of the facts found in Part 2 concerning RaeJean Bonham, WPI, and APFC should come to mind. It is not difficult to see the application of these cases to *Bonham.*

Fish v. East- One of the earliest cases is *Fish v. East*, 114 F.2d 177 (10th Cir.1940). The court approved substantive consolidation of a non-debtor which was an "instrumentality" of the debtor.

The case, like the *Bonham* case, involved the consolidation of a non-debtor. There was a motion to consolidate a wholly owned subsidiary, Tiger Placers Company (Placer), and a related partnership, Blue Ridge Co., with the debtor parent, Royal Tiger Mines Company (Mines).

Although there was a commonality of principals in Mines and Placer, when Mines began having financial difficulties and could not raise funds, the principals bailed out of Mines and transferred assets to Placer and Blue Ridge, also owned by the insiders. The effect was to divert assets from the Mines' creditors in a very manipulative way. The 10th Circuit affirmed consolidation, indicating, *Id.* at 191:

> Corporate entity may be disregarded where not to do so will defeat public convenience, justify wrong or protect fraud. [citations omitted] The board of each company was at all times made up of members of the dominating group of their employees or their attorneys.
>
> ...
>
> The instrumentality rule here has application. The determination as to whether a subsidiary is an instrumentality is primarily a question of fact and degree. The following determinative circumstances are recognized:
>
> (1) The parent corporation owns all or majority of

> the capital stock of the subsidiary. (2) The parent and subsidiary corporations have common directors or officers. (3) The parent corporation finances the subsidiary. (4) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation. (5) The subsidiary has grossly inadequate capital. (6) The parent corporation pays the salaries or expenses or losses of the subsidiary. (7) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation. (8) In the papers of the parent corporation, and in the statements of its officers, 'the subsidiary' is referred to as such or as a department or division. (9) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take direction from the parent corporation. (10) The formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

Sampsell v Imperial Paper & Color Corp.- *See*, discussion in Part 4.2 of this *Memorandum Decision.* In *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941), substantive consolidation was approved to circumvent the ***79** debtor's fraudulent transfer of assets to a non-debtor entity held by insiders.

Stone v. Eacho- Another earlier case was *Stone v. Eacho*, 127 F.2d 284 (4th Cir.1942), *reh den* 128 F.2d 16 (4th Cir.1942), *cert den* 317 U.S. 635, 63 S.Ct. 54, 87 L.Ed. 512 (1942). Tip Top Tailors, a New Jersey corporation, was a bankrupt in a Delaware bankruptcy. Its subsidiary, also named Tip Top Tailors, was a bankrupt in a separate Virginia proceeding.

The Delaware trustee sought to consolidate the cases. Both corporations were insolvent. The Virginia corporation was almost completely financed through the parent New Jersey store, which maintained the inventory, did the actual tailoring, and paid the bills. The court found that the subsidiary was not treated as a separate entity and the creditors dealt with the parent and subsidiary as one. The court said, *Id.* at 288:

> It is well settled that courts will not be blinded by corporate forms nor permit them to be used to defeat public convenience, justify wrong or perpetrate fraud, but will look through the forms and behind the corporate entities involved to deal with the situation as justice may require. [citations omitted]
>
> Not only is this done for the purpose of holding a stockholder or parent corporation for debts created by an insolvent corporate agent or subsidiary which is a mere instrumentality of the stockholder or parent, but also for the purpose of allowing the creditors of the stockholder or parent to reach assets held by such a subsidiary. [citations omitted]

Soviero v. Franklin National Bank- *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (2nd Cir.1964), is the first of three important 2nd Circuit cases regarding substantive consolidation.

A bankruptcy trustee of Raphan Carpet Corporation sought the adjudication of assets of thirteen separate corporations, each having "Raphan" in its corporate name. Although the corporations filed separate tax returns and kept separate books, they were done by the same accountants. The corporations were run very loosely. There were no minutes. The principals of the corporations treated them as a consolidated business. All the affiliated corporations issued consolidated financial statements on which they listed their assets without separation.

Though suppliers shipped to affiliated corporations, all the billing was to the bankrupt. The bankrupt paid for advertising, labor, insurance, and other costs. The court said, *Id.* at 448:

> It is difficult to imagine a better example of commingling of assets and functions and of the flagrant disregard of corporate forms than as here demonstrated by the bankrupt. One gains the distinct impression that the bankrupt held up the veils of the fourteen collateral corporations primarily, if not solely, for the benefit of the tax gatherer, but otherwise completely disregarded them. Even Salome's could not have been more diaphanous. On these facts, we are convinced that the claims of individual corporate entities advanced for the Affiliates and Realty are 'without color of merit, and a mere pretense.' [citations omitted]

Chemical Bank New York Trust Co. v. Kheel- In *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (2nd Cir.1966), a shipping magnate owned a number of corporations engaged in the shipping trade. All were in Chapter X under the Bankruptcy Act. Reorganization was not successful and a reorganization trustee was in the process of liquidation. The trustee sought to consolidate and Chemical Bank opposed the motion.

The corporations were operated very loosely as figureheads for the shipping magnate. No attention was paid to corporate formalities. Funds were transferred back and forth in a very complex pattern, and in a manner which would have been very difficult to trace.

Chemical Bank was trustee for bondholders under a secured indenture. Chemical Bank questioned the referee's decision to order consolidation where it was not shown that Chemical Bank had dealt with all the corporations as a unit. The court said, however, *Id.* at 847:

> ***80** We find no such limitation on the power of the reorganization court. See *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (2nd Cir.1964); *Stone v. Eacho*, 127 F.2d 284 (4th Cir.), rehearing denied 128 F.2d 16, cert. denied 317 U.S. 635, 63 S.Ct. 54, 87 L.Ed. 512 (1942). While the record in the *Soviero* case indicates that there was evidence that the Bank had dealt with the bankrupt and its affiliates as one, the opinion does not make this a necessary foundation for the result. Moreover, we have here an additional factor not present in *Soviero* or *Stone v. Eacho*, the expense and difficulty amounting to practical impossibility of reconstructing the financial records of the debtors to determine intercorporate claims, liabilities and ownership of assets. The power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others. Yet in the rare case such as this, where the interrelationships of the group are hopelessly obscured and the time and expense necessary even to attempt to unscramble them so substantial as to threaten the realization of any net assets for all the creditors, equity is not helpless to reach a rough approximation of justice to some rather than deny any to all.

While Circuit Judge Friendly concurred, he criticized the majority's reasoning as focusing too much on the complexities of the accounting at the expense of the rights of individual creditors who might have dealt separately with certain of the corporations. He concurred with the result, however, on the ground that Chemical Bank apparently did not establish such a reliance which he apparently thought was its obligation to prove.

Flora Mir Candy Corp. v. R.S. Dickson & Co.- The third landmark 2nd Circuit case is *Flora Mir Candy Corp. v. R.S. Dickson & Co.*, 432 F.2d 1060 (2nd Cir.1970), authored by Judge Friendly. In this case, Judge Friendly's deference to the creditors' reliance on the assets of one of the corporate entities prevailed, notwithstanding a situation where the books and records were extremely difficult to sort out.

Debentures had been issued by Meadors, Inc., six years before it was acquired by an intermediate corporate buyer. Subsequently, Meadors was sold to Flora Mir Candy Corporation, which was engaged in a corporate acquisition program. About 7 1/2 years after the debentures had been issued by Meadors, Flora Mir and related companies, including Meadors, filed for Chapter X1 in the Southern District of New York. Prior to the bankruptcies, however, the Meadors' bondholders had sued several of the Flora Mir companies and Meadors for fraud in a South Carolina court.

The substantive consolidation would have diluted the bondholders' recovery. It would have had the effect of eliminating the intercompany transfers and allowed other creditors to share in any recovery which was rightfully the bondholders.

It was argued in favor of substantive consolidation that it would result in a much quicker arrangement than working through the complexities of an accounting. Although a speedy reorganization might have been desirable, the court held that a quicker or easier arrangement should not be accomplished at the expense of Meadors' debenture holders.

The principal to be derived is that the complexities of untangling the accounting is insufficient reason in some cases to grant substantive consolidation where creditors' vested rights are harmed in the process.

In re Gulfco Investment Corporation- Similarly, in *In re Gulfco Investment Corporation*, 593 F.2d 921 (10th Cir.1979), a court was faced with a convoluted corporate structure as shown on an organizational chart at the end of the case. *Id.* at 932. A trial court had ordered consolidation, but the 5th Circuit reversed. The bankruptcy court principally based its decision to grant substantive consolidation on the complex accounting issues and difficulties in evaluating intercompany accounts and determining the assets and liabilities of each corporation. The bankruptcy court found that accounting difficulties were ***81** of such a magnitude that they outweighed any individual equitable problems that might have occurred.

The consolidation in *Gulfco*, however, would have eliminated the security interests of some creditors and also eliminated certain guarantees made by one of the debtor corporations to secure the debt of another debtor corporation. The 5th Circuit held that the trial court had not given enough weight to the rights of the secured claimants and the guarantees. Where the corporation guarantees the debts of a sub or affiliate, a creditor is deprived of multiple recoveries from the various layers of corporations by their consolidation. In the consolidation, the creditor is reduced to one claim. The court held that this should not be done except in compelling circumstances. The circumstances, though severe, were not compelling enough to override the creditors' rights which would have been diluted in the consolidation process.

4.4. *Substantive Consolidation Cases Under The Bankruptcy Code*- After the adoption of the 1978 Bankruptcy Code, the courts have struggled to articulate a test to govern whether to grant substantive consolidation. I will discuss two of the leading circuit court cases and a few of the often cited bankruptcy court cases.

The circuit court cases which attempted to articulate a test to determine if substantive consolidation is appropriate are *In re Augie/Restivo Baking Co., Ltd.*, 84 B.R. 315 (Bkrtcy.E.D.N.Y.1988) from the 2nd Circuit and *Eastgroup Properties v. Southern Motel Assoc., Ltd.* from the 11th Circuit. There are no 9th Circuit cases requiring that a particular test be used. The bankruptcy court cases are *In re Snider* from Massachusetts and *In re Vecco* from Virginia.

In re Vecco Construction Industries, Inc.- In *In re Vecco Construction Industries, Inc.*, 4 B.R. 407 (Bankr.E.D.Va.1980), the court attempted to fashion a general test based on the pre-Code cases discussed in part 4.3. The parent and four subsidiaries were engaged in the concrete construction business in different locations and in providing labor for those businesses. Over a year before the bankruptcy, the parent had acquired all the assets of the subs in a *de facto* consolidation. After filing chapter XI for the parent and chapter 11s for the subsidiaries, the debtors moved to substantively consolidate. The motion was unopposed. The court endorsed the "liberal trend" in allowing consolidations from the widespread use of interrelated corporations operating under the parent's shield for tax and business purposes. *Vecco* at 409.

And, the court came up with a seven-part test to determine if a case should be substantively consolidated, *Vecco* at 410:

> First, the degree of difficulty in segregating and ascertaining individual assets and liability. Second, the presence or absence of consolidated financial statements. Third, the profitability of consolidation at a single physical location. Fourth, the commingling of assets and business functions. Fifth, the unity of interests and ownership between the various corporate entities. Sixth, the existence of parent and inter-corporate guarantees on loans. Seventh, the transfer of assets without formal observance of corporate formalities.

In re Snider Bros., Inc.- In *In re Snider Bros., Inc.*, 18 B.R. 230 (Bankr.D.Mass.1982), the creditors' committees of six integrated, family-run businesses involved in purchasing and slaughtering beef, sought substantive consolidation. Only a secured creditor objected. The separate companies operated in different phases of the beef industry, and kept separate books. They operated from one location. There were intercompany loans and guarantees. The committees sought consolidation so the businesses could be better marketed.

The objecting secured creditor's complaint that it would be diluted by $70,000 was not refuted, but the committees argued that the bank had dealt with the debtors as a unit.

The court denied substantive consolidation. Acknowledging the attempt of some courts, like *Vecco Construction*, to set out a test based on various criteria, the court said, *Id.* at 234:

> I find that the only real criterion is ... the economic prejudice of continued debtor separateness versus the economic prejudice of consolidation. There is no one set ***82** of elements which, if established, will mandate consolidation in every instance. Moreover, the fact that corporate formalities may have been ignored, or that different debtors are associated in business in some way, does not by itself lead inevitably to the conclusion that it would be equitable to merge otherwise separate estates.

The commingling of assets and flagrant disregard of corporate forms is not, itself, enough to justify consolidation. Rather, it is "the injustice to creditors if consolidation is not permitted." *Id.* at 235. The proponent of consolidation must show the harm which arose from the intermingling or the unity of interest. *Id.* at 238.

Once a proponent has established a case for substantive consolidation, it is still possible to raise a defense that, *Id.* at 238:

> ... there is still the matter of the defense that the benefits of consolidation do not outweigh the harm to be caused to the objector. A creditor who has looked solely to the credit of its debtor and who is certain to suffer more than minimal harm as a result of consolidation may be entitled to denial of a request for consolidation.

Thus, consolidation was denied, even without reference to the objection of the secured creditor. The corporations had not been flagrant in disregarding corporate formality. They kept separate books. Their method of operation was similar to many family-run businesses.

Augie/Restivo Baking Co., Ltd.- *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515 (2nd Cir.1988), involved the bankruptcies of several corporations. Before they combined operations, Augie's Baking Company, Ltd. and Restivo Brothers Bakers, Inc. operated separately in different boroughs in New York City. Augie's Baking sold its stock to Restivo and the company adopted the Augie/Restivo name. Augie's Baking had been financed by Union Bank and Restivo was heavily financed by Manufacturers Hanover Trust Company (MHTC). No formal merger had ever taken place. The land that Augie's Baking owned was still in its name. Accounts had not been formally transferred.

After the combination, the new Augie/Restivo operated in its own name and did not use Augie's separate name. After the bankruptcy case was filed, numerous cash collateral orders between Augie/Restivo and MHTC were entered into with a result that all of its prepetition accounts receivable claims had been transferred to priority administrative claims under the cash collateral orders.

Apparently, it was necessary to seek consolidation to confirm a plan because Union Bank objected. It objected on the grounds that a consolidation would have diluted its recovery. The circuit court agreed with Union Bank. It reviewed the 2nd Circuit cases, which are outlined in Part 4.3 of this *Memorandum*. It distilled the cases into the following test, *Augie/Restivo* at 518:

> An examination of those cases, however, reveals that these considerations are merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and "did not rely on their separate identity in extending credit," or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors. [citations omitted]

The court found that the affairs were not so entangled that they could not be understood without enormous effort (i.e., not nearly as bad as those in *Chemical Bank New York v. Kheel*), and determined that Union Bank had in fact dealt with Augie's Baking as a separate entity. For that reason, consolidation was denied.

Eastgroup Properties v. Southern Motel Assoc., Ltd.- In *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir.1991), Gainsville P-H Properties (GPH) and Southern Motel Association (SMA) were commonly owed. They filed chapter 11 cases, but were converted to chapter 7 cases. The chapter 7 trustee sought to substantively consolidate them. Eastgroup, a creditor of SMA, objected.

SMA and GPH operated out of the same office, and GPH employees performed services for SMA. They had written agreements about the operation of eleven motel properties, five of which SMA had leased from Eastgroup. GPH paid some of SMA's ***83** obligations and there were intercompany transfers.

On what appears to be rather weak evidence, the bankruptcy court granted the motion for substantive consolidation, to prevent the SMA equity holders from realizing a bankruptcy dividend while the GPH creditors would not be paid. In fact, the mathematics of the SMA and GPH cases indicated that both cases were administratively insolvent, let alone paying prepetition creditors or equity holders.

In *Eastgroup Properties*, the court noted, at 248-49:

> There is, however, a "modern" or "liberal" trend toward allowing substantive consolidation, which has its genesis in the increased judicial recognition of the widespread use of interrelated corporate structures by subsidiary corporations operating under a parent entity's corporate umbrella for tax and business purposes. [footnote omitted]

The 11th Circuit Court then stated the test it would use, adopting a standard set out in *In re Auto-Train Corp.*, 810

F.2d 270, 276 (D.C.Cir.1987). *Eastgroup* said, at 249:

> Under this standard, the proponent of substantive consolidation must show that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit. When this showing is made, a presumption arises "that creditors have not relied solely on the credit of one of the entities involved." Once the proponent has made this prima facie case for consolidation, the burden shifts to an objecting creditor to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation. ... Finally, if an objecting creditor has made this showing, "the court may order consolidation only if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm." [omitting internal and citations]

4.5. *Substantive Consolidation of Non-Debtors Under the Bankruptcy Code.*- Some of early substantive consolidation cases involved the consolidation of non-debtors. These include *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941); *Fish v. East*, 114 F.2d 177 (10th Cir.1940); and *Soviero v. Franklin National Bank of Long Island*, 328 F.2d 446 (2nd Cir.1964).

Since the inception of the 1978 Bankruptcy Code, over a dozen cases have considered the issue of substantively consolidating non-debtors into an existing bankruptcy case. These cases have built on the pre-Code cases described in Part 4.3 and those decided since the 1978 Bankruptcy Code went into effect, such as those described in Part 4.4.

[10][11] Most of the non-debtor cases acknowledge that consolidating a non-debtor's estate with the case of an existing debtor is a much more sensitive matter than consolidating existing debtors. If substantive consolidation of existing bankruptcy debtors is to be applied cautiously, even more care should be taken with respect to consolidating non-debtors. *See,* Christopher J. Predko, Note: *Substantive Consolidation Involving Non-Debtors: Conceptual and Jurisdictional Difficulties In Bankruptcy*, 41 *Wayne Law Review*, 1741 (Summer 1995). Nonetheless, there are cases in which substantive consolidation of non-debtors is the appropriate procedure and/or remedy under the given facts.

A few of the cases discuss the procedural anachronisms which may arise (e.g., how to give notice to the non-debtor's creditors of the procedure and when is the "order for relief?").

Some of the cases discuss whether the equitable powers of a bankruptcy court under 11 U.S.C.A. § 105(a) stretch so far as to permit substantive consolidation of non-debtors. There is discussion in some cases whether substantively consolidating non-debtors subverts the involuntary bankruptcy provisions of 11 U.S.C.A. § 303.

Here is a sample of the non-debtor cases:

Cases *allowing* substantive consolidation of non-debtors are:

- *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. 89 (Bankr.D.C.1981)
- *In re Crabtree*, 39 B.R. 718 (Bankr.E.D.Tenn.1984)

***84** • *In re Tureaud*, 45 B.R. 658 (Bankr.N.D.Okla.1985), *affd* 59 B.R. 973 (1986)

- *Matter of Baker & Getty Financial Services, Inc.*, 78 B.R. 139 (Bankr.N.D.Ohio 1987)
- *In re Munford, Inc.*, 115 B.R. 390 (Bankr.N.D.Ga.1990)
- *Matter of New Center Hospital*, 187 B.R. 560 (E.D.Mich.1995)
- *In re United Stairs Corp.*, 176 B.R. 359 (Bankr.D.N.J.1995)
- *In re Creditors Service Corp.*, 195 B.R. 680 (Bankr.S.D.Ohio 1996)

Cases *not allowing* substantive consolidation of non-debtors are:

- *In re Alpha & Omega Realty, Inc.*, 36 B.R. 416 (Bankr.D.Idaho 1984)
- *In re DRW Property Co. 82*, 54 B.R. 489 (Bankr.N.D.Tex.1985)
- *In re R.H.N. Realty Corp.*, 84 B.R. 356

(Bankr.S.D.N.Y.1988)

• *In re Julien Co.*, 120 B.R. 930 (Bankr.W.D.Tenn.1990)

• *In re Lease-A-Fleet*, 141 B.R. 869 (Bankr.E.D.Pa.1992)

• *In re Circle Land and Cattle Corp.*, 213 B.R. 870, 877 (Bankr.D.Kan.1997)

In re 1438 Meridian Place, N.W., Inc.- In *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. 89 (Bankr.D.C.1981), the court had a contested matter before it in which creditors sought to substantively consolidate the debtor's estate with other non-debtor corporations and the non-debtor individuals who owned the corporations. Nick and Miranda Rangoussis owned about eight corporations in the Washington, DC area. Each corporation operated a separate rental property. After various tenants obtained a $34,000 judgment against one of the corporations, it filed chapter 11. The tenants then sought to bring in the other corporations as well as the Rangoussises individually. Much like the trustee in *Bonham*, the creditors in *Meridian* sought to disregard the corporate veil and amend the caption to include the non-debtor entities.

The individual corporations, although they each operated separate properties, used a common bank account for income and expenses. The account paid the personal bills of the Rangoussises also. The accounting records were in such disarray that, although these were separate rental properties, there were no accounting records or way to identify the income and expenses of each separate property. Most of the corporate formalities had been disregarded.

On the basis of this record, the court found that substantive consolidation was appropriate. In doing this, the court addressed two arguments against consolidation raised by the debtor and non-debtor targets. First, they argued that the issue should be addressed in an adversary proceeding under the former FRBP 701. Secondly, they said that to bring them into the bankruptcy arena, the movants should have proceeded by way of an involuntary petition pursuant to 11 U.S.C.A. § 303.

The court did not read the requirements of the former FRBP 701 as requiring an adversary proceeding. Nor, was an involuntary petition necessary, although it would have been an appropriate way to proceed. The burden of proof was on the creditors seeking to bring in the non-debtor entities, but here they had established the right by showing: (a) a failure to observe corporate formalities; (b) absence of relevant corporate financial records; (c) undercapitalization; (d) principal officers dominating all the corporations; and, (e) commingling of funds.

With respect to the contention that the only appropriate procedure would have been involuntary protection under 11 U.S.C.A. § 303, the court said, *Id.* at 95:

> This assertion misses the mark completely. The tenant creditors are in fact creditors of only 1438 Meridian Place, N.W., and they could not comply with the mandated requirements of 11 U.S.C.A. § 303(b)...

The creditors in the *Bonham* bankruptcy argue that trustee Compton should have promptly filed *voluntary* petitions for WPI and APFC. This disregards the chaotic state of the records, and the difficulty in getting information from RaeJean Bonham. It was only after an enormous forensic accounting effort that the trustee could see the forest for the trees.

85** ***In re Crabtree- In *In re Crabtree*, 39 B.R. 718 (Bankr.E.D.Tenn.1984), creditors sought to have a corporation added to the caption of an individual case and its assets consolidated in the individual case. This was based on an *alter ego* claim. In this case, the individual debtor was the sole shareholder of West Knoxville Investment Company, Inc. (WKIC), the non-debtor corporation. No creditors objected to the motion.

The court found that WKIC was the *alter ego* of Crabtree because he was the sole shareholder, guaranteed the corporation's debts, the corporation operated with little formality, and the financial affairs of Crabtree and the corporation were financially intermingled. The corporation acted as a shell nominee for procuring loans for Crabtree's investment schemes. "The affairs of Crabtree and West Knoxville Investment Company, Inc., are so intermingled and entwined that their separate assets and liabilities cannot be ascertained, and any attempt to separate their financial affairs would consume substantial assets of the estate with no considerable likelihood that such an exercise would be successful." *Id.* at 721.

The court held that it would amend the caption of the case to add WKIC *nunc pro tunc* as of July 14, 1983 (apparently the date of filing the involuntary petition). The court

said: "The amended petition does not add a second debtor to this case, but rather reflects the reality that West Knoxville Investment Company, Inc. is simply Crabtree's *alter ego* and an instrumentality used by him to conduct his financial affairs." *Id.* at 721. Likewise, the court approved the use of a motion to accomplish this, citing *In re 1438 Meridian Place, N.W., Inc.* and *In re Auto-Train Corp.* (the bankruptcy case which was later affirmed at *In re Auto-Train Corp.*, 810 F.2d 270 (D.C.Cir.1987)).

In re Tureaud- The next case in which the court approved substantive consolidation of a non-debtor is *In re Tureaud*, 45 B.R. 658 (Bankr.N.D.Okla.1985). This matter was also commenced by motion for substantive consolidation, as opposed to an adversary. This time, the motion was brought by the chapter 11 trustee. The court held that substantive consolidation would simplify and facilitate the administration of the assets and liabilities of the various entities. No secured creditor would be harmed because security interests were not being eliminated, nor was the status of secured creditors being changed. Regarding the court's power to consolidate, it said at 662: "Under its general equitable powers, 11 U.S.C.A. § 105(a), a bankruptcy court may substantively consolidate affiliate corporations within a pending case when the assets and liabilities of different entities are dealt with as if the assets were held by, and the liabilities were incurred by a single entity." In support of this conclusion, the court discussed *Sampsell*, *Fish v. East*, and *Matter of Gulfco.*

Matter of Baker & Getty Financial Services, Inc.- A case which bears some similarity to the facts of the *Bonham* case, is *Matter of Baker & Getty Financial Services, Inc.*, 78 B.R. 139 (Bankr.N.D.Ohio 1987). In that case, Philip Cordek caused three corporations to be formed; Baker & Getty Financial Services, Inc., Baker & Getty Diversified, Inc., and Baker & Getty Securities, Inc. None of them were actually licensed to be broker dealers, however. Nonetheless, the three corporations engaged in a Ponzi scheme to obtain investments on the promise of quick turnovers.

Involuntary chapter 7 cases were brought against the three corporations, who did not contest. The creditors filed a motion to substantively consolidate the three cases with the non-debtors, Philip and Suzan Cordek. The Cordeks did not oppose.

Cordek had freely used the assets of the debtors for his own purposes before the bankruptcy petitions were filed. The court explained, *Id.* at 140-141:

> There were five bank accounts which were used by CORDEK for business and personal matters. Three of the accounts were opened in the name of "BAKER & GETTY DIVERSIFIED". Two of the accounts were personal accounts of CORDEK. On numerous occasions, corporate funds were used for personal matters. For example, corporate funds were used by CORDEK to: (1) purchase automobiles; (2) repay his educational loans; (3) purchase a boat which was eventually titled in his wife's ***86** name; (4) buy furniture, jewelry and other personalty; (5) pay for a home located near Cleveland, Ohio, and improvements to that home; and (6) pay for hotel rooms for guests attending his wedding. Conversely, personal funds were used to satisfy corporate obligations. [reference to exhibits omitted] CORDEK testified at a hearing on this Motion that the bank accounts were used interchangeably.

The only objection was First National Bank of Barnesville. The bank had loaned over $1 million to a Byron Rice, a regular business customer, to allow him to make a loan with Cordek to purchase various investments, which were to have been sold in a short time at supposed profit.

The bank was aware that Cordek was associated with Baker & Getty, but assumed that the matter was a personal one rather than the business of Baker & Getty. The bank was satisfied with Rice's assets as security for the loan because of its long business relationship with Rice, but nonetheless required Cordek to be a signatory on the note.

Within 90 days of the involuntary petitions, the bank had received $200,000 in payment from Cordek and the perfection of a security interest in certain of the Cordeks' property. The bank was the only one to oppose consolidation of the Cordeks' estates as of the date of the involuntary filings, because their payments were received within 90 days and might have been considered preferential under 11 U.S.C.A. § 547.

The court had no problem finding that this was an appropriate case for substantive consolidation. It determined it must consider the bank's rights as the Cordeks' personal creditor against the interests of other creditors. Most of the major creditors of Cordek were also creditors of the corporate debtors.

The court explained its reasoning, *Id.* at 142-143:

> However, according to uncontroverted testimony, the Bank relied wholly on Mr. Rice's assets and reputation and not on Mr. Cordek's assets or reputation in approving the August, 1986 loan. It is only now that the Bank declares their reliance on Mr. Cordek's personal assets. Furthermore, the Bank's actions fail to validate their claim of reliance on CORDEK's individual assets. The Bank failed to: (1) timely perfect its liens; (2) perform an adequate title search; or (3) conduct a sufficient credit investigation of Mr. Cordek. The Bank's failure to take these actions is inconsistent with their alleged dependence upon Mr. Cordek's assets. Thus, the Bank will not suffer severe prejudice from a consolidation order since there is no showing it relied on CORDEK's assets in consenting to the loan.
>
> However, even if the Bank were deemed to be prejudiced by the consolidation, the Corporate Creditors appear to be similarly situated, making it equitable to treat them the same. The advantages of consolidation outweigh any prejudice the Bank might experience.

In re Munford, Inc.- *In re Munford, Inc.*, 115 B.R. 390 (Bankr.N.D.Ga.1990), was not a case where the court ultimately approved substantive consolidation, but rather where the court indicated that an adversary complaint sufficiently stated a case for substantive consolidation, which should be heard on the merits. In the decision, Judge W. Homer Drake gave an excellent analysis of the case law. Munford operated about 500 convenience stores in the south. It licensed the right to operate the stores under the name of "Majik Market" to TOC Retail, Inc. Majik Market Management Corporation (MMMC) was created to manage the operations of both Munford and TOC. Munford and TOC were being acquired in a complicated financial transaction by the Panfida Group through intermediaries. MMMC, with the approval of the bank underwriting the financing, was to provide management services to Munford and TOC.

The complaint for consolidation alleged that by virtue of the closing process, which was still under way at the time of the bankruptcy, TOC and MMMC had become entangled in the business operations of Munford. They shared telephone systems, inventory acquisitions, fleet leasing, advertising, computer systems, and MMMC really operated Munford and TOC as a combined entity. All the business decisions were made on the ***87** basis of TOC and Munford collectively. The insurance for the companies was combined. Funds were transferred back and forth between the companies in a manner that had little relationship to the actual benefit or burdens of the respective parties.

Munford contended that the business functions of the several companies could not be separated without physical division of the operations, records, and personnel, and it would result in an economic loss. Finally, Munford claimed he could not prepare, with any degree of competence, financial statements which would be necessary for a successful reorganization unless the businesses, Munford, TOC and MMMC, were substantively consolidated. In denying the motion to dismiss, the court noted that consolidation need not be based only on the "instrumentality" theory. It could be based on a finding that it would be more equitable under the circumstances of the particular case. *Munford* at 394:

> Munford's theory of recovery is distinct from the consolidation available under the "instrumentality" theory. As will be discussed in more detail below, substantive consolidation may be based on a finding that it would be more equitable to all of the parties to allow consolidation under the circumstances of the case, *In re Tureaud*, 59 B.R. 973, 975-76 (N.D.Okl.1986); *In re Baker & Getty Fin. Serv. Inc.*, 78 B.R. 139, 142 (Bankr.N.D.Ohio 1987); *In re Snider Bros., Inc.*, 18 B.R. 230, 234 (Bankr.D.Mass.1982), by showing that the affairs of the entities are inextricably intertwined or that creditors dealt with them as a single economic unit, and does not require a finding of fraud or intent to hinder or delay creditors.

The defendants also challenged the court's authority to consolidate the debtor's assets with those of a non-debtor. The defendants questioned the use of 11 U.S.C.A. § 105(a), the statute defining the court's general equitable powers, and suggested that 11 U.S.C.A. § 303 was the appropriate manner to bring about the results sought. The court rejected these arguments. *Munford* at 396-398. Notwithstanding case law in other areas indicating that a bankruptcy court's equitable powers cannot be expanded under § 105(a) to create a right where none is provided for or implied in the bankruptcy code, the court cited the long history of substantive consolidation under equitable powers. The court found that substantive consolidation was ingrained in the fabric of bankruptcy law, beginning with *Sampsell v. Imperial Paper Corp.* and *Soviero v. Franklin National Bank.* It also found that substantive consolidation is a different process than that sought by § 303, and substantive consolidation does not circumvent

the requirements of § 303.

In re United Stairs Corp.- In *In re United Stairs Corp.*, 176 B.R. 359 (Bankr.D.N.J.1995), the chapter 7 trustee and First Fidelity Bank filed an adversary proceeding against several affiliated non-debtor corporations as well as their principals.

Before bankruptcy, First Fidelity had sued United Stairs for defaulting on several million dollars in loans. First Fidelity was aggressively pursuing the litigation and, after receiving a default judgment, sought to restrain certain transfers by United Stairs to Excel Cabinet Corporation and Spiral Leasing Corporation, corporations owned ostensibly by the daughter of Louis Manzo (the principal of United Stairs) and his sister respectively. Transfers of equipment had been made to these corporations for nominal amounts. Before the property could be recovered, however, United Stairs filed bankruptcy.

The court found authority under 11 U.S.C.A. § 105(a) to **substantively consolidate** a **non-debtor** entity with a debtor under the appropriate circumstances. The court said, *Id.* at 368-69:

> While many consolidation cases involve the consolidation of entities already in bankruptcy, it is accepted that a **non-debtor** entity may be consolidated with a debtor under appropriate circumstances. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941); see also *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. 89 (Bankr.D.D.C.1981); and *In re Crabtree*, 39 B.R. 718 (Bankr.E.D.Tenn.1984). In *Sampsell* the Supreme Court found that substantive consolidation of a **non-debtor** corporation ***88** with the individual bankrupt's estate was proper where the transfer of property to the **non-debtor** corporation was not in good faith but was made for the purpose of placing it beyond the reach of the original debtor's creditors, and where the effect of the transfers was to hinder, delay or defraud the individual's creditors. Id. 313 U.S. at 218-19, 61 S.Ct. at 906-07; see also Patrick C. Sargent, *Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue*, 44 Bus.Law 1223, 1233-36 (1989) (discussing the consolidation of debtor subsidiaries).
>
> Consolidation, of course, is a power that should be used sparingly. *Snider Bros.*, 18 B.R. at 234. This power is not an "instrument of procedural convenience, but a measure vitally affecting substantive rights." Id. See *Matter of Flora Mir Candy Corp.*, 432 F.2d 1060, 1062 (2nd Cir.1970); *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2nd Cir.1966). Substantive consolidation should be considered with extreme caution and granted only in extraordinary situations. *In re Lease-A-Fleet, Inc. v. Robins Le-Cocq, Inc.*, 141 B.R. 869, 872-73 (Bankr.E.D.Pa.1992).
>
> While this court is mindful of the seriousness of the remedy of consolidation, this is a case where extraordinary circumstances exist and an examination of the equities requires extension and substantive consolidation. Where the **debtor** and **non-debtor** entities are **alter egos** of each other extraordinary circumstances are present. *Lease-A-Fleet*, 141 B.R. at 872-73. In this case, no one but Louis Manzo, acting as president of United Stairs, had any knowledge of the operations of the various businesses. Manzo treated each of them as an **instrumentality**; using raw materials, employees, physical space, telephone and even stationary as needed regardless of the corporate niceties. Similar to the debtor's actions in Sampsell, the transfers of property to Spiral and Excel were not in good faith but were made for the purpose of placing United Stairs' assets beyond the reach of its creditors. *Sampsell*, 313 U.S. at 218-19, 61 S.Ct. at 906-07.

After discussing the criteria for determining whether a case should be substantively consolidated and the various tests that courts have fashioned to deal with the issue, the court said that, *Id.* at 369:

> ... while such tests may be helpful in some analyses this court adopts the ultimate test of balancing of the equities. In doing so, the court must weigh the economic prejudice of continued debtor separateness against the economic prejudice of substantive consolidation. *In re Cooper*, 147 B.R. 678, 682 (Bankr.D.N.J.1992); *In re Snider Bros., Inc.*, 18 B.R. 230, 234 (Bankr.D.Mass.1982). This determination must be sui generis. *In re Augie/Restivo*, 84 B.R. at 321, quoting 5 *Collier on Bankruptcy*, ¶ 1100.06, p. 1100-33 (15th Ed.1985).

The court had no problem in finding that the trustee and First Fidelity had established a right to substantively consolidate the non-debtor corporations with the debtor.

Matter of New Center Hospital- The summary judgment approving substantive consolidation in an adversary proceeding was affirmed in part in *Matter of New Center*

Hospital, 187 B.R. 560 (E.D.Mich.1995). The consolidation was sought by the Internal Revenue Service and the Department of Housing and Urban Development against debtor hospital and a number of alleged *alter egos*. The bankruptcy court granted summary judgment on the basis that the medical corporations and hospital acted as *alter egos* of one another and that substantive consolidation was warranted. It ordered the consolidation *nunc pro tunc* to the date of the appointment of a chapter 11 trustee. The district court affirmed the consolidation, but remanded the *nunc pro tunc* portion.

Although the bankruptcy court relied on Michigan case law to determine if an *alter ego* situation existed under the facts, the substantive consolidation was not ordered under the state *alter ego* policy, but under the bankruptcy court's equitable powers under 11 U.S.C.A. § 105(a). *Id.* at 567.

Having found that the debtors and non-debtor corporations were *alter egos*, the court found that the bankruptcy court was correct in determining that the affairs of the ***89** debtors and non-debtors were so entangled as to warrant substantive consolidation. The bankruptcy court found under the *Augie/Restivo* test that there was sufficient evidence of creditors dealing with the entities as a unit and sufficient entanglement to make the business affairs of the debtors and non-debtor corporations "inextricably intertwined that untangling the affairs would be either impossible or too costly to the estate." *Id.* at 569. The district court found that under an *Auto-Train* analysis "the facts also support a finding of substantial identity-the *alter ego* issue." The court also determined that because the United States was the largest creditor, the benefits of consolidation outweighed the detriments.

On the issue of the appropriate date to fix the consolidation of the non-debtors, the district court reversed. It did this on the basis principally of *Auto-Train*, because there had been insufficient inquiry into the possible harm to creditors who might have dealt separately with the non-debtor corporations as of a certain date.

In re Creditors Service Corp.- In *In re Creditors Service Corp.*, 195 B.R. 680 (Bankr.S.D.Ohio 1996), the court substantively consolidated a chapter 7 corporate debtor with non-debtor entities and with an individual owning all of the debtor's shares. The debtor was in the collection business. It had allowed the bar date on various collections for Consolidated Freightways of Delaware, Inc. to pass. Consolidated Freightways obtained a large judgment against the debtor prior to the bankruptcy, but the bankruptcy was filed before collection of the Consolidated Freightways' judgment could proceed.

The business, at the time of the bankruptcy, was run by Kathleen Cooley. She was the sole shareholder of the debtor. She was also the principal in a number of other collection businesses, most of which operated as corporations.

The court gave a detailed analysis of the intricate involvement of all the parties and concluded that: (a) most of the entities operated out of the same location at one time; (b) the debtor bought insurance for all the entities; (c) some of the employees performed work for one entity and were paid by another; (d) some of the non-debtor entities retained debtor's funds postpetition; (e) there were undocumented loans made by principals to various of the entities and by the entities among themselves; (f) payment of Ms. Cooley's salary for services to one of the non-debtor corporations was made by the debtor for a "management fee;" (g) one of the non-debtors sold the debtor's furniture postpetition; (h) there was no rational allocation of the rent paid by the debtor and non-debtor entities to the non-debtor which owned the real estate; (i) some of the non-debtors failed to pay any rent at all; (j) significant salaries were received by officers in the years just before the filing, with transfers back of some of those sums in the form of loans without the benefit of any documentation; and (k) the debtor made payments on Ms. Cooley's personal credit cards.

The court acknowledged that there was no specific statutory authority for a bankruptcy court to substantively consolidate entities, but noted that many courts had found a broad equitable power to do so under 11 U.S.C.A. § 105(a), citing *Munford, Tureaud*, and *New Center Hospital*, 179 B.R. 848, 853 (Bankr.E.D.Mich.1994), *affd. in part, rev'd in part*, 187 B.R. 560 (E.D.Mich.1995). While the remedy of substantive consolidation is similar to piercing the corporate veil, it is not the same. *Creditors Service*, at 689:

> Practically, substantive consolidation is similar to the state law remedy of piercing the corporate veil based on a finding that the entities are alter egos. See J. Stephen Gilbert, *Note, Substantive Consolidation in Bankruptcy: A Primer*, 43 Vand.L.Rev. 207 (1986); *In re Cooper*, 147 B.R. at 683-84. Piercing the corporate veil, however, is not a prerequisite to the utilization of the bankruptcy law remedy of substantive consolidation. *In re Munford*, 115 B.R. at 394, citing *In re Tureaud*, 59 B.R.

> at 975-76; *In re Snider, Inc.*, 18 B.R. 230, 234 (Bankr.D.Mass.1982). The bankruptcy remedy of substantive consolidation ensures the equitable distribution of property to all creditors, while on the other hand, piercing the corporate veil is a limited merger for the benefit of a particular creditor. See *In re Cooper*, 147 B.R. at 683-84.

***90** The court also noted, as almost all other courts have, that the remedy of substantive consolidation is extreme and should be exercised with great care. It involves consolidating the assets and liabilities of separate entities into one. This should not be a mere instrument of convenience, but only done where considered absolutely necessary and where the benefits outweigh any injury to affected creditors. *Id.* at 689.

In re Alpha & Omega Realty, Inc.- The first case denying substantive consolidation of non-debtors is *In re Alpha & Omega Realty, Inc.*, 36 B.R. 416 (Bankr.D.Idaho 1984). In this terse opinion, the court questioned whether 11 U.S.C.A. § 105(a) could be used as authority for substantive consolidation of non-debtors. The court declined to follow *1438 Meridian Place, N.W., Inc.* Part of its rationale was that the Supreme Court's *Marathon Pipe Line* case indicated that the expanse of jurisdiction of the bankruptcy court envisioned by the 1978 Bankruptcy Code had been substantially diminished. The court said, *Id.* at 417:

> I also question the conclusion of that court that non-debtor parties can essentially be declared involuntary debtors through use of a "veil piercing" theory, especially when raised by motion and not through either an adversary proceeding or involuntary petition under § 303 with their attendant protections.

The trustee in *Bonham* was, of course, not in a position to bring involuntary petitions against WPI or APFC since he was not a creditor. Some opponent's of the trustee's motion to consolidate suggest he should have filed voluntary proceedings against WPI and APFC. I will discuss this in Part 4.6.

In re DRW Property Co. 82- A more thoughtful opinion is *In re DRW Property Co. 82*, 54 B.R. 489 (Bankr.N.D.Tex.1985). Donald R. Walker, a real estate developer, sought substantive consolidation of 85 partnerships that had filed voluntary chapter 11 cases with 109 non-debtor limited partnerships, principally for economy in proposing a plan and to obtain federal income tax advantages.

Walker was a substantial real estate investor, developer, and syndicator in the early 1980's. The 109 non-debtor partnerships each operated separate properties and were used for investment vehicles to obtain financing. There were several types of partnerships, some simple and some more complex.

Notwithstanding the rapid expansion of his business, their accounting and financial management functions lagged. The investments made by individuals were difficult to trace to a specific partnership. The funds for each project were ultimately channeled into a central cash management account, and weaker projects were supported by stronger ones.

The strongest argument for consolidation was the almost hopeless entanglement of the records of the 109 partnerships. The court noted the holding in *Chemical Bank New York Trust Co. v. Kheel*, where the interrelationships of the group were hopelessly obscured and the expense of unscrambling them would have substantially jeopardized the recovery of any funds for creditors.

Ultimately, the court found that the *Kheel* test might be applicable with respect to the accounting for the *partnership interest of the various limited partners* (i.e., the equity interest), but, although difficult, it was possible to trace the *income and expense from each project* (i.e., the creditors' interest). There were sufficient records to track the income and expense of each project, although it might cost $2 million in accounting fees to straighten out.

The court found that substantive consolidation was not warranted because it appeared that if the assets were consolidated it would be to the detriment of the creditors of those projects which were strong and could pay the creditors, and to the benefit of those which were weak and could not. Thus, the court focused on the creditors' rights as opposed to the equity holders and determined that the right to substantive consolidation was not established. Additionally, the court questioned the ability to substantively consolidate for the purpose of obtaining the tax benefit the debtor sought by the application.

In the *Bonham* case, there are no substantial assets in either WPI or APFC, and the estate will only benefit from the avoidance recoveries.

91** ***In re R.H.N. Realty Corp.- *In re R.H.N. Realty*

Corp., 84 B.R. 356 (Bankr.S.D.N.Y.1988), is cited by some courts as an example of a case where a court found it had no jurisdiction to consider substantive consolidation of a non-debtor into a pending case.

R.H.N. Realty Corp. was an involuntary chapter 7 proceeding. A creditor and the trustee filed a complaint. One of the counts in the complaint, which only the creditor and not the trustee asserted, was for a declaration that the non-debtor was an *alter ego.* The creditor sought a judgment against the non-debtor for the benefit of the creditor only, and not the estate. Subsequently, the creditor moved to state a count for substantive consolidation of the estate of the non-debtor with the estate of the debtor.

Thus, the only issue was whether a motion to amend should be granted. The court acknowledged the authority of a bankruptcy court to substantively consolidate the affairs of parties when they are so intertwined as to make it impossible to administer them as separate entities. *Id.* at 358. The court indicated that substantive consolidation should be applied with great caution and particularly when *nunc pro tunc* consolidation is sought.

The grounds for denial of the motion appeared to be that insufficient "evidence" was stated for the amendment. However, the court did add the following, *Id.* at 359:

> Moreover, the order for relief has already been entered against the debtor corporation. To amend the caption so as to add Haverstraw as a co-debtor would deprive Haverstraw of the opportunity of contesting the involuntary petition, as permitted under 11 U.S.C.A. § 303(d) and (h). This procedure offends the fundamental due process requirements of the Fourteenth Amendment. See *Mullane v. Central Hanover Bank and Trust Company*, 339 U.S. 306, 70 S.Ct. 652, 94 L.Ed. 865 (1950). For this reason alone, the plaintiffs' cross-motion must be denied.

These few sentences are the only reason for denying substantive consolidation. The court did not explain how this squared with its earlier acknowledgment that substantive consolidation was an admitted part of bankruptcy jurisprudence. Nor did the court consider that there might be methods of giving notice to the creditors of the non-debtor which would accord with due process.

In re Julien Co.- The court in *In re Julien Co.*, 120 B.R. 930 (Bankr.W.D.Tenn.1990), dismissed a motion for substantive consolidation made by the chapter 11 trustee on procedural grounds. The court felt that the matter should have been brought by an adversary or through another device such as an involuntary petition pursuant to 11 U.S.C.A. § 303. The facts in the opinion are rather sparse. The trustee's motion sought to amend the petition in order to identify the debtor as "Julien J. Hohenberg d/b/a The Julien Company."

The court briefly discussed, but did not analyze the factual allegations made by the chapter 11 trustee supporting an *alter ego* approach to substantive consolidation. After analyzing a number of the earlier substantive consolidation cases, the court said, *Id.* at 936-37:

> This Court does not conclude that a bankruptcy court should never order substantive consolidation or that it lacks the equitable authority to do so in an appropriate factual environment. However, the bankruptcy court should cautiously exercise that authority only when the facts demand it. In those cases discussed herein where the debtor has been consolidated with other bankruptcy debtors, the remedy or results are not offensive to this Court when the facts demonstrate that the debtors were in fact one entity or were so intertwined as to be indistinguishable and when the result is equitable for the creditors of each estate. But, this Court has great difficulty with the present facts where the corporate debtor's Trustee attempts to say that the debtor is not in fact a corporation and that therefore the nondebtor individual's assets are property of the debtor's estate. It is troublesome for the debtor to pierce its own veil and deny its corporate existence and conclude that as a result Mr. Hohenberg's assets belong to the debtor. The attempted remedy is more offensive because it is sought by ***92** motion rather than by adversary proceeding.

The court also alluded to the fact that the trustee perhaps did not have standing to pursue the *alter ego* claim against Mr. Hohenberg, citing *Caplin v. Marine Midland Grace Trust Co. of N.Y.*, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972), and similar cases. In making this reference, the *Julien* court failed to recognize the distinction between veil piercing as a state law doctrine versus substantive consolidation as a bankruptcy doctrine recognized by virtue of a supreme court opinion, and a number of circuit and bankruptcy courts. *See*, the discussion at Part 4.2 of this *Memorandum Decision.*

In re Lease-A-Fleet, Inc.- Perhaps the most articulate case to voice the concerns about consolidating a non-debtor with a debtor's case, in *In re Lease-A-Fleet, Inc.*,

141 B.R. 869 (Bankr.E.D.Pa.1992). Unfortunately, the case is colored by the judge's obvious distaste for the plaintiff. He believed the plaintiff was both over-litigious and was seeking substantive consolidation for some unspecified advantage which neither he nor any other creditor could fathom.

Nonetheless, the court went through a discussion of the criteria for substantive consolidation, *Id.* at 871-72, and a thoughtful discussion of the conceptual difficulties of consolidating a non-debtor at 872-76.

One of the conceptual problems alluded to was what type of notice was due to creditors. In that case, the court required notice to be given to all creditors of the non-debtor corporation. Additionally, substantive consolidation of non-debtors might circumvent the procedures for involuntary cases under 11 U.S.C.A. § 303.

The court also noted the difficulty in applying certain protections for debtors, or rights given to them. For example, how to apply § 362 regarding the automatic stay, or the avoiding powers under §§ 542-549.

In essence, the court points out that those courts which have allowed substantive consolidation had not fully explored the possible ramifications of the "what ifs." The court said, *Id.* at 874:

> It is therefore not surprising to this court to find that placing an involuntary non-debtor consolidatee in such an unusual circumstance, betwixt and between the Bankruptcy Code, should be reserved for unusual circumstances which might justify such a conceptually-strange measure.

In re Circle Land and Cattle Corp.- The judge in *In re Circle Land and Cattle Corp.*, 213 B.R. 870 (Bankr.D.Kan.1997), strongly disputed that the bankruptcy court has authority under § 105(a) to consolidate the estate of a non-debtor into a debtor's pending bankruptcy case. The court first noted that the oversecured creditor who had sought the consolidation had mistaken its remedies. The creditor referred to the state corporate law of piercing a corporate veil. The court said, *Id.* at 874:

> State corporate law authored the alter ego doctrine. Federal bankruptcy law conceived substantive consolidation, the doctrine of joining the estates of bankrupt entities. The two doctrines are distinguished in a well-regarded bankruptcy treatise discussing administrative and substantive consolidation, on the one hand, and piercing-the-corporate-veil jurisprudence and merger, on the other:
>
> > "Substantive consolidation should not be confused with either the corporate law concept of piercing the corporate veil or the bankruptcy law concept of joint administration. Unlike piercing the corporate veil, substantive consolidation does not seek to hold shareholders liable for acts of their incorporated entity. A corporate law concept closer to substantive consolidation is merger of two corporations under state law." [footnote omitted]

The *Circle Land* court also did not reflect on or explain the fact that the Supreme Court in *Sampsell* and a circuit court in *Soviero* permitted substantive consolidation of non-debtors.

The adversary complaint for substantive consolidation spelled out a number of grounds which might typically be considered in an *alter ego* argument. The opinion has a section entitled "Substantive Consolidation ***93** Law" aligned with Headnotes 6 through 8 at pages 875-76. There, the court cites some of the older cases such as *Stone v. Eacho* and *Soviero v. Franklin National Bank of Long Island.* Then, in another section of the opinion entitled "Consolidating a Non-Debtor," the court cites a number of cases which have approved consolidation and state that they all disregard § 303's requirements. *Id.* at 876:

> Nevertheless, the bankruptcy decisions upon which Helena relies have consolidated a non-debtor with a debtor using § 105 in disregard of § 303's requirements. See *In re 1438 Meridian Place, N.W.*, 15 B.R. 89 (Bankr.D.D.C.1981); *In re Crabtree*, 39 B.R. 718 (Bankr.E.D.Tenn.1984); *In re Tureaud*, 45 B.R. 658 (Bankr.N.D.Okla.1985); *In re Munford, Inc.*, 115 B.R. 390 (Bankr.N.D.Ga.1990); *In re Fairfield Construction Co.*, 1995 WL 434474, 1991 Bankr.LEXIS 1395 (E.D.Mich.1991); *In re New Center Hospital*, 179 B.R. 848 (Bankr.E.D.Mich.1994); *In re United Stairs Corp.*, 176 B.R. 359 (Bankr.D.N.J.1995). In effect, these courts have used § 105 as a grant of subject matter jurisdiction.

To counter these decisions, the judge cited a group of contrary cases. *Id.* at 877:

> Contrary to those decisions that permit substantive

> consolidation of a non-debtor with a debtor, others have refused to take jurisdiction over a non-debtor for substantive consolidation purposes. See *In re Alpha & Omega Realty, Inc.*, 36 B.R. 416 (Bankr.D.Idaho 1984); *In re DRW Property Co.* 82, 54 B.R. 489 (Bankr.N.D.Tex.1985); *In re R.H.N. Realty Corp.*, 84 B.R. 356 (Bankr.S.D.N.Y.1988); *In re Julien Co.*, 120 B.R. 930 (Bankr.W.D.Tenn.1990); *In re Lease-A-Fleet*, 141 B.R. 869 (Bankr.E.D.Pa.1992); *In re Ira S. Davis, Inc.*, 1993 WL 384501, 1993 Bankr.LEXIS 1383 (E.D.Pa.1993); *In re Hamilton*, 186 B.R. 991 (Bankr.D.Colo.1995). These decisions question whether bankruptcy courts have subject matter jurisdiction over non-debtor corporations for purposes of substantive consolidation, and they reason that consolidation of a non-debtor is contrary to the Code limitations for involuntary bankruptcy petitions. I agree with the reasoning of these decisions.

I believe this is an over-broad reading of some of these cases. For example, *DRW Property* is not a case where the judge ruled that substantive consolidation was improper, but that it should be used very conservatively. *In re Julien* acknowledged the authority of a bankruptcy court to substantively consolidate, but questioned the procedure that had been chosen. Likewise, *In re Lease-A-Fleet*, though very skeptical about most cases qualifying for substantive consolidation of non-debtors, did not rule out the situation where there might be such a case under the right facts.

[12] 4.6. *Motion is Appropriate to Determine the Substantive Consolidation Issue*- All those parties opposing substantive consolidation are *Bonham Recovery Actions* (*BRA*) defendants in adversary proceedings in which the trustee seeks to avoid transfers and recover payments made to the defendants by WPI, APFC, and/or Bonham. They argue that the trustee's presentation of the substantive consolidation motion as a contested matter, instead of by an adversary proceeding or voluntary petitions against WPI and APFC, is procedurally improper. *See, e.g.,* the *BRA* defendants' joinder and supplement to *Response and Objection to Trustee's Motion For Substantive Consolidation,* Docket Entry 1108, filed by Brad Ambarian for various defendants.

They cite *In re Julien Co.*, 120 B.R. 930 (Bankr.W.D.Tenn.1990) and *In re Alpha & Omega Realty Inc.*, 36 B.R. 416 (Bankr.D.Idaho 1984), discussed in Part 4.5 of this *Memorandum Decision.* In *Julien,* a chapter 11 trustee sought to bring in an individual and amend the caption to reflect this. Unlike Mr. Julien, a non-debtor who fought substantive consolidation, the Bonham trustee, WPI, and APFC do not contest consolidation. Indeed, WPI and APFC are disenfranchised corporations, without tangible assets. The only hope of recovery for the creditors of any of these three entities is from consolidation and the avoidance actions brought by the trustee.

Alpha & Omega is a brief decision in which the court, alluding to the reduced jurisdiction of bankruptcy courts after *Marathon Pipe Line,* said that the proper procedure was ***94** using an 11 U.S.C.A. § 303 involuntary petition. *See, also, In re R.H.N. Realty Corp.*, 84 B.R. at 359.

In *Bonham,* the trustee was not in a position to file an involuntary petition. However, similar to the *Alpha & Omega* rationale, the objecting parties indicate that he should have filed a voluntary petition and, failing to do that, should not be allowed to substantively consolidate WPI and APFC.

The problem with this argument is that the trustee came into the case in late 1995, without any knowledge of the operation. The trustee is a certified public accountant, and immediately began a forensic investigation. Bonham, WPI, and APFC, he discovered, kept no standard accounting records to guide him, had no computer records, and the records that were available were incomplete. He met stonewalling at almost every point from RaeJean Bonham. He did not come into this case with perfect knowledge of the background, but only developed this after months of arduous investigation, including tedious analysis and inputting records into a data base.

In a case where Bonham, WPI, and APFC are *alter egos,* restricting the procedure for recovery of avoidable transfers by a requirement that the trustee file voluntary cases for WPI and APFC will work an injustice on the creditors who might otherwise receive a dividend in bankruptcy. No doubt if he had, there would be challenges to his authority to have done so, based on the uncertainty of corporate ownerships, since the corporate formalities were not observed.

More importantly, when the trustee began to accumulate sufficient knowledge to have filed a voluntary proceeding for WPI and APFC, a significant amount of time had passed since the involuntary was filed against RaeJean Bonham on December 19, 1995. The facts show that her Ponzi activities were on the decline during 1995. By being relegated to the later date of the voluntary petition, the trustee would have missed the time limit to bring fraudu-

lent transfer actions under 11 U.S.C.A. § 548 against many of the transfers which occurred during the height of Bonham's activities.

Substantive consolidation may be sought by different parties. Sometimes the trustee or debtor-in-possession seeks it. Often, it is a creditor. The important thing, for due process purposes, is notice and an opportunity to be heard. An adversary proceeding would have been a cumbersome way to bring this issue to the court. Should the trustee have named the 600 *BRA* defendants in one large adversary? How would they have been served? With individual subpoenas or by notice? Who would have represented their interests?

In the present case, the trustee used the most effective procedure-a motion. Notice was served on all *BRA* defendants and responses were received opposing consolidation in about 200-300 of the individual adversary proceedings. The trustee, anticipating FRCivP 56(f) type motions, sought early on to make the documents of the debtor available. While this has proved to be a cumbersome task, it is not through lack of effort by the trustee to make the documents available.

This is not a one-on-one situation where the trustee seeks to bring in a non-debtor entity and the non-debtor opposes. In such a case, the matter has often been by an adversary because the logistics are simple-serve one party. Even in a case where an adversary is used, a court has seen that the rights of creditors of the non-debtor must be addressed. The court in *In re Lease-A-Fleet,* 141 B.R. 869, 873 (Bankr.E.D.Pa.1992), discussed in Part 4.5, notwithstanding the fact that an adversary had been used, required separate notice to the creditors of the non-debtor corporation. The procedure adopted by the *Bonham* trustee closely approximates the one required in *Lease-A-Fleet* to protect creditors who were not actual parties to the pending adversary proceeding.

Many of the non-debtor consolidation cases discussed in Part 4.5 of this *Memorandum Decision* were prosecuted as motions. Although it was often not an issue in some of the cases, other courts specifically held that a proceeding need not be by adversary rules or an involuntary petition. *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. at 94-95; *In re Crabtree,* 39 B.R. at 721 (motion acceptable ***95** instead of involuntary petition). The court in *Meridian* distinguished the relief sought by substantive consolidation from the type which had to be brought under FRBP 701, the predecessor of FRBP 7001. While some aspects of consolidation may have traits akin to FRBP 7000(1) regarding the delivery of property of a trustee, or 7001(9) declaratory judgment, the relief is distinct from the relief sought in those rules.

I will overrule the objection to the motion procedure chosen by the trustee to accomplish consolidation of WPI and APFC.

[13] 4.7. *Application of Law to Determine If WPI and APFC Should be Substantively Consolidated With the RaeJean Bonham Case*- The two key questions in this matter are: (a) should WPI and APFC, non-debtors, be consolidated with the *Bonham* estate, and if so, (b) should the effective date be the petition date for *Bonham,* or the date of the motion to consolidate? I will discuss the first question in Part 4.7 of this *Memorandum Decision,* and discuss the effective date in Part 4.8 (although this issue blurs into Part 4.7).

To answer these questions, it is important to distinguish the two types of creditors involved in this case. First, there are the creditors of the Bonham, WPI, and APFC estates whose claims will be paid something (probably less than fifty-cents on the dollar) if there are assets recovered by the trustee. I will call this type of creditor a **"Claimant."** Secondly, there are creditors of WPI, APFC, and Bonham who were paid prepetition, but are subject to avoidance claims (such as for fraudulent transfers). I will call this type of creditor a **"Target."**

Though not applicable to the *Bonham* case, other cases may have Targets, not because they are subject to avoidance actions, but because any bankruptcy recovery may be diluted by consolidation of assets with those of a financially weaker debtor. If consolidation is not granted, *nunc pro tunc,* in *Bonham,* there will be nothing to dilute.

[14][15] Most of the case law regarding substantive consolidation is an attempt to balance the rights of Claimants and Targets. Simplistically, the Claimants first must make their case for substantive consolidation (e.g., by showing why consolidation is fair or just because of the intermingling of assets, *alter ego* behavior, fraud, etc.), and then the Targets must show why consolidation, which might otherwise be appropriate, should be denied (e.g., because of a reliance on the separate entity, unfair dilution of recovery if consolidation occurs, etc.).

Some creditors of *Bonham* are both Claimants and Targets because they had not been paid in full by WPI or

APFC prepetition, but had received some payments within the avoidance period. Many Targets in *Bonham* are willing to give up the right to be a Claimant because they do not want to pay the trustee in whole dollars to recover only a small percentage of the amount from the trustee in a dividend. Thus, some Claimants who are also *BRA* defendants (Targets), are willing to withdraw their proofs of claim (their right to be Claimants) to get their *BRA* adversary proceedings out of the bankruptcy court by claiming the right to jury trial to be heard in the United States District Court where they feel they will fare better at defeating the trustee's avoidance action.

Some of the Claimants are not *BRA* defendants (Targets), but are creditors who may have invested in and never received any repayment from WPI or APFC. Also included among the Claimants is Delta Air Lines with a $2,000,000 claim. These Claimants will get distributions from any avoidance recoveries made by the trustee and have every incentive to see the cases substantively consolidated, *nunc pro tunc* as of December 19, 1995. Otherwise, they stand to get nothing.

There is no question that consolidation will help, and not prejudice, a Claimant under the facts of the *Bonham* case. Conversely, Targets, unless they can raise some defense to the trustee's avoidance actions, will be harmed-they will have to pay any judgments against them to the bankruptcy trustee. Whether it is fairer to consolidate or not is what this long *Memorandum Decision* is about. Either way, there will be a lot of pain involved. There are, unfortunately, “widows and orphans” in both the Claimant and Target groups. The trustee is attempting to see ***96** that the Claimants recover as much as possible. The Targets' goal is just the opposite.

The Claimants, represented by the trustee, have made a strong *prima facie* case for consolidation of WPI and APFC with the existing estate of RaeJean Bonham. Under almost any of the tests devised by the courts in the cases mentioned in Parts 4.3-4.5 of this *Memorandum Decision*, the Claimants (or the trustee on their behalf) can make a compelling *prima facie* case for substantive consolidation. Whether there are sufficient countervailing reasons which can be established by the Targets to deny consolidation is the subject of Part 4.8.

The reasons for consolidation are, first, the financial affairs of Bonham, WPI and APFC are hopelessly entangled. Second, the Claimants were enticed into investing in a fraudulent Ponzi scheme, and the funds were used to pay other investors (Targets) in the Ponzi scheme and to support Bonham and her family. Third, neither Bonham, WPI, nor APFC has any significant assets to cover the millions of dollars in claims, and Bonham, WPI and APFC should be treated as *alter egos* to allow a recovery to Claimants.

Some of the specific facts to show that WPI and APFC were *alter egos* of Ms. Bonham are:

• RaeJean Bonham was the sole shareholder of each corporation. She and her husband Steve were the only officers. Steve has denied an active role in the corporations. RaeJean has indicated she “is” WPI. *See*, ¶¶ 2.2.3, 2.2.4 and 2.3.2.

• Ms. Bonham observed few corporate formalities for either WPI or APFC. She had few corporate books, including minutes, stock registers, or resolutions, except perhaps those that were required by banks to open accounts. *See*, ¶¶ 2.2.5-2.2.8 and 2.3.12-2.3.17.

• Money flowed between the three entities (Bonham, WPI and APFC) freely and usually without a legitimate business purpose. On the contrary, one can infer a corrupt purpose in transferring funds between WPI and APFC, since the use of APFC seems to coincide with the Alaska securities investigation of WPI, and it is probable that Bonham merely put up another corporate shell to operate her Ponzi scheme. *See*, ¶¶ 2.4 and 2.6 regarding the limited nature of the ticket sales business compared to the aggressive nature of the investment scheme; ¶ 2.9 regarding the Alaska Securities Investigation; ¶ 2.3 regarding the coinciding establishment of APFC; and, ¶ 2.8 regarding the various bank accounts.

• Bonham had no computer data bases of investors or other business activity. There are no standard financial accounting records, or other records which were organized in a way that the assets and liabilities of Bonham, WPI and APFC can be readily sorted out and segregated. Most of Bonham's money came from investors, whose investments were funneled through WPI or APFC. Sometimes, investors wrote their checks to WPI and were issued contracts by APFC. Sometimes contracts were rolled over from WPI to APFC and vice versa. Funds from one corporation were used to pay the investment contracts written on the names of the others. *See*, ¶ 2.2.7.

• Bonham freely used money from the investors to sup-

port a fashionable lifestyle for herself, her husband, and her children, providing for their home, vehicles, boats, education, and recreation. *See,* ¶ 2.11.

• All investors dealt directly with RaeJean Bonham, the individual. Although they indicated they only dealt with her as agent, none indicated they had any specific financial information about WPI or APFC other than the fact that it paid them and perhaps others exorbitant returns. *See,* ¶¶ 2.12.4-2.12.8

These facts show that WPI and APFC were really the *alter egos* of Ms. Bonham, or in the vernacular of the earlier cases cited in Part 4.3 of this *Memorandum Decision*, that they were the "instrumentalities" of Bonham, and the financial affairs of the three were hopelessly entangled. They also show the use of the corporations for a fraudulent purpose.***97** As such, the three should be treated as one entity and consolidated. *See, Fish v. East, Sampsell v. Imperial Paper & Color Corp., Stone v. Eacho, Soviero v. Franklin National Bank, Chemical Bank New York Trust Co. v. Kheel,* discussed in Part 4.3; *In re Vecco Construction Industries, Inc., Eastgroup Properties v. Southern Motel Assoc., Ltd.,* discussed in part 4.4; and, *In re 1438 Meridian Place, N.W., Inc., In re Crabtree, Matter of Baker & Getty Financial Services, Inc., In re Munford, Inc., In re United Stairs Corp.,* and *In re Creditors Service Corp.,* discussed in Part 4.5.

Applying the probing analysis suggested in *In re Snider Bros., Inc.*, 18 B.R. 230, 234 (Bankr.D.Mass.1982) (*see,* Part 4.4), I have compared the economic prejudice of continued separateness of WPI, APFC and Bonham to any prejudice from their consolidation. No Claimant will be prejudiced by consolidation. The Claimants will get nothing without consolidation.

Snider admonishes that mere commingling of assets is not enough to justify consolidation, *Id.* at 235, but harm must be shown by the intermingling of assets, *Id.* at 238. This can be shown. Bonham promoted a fraudulent investment scheme-a Ponzi scheme. Claimants were induced to invest funds. There funds were channeled, according to some unknown whim or scheme of Bonham, between WPI and APFC. She freely used some of the funds for her own purposes while the Ponzi scheme made the WPI and APFC enterprises hopelessly insolvent. No Claimant can truly trace where his or her funds were used. Did they go to pay APFC contracts or expenses, WPI contracts or expenses, or to Bonham? Likewise, no Target can truly trace the source of the Target's prepetition payment. Were their funds received from WPI or APFC, or just funneled through these entities?

Under the *Snider* analysis, consolidation is justified. It then becomes the burden of those opposing consolidation to show that the benefits of consolidation are outweighed by the harm. *Snider* at 238. I have found in ¶¶ 2.12.4-2.12.8 that a reasonable reliance has not been established. I will discuss this further in Part 4.8 of this *Memorandum Decision.*

Under either the *Augie/Restivo* or *Eastgroup Properties* tests discussed in Part 4.5, consolidation is justified. To reiterate the *Augie/Restivo* test, after examining the historical and more recent case law, the court said, *Id.* at 518:

> An examination of those cases, however, reveals that these considerations are merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and "did not rely on their separate identity in extending credit," or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors. [citations omitted]

Certainly the affairs of Bonham, WPI and APFC were hopelessly entangled. Also, Targets apparently dealt with WPI and APFC interchangeably, dealing solely through RaeJean Bonham. There was an overall pattern of shuffling of funds between WPI and APFC, and a haphazard assignment of investment contracts to either WPI or APFC at Bonham's whim. The Targets appear to have relied on the exorbitant return as opposed to any particular corporate identity. The trustee has established the right to substantive consolidation under the *Augie/Restivo* test.

The *Eastgroup* test is, *Id.* at 249:

> [T]he proponent of substantive consolidation must show that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit. When this showing is made, a presumption arises "that creditors have not relied solely on the credit of one of the entities involved." Once the proponent has made this prima facie case for consolidation, the burden shifts to an objecting creditor to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation.... Finally, if an objecting creditor has made this showing, "the court may order consolidation only if it determines that the demonstrated benefits of consoli-

> dation 'heavily' ***98** outweigh the harm." [omitting internal and citations]

The facts I have outlined indicate that WPI and APFC were *alter egos* of Bonham. The harm to be avoided is having those Targets who were lucky enough to be paid within the avoidance period with funds, the source of which (WPI or APFC) is undeterminable, keep those funds, including the exorbitant profit, to the detriment of those Claimants who were unlucky enough not to have been paid. The benefit, is having those funds returned to the consolidated bankruptcy estates for equitable distribution to the unsecured creditors.

The question remains, should those Targets who benefitted from payments from the Ponzi scheme be protected from a *nunc pro tunc* consolidation? I will discuss this in Part 4.8.

[16] 4.8. *Should the Consolidation be Nunc Pro Tunc to Original Filing Date?*- One of the most important issues in the substantive consolidation motion is the effective date. The involuntary bankruptcy against RaeJean Bonham was filed on **December 19, 1995**. The *Trustee's Motion For Order Confirming That Assets And Liabilities Of Bonham, World Plus And Atlantic Pacific Funding Corp Are Subject To Administration, For Joint Administration And For Substantive Consolidation Of Estates And To Amend Caption,* was not filed until a year later on January 22, 1997 (Docket Entry 731).

Some defendants in the *BRA* argue that the effective date for substantive consolidation should be no earlier than **January 22, 1997**.

On December 19, 1995, the date of the involuntary petition against RaeJean Bonham, her operations had been, in essence, shut down by the Alaska Division of Securities. Both WPI and APFC had been decertified by their respective states, Alaska and Nevada. During the final year of Bonham's operation, her Ponzi scheme was beginning to unwind and the rate of new investments was declining. *See,* ¶ 2.6.4.

If the effective date for the purpose of substantive consolidation for WPI and APFC is January 22, 1997, the one-year statute of limitations under 11 U.S.C.A. § 548(a) would only cover transfers made after January 22, 1996. In other words, no fraudulent transfer under § 548 would be recoverable for payments on contracts nominally with WPI or APFC.

In re Auto-Train Corp.- The *BRA* defendants principally rely on *In re Auto-Train Corp.*, 810 F.2d 270 (D.C.Cir.1987). I conclude, however, even applying the *Auto-Train* test, that substantive consolidation should be effective on December 19, 1995.

The issue in *Auto-Train* was whether funds transferred by Railway Services Corporation (Railway), a wholly owned subsidiary of Auto-Train, to Midland-Ross Corporation were a preference under 11 U.S.C.A. § 547. The dispute arose out of a transaction in which Ronsco Supply Company, Inc. brokered a deal for the sale of some railroad equipment from Midland-Ross to Marine Industries, Ltd. Because Marine Industries was a Canadian company, for some reason Midland-Ross could not deal directly with Marine. Ronsco proposed that Railway be used as an intermediary.

Ronsco, as Marine's agent, submitted a purchase order for the railroad equipment to Railway. Railway, in turn, submitted its own purchase order to Midland-Ross, the manufacturer.

The railroad equipment was shipped directly to Marine in Canada. Marine transferred about $500,000 to Railway. This included the purchase price and shipping charges totaling about $495,000, plus a $5,000 commission for Railway. Railway transferred the funds to Midland-Ross, less the $5,000 commission, over the period of June 11, 1980, through July 15, 1980.

On September 8, 1980, Auto-Train filed a voluntary chapter 11. On November 10, 1980, the chapter 11 trustee filed a motion to amend the caption of the Auto-Train petition and add Railway as a named party. The bankruptcy court conducted a hearing on November 21, 1980, and ordered the substantive consolidation of Railway into the Auto-Train estate effective as of September 8, ***99** 1980, the date of the Auto-Train voluntary petition.

The trustee then sought to avoid the transfer under § 547 of the Bankruptcy Code as preferential. Among the defenses, Midland-Ross claimed that the court had no authority to order a *nunc pro tunc* consolidation. The bankruptcy court held that *nunc pro tunc* consolidation was appropriate, and that issue was eventually appealed to the Circuit Court for the District of Columbia.

The trustee argued that *nunc pro tunc* consolidation re-

flected the facts as they really existed, that Railway had no existence separate from Auto-Train. The issue of substantive consolidation was not contested by Midland-Ross, only its *nunc pro tunc* application. The D.C. Circuit Court said that the criteria for determining whether to substantively consolidate were not precisely the same as those for determining the effective date of the consolidation.

Focusing first on whether or not a bankruptcy court should order consolidation, and not what the appropriate effective date should be, the court said, *Id.* at 276:

> Before ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties. *See, e.g., In re Snider Bros., Inc.*, 18 B.R. 230, 237-38 (Bankr.D.Mass.1982). The proponent must show not only a substantial identity between the entities to be consolidated, but also that consolidation is necessary to avoid some harm or to realize some benefit. *Id.; see also Flora Mir Candy Corp. v. R.S. Dickson & Co.*, 432 F.2d at 1063; *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d at 847. At this point, a creditor may object on the grounds that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation. *See Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d at 848 (Friendly, J., concurring). If a creditor makes such a showing, the court may order consolidation only if it determines that the demonstrated benefits of consolidation "heavily" outweigh the harm. *In re Continental Vending Machine Corp.*, 517 F.2d at 1001. [internal and end citations omitted]

[17] The court found that there was an additional and slightly different balancing process before a court could order *nunc pro tunc* consolidation. This is because a *nunc pro tunc* order would subject certain transferees to avoidances which might have lapsed if a later date for consolidation were fixed. *Id.* at 276. An important factor in determining the appropriate date is a transferee's reliance on an entity's apparent separateness. Otherwise, in any group of affiliated corporations, "a sign of weakness in any member of a family of corporations would lead creditors to descend on each member, strong or weak, to claim their pound of flesh." *Id.* at 277.

A rule automatically adopting a *nunc pro tunc* date would make creditors reluctant to deal with financially troubled companies. It would also hinder the ability of sound companies to help their weaker affiliates out of a predicament. The court announced the following test, *Id.* at 277:

> In light of these considerations, a court should enter a consolidation order nunc pro tunc only when it is satisfied that the use of nunc pro tunc yields benefits greater than the harm it inflicts. This inquiry will closely parallel that conducted with respect to consolidation. Because the consolidation proceeding will already have established a substantial identity between the entities to be consolidated, this inquiry begins with the proponent of nunc pro tunc making a showing that nunc pro tunc is necessary to achieve some benefit or avoid some harm. Following this showing, a potential preference holder may challenge the nunc pro tunc entry of the consolidation order by establishing that it relied on the separate credit of one of the entities to be consolidated and that it will be harmed by the shift in filing dates. If a potential preference holder meets this burden, the court must then determine whether the benefits of nunc pro tunc outweigh its detriments. [footnote omitted]

The court held that Railway was a legitimate corporation, and notwithstanding the fact that it had acted as a middleman in the ***100** Midland-Ross and Marine transaction, Midland-Ross was justified in relying, and had relied, on Railway's separate existence. Railway dealt with the public as an entity separate from Auto-Train. Midland-Ross had even extended credit to Railway after Auto-Train filed its bankruptcy. Railway had also filed an S-1 registration statement with the SEC, indicating its assets, liabilities, and operations were separate from Auto-Train's. Thus, the order of a *nunc pro tunc* consolidation was reversed, and Midland-Ross's payment to Railway was not within the 90-day preference period.

Baker & Getty Financial Services, Inc.- Refusing to follow *Auto-Train*, the 6th Circuit in *Baker & Getty Financial Services, Inc.*, 974 F.2d 712, 721 (6th Cir.1992), found that the distinction between whether a case should be substantively consolidated or not to begin with, was so close to the test proposed by *Auto-Train* to determine the effective date that adopting this distinction would not be wise. It permitted a consolidation effective as of the original petition date. This case involved the same facts discussed in *Matter of Baker & Getty Financial Services, Inc.*, 78 B.R. 139 (Bankr.N.D.Ohio 1987), discussed in Part 4.5.

Matter of Evans Temple Church- *Baker & Getty Financial Services, Inc.* relied on the reasoning of *Matter of Evans Temple Church of God In Christ and Community*

Center, 55 B.R. 976 (Bankr.N.D.Ohio 1986).

In *Evans*, a *pro se* debtor, Evans, had filed an individual case on February 23, 1984. He filed an amended petition, improperly joining himself and a corporate debtor, Evans Temple Church. Later still, a proper corporate case was filed for Evans Temple Church. The individual case and corporate case were ultimately substantively consolidated.

A prepetition transfer by the corporate debtor was within the 90-day preference period if the date of the earlier individual petition date was used. On the other hand, the proper corporate filing was well after the preference period had expired. The defendant in the preference action had received notice in both cases.

Thus, the court had the issue before it which exists in the *Bonham* case, about whether the date of original filing should be used to determine if a transfer was made within the proscribed avoidance period (e.g., one year for a § 548 fraudulent transfer).

The court found it would be appropriate to use the date of the original filing, stating, *Id.* at 982-83:

> We have found no authority on the issue of whether a debtor who files a petition for relief under the Bankruptcy Code subsequent to the filing by an affiliate may avail itself of the earlier date for purposes of the preference provisions when the cases are later substantively consolidated. So far as we can tell, no decision on this issue has ever been reported. However, an analysis of the purposes behind the doctrine of substantive consolidation and of the preference provisions leads us to conclude that the latter-filing debtor may avail itself of the earlier filing date.
>
> If the reasons for substantively consolidating two cases filed under the Code is to protect the unsecured creditors of both debtors where the assets and liabilities of the debtors are so intermingled as to make them substantially the same, and if the purpose of the preference provisions is to assure equality of distribution among all creditors, then it logically follows that where two cases are substantively consolidated upon a determination by the Court that the assets and liabilities of each debtor are not clearly separable, the preference provisions require us to treat the creditors of both debtors in substantially the same manner. In order for us to do so, we must assign a like filing date to both Debtors for purposes of the preference provisions. We hold that the Church may avail itself of the February 23, 1984, filing date for purposes of determining whether the payment to Carnegie Body constituted a preference under Section 547.
>
> We believe our conclusion to lie within the spirit and purposes of the Bankruptcy Code. Moreover, we do not believe our conclusion to be manifestly unfair to Carnegie or Associates. When Evans filed his first individual pro se petition on February ***101** 23, 1984, both Carnegie and Associates were listed as creditors. Neither Carnegie nor Associates denied that it was a creditor of Evans individually. In the pleadings, Carnegie refers to all actions taken by Debtors as undertaken by "Reverend Willie Evans, II, and/or Evans Temple Church of God in Christ and Community Center, Inc." If the parties herein cannot attribute actions to the separate Debtors, it seems to us that the only fair and reasonable conclusion is that Evans and the Church are substantially the same Debtor and that the Church must be permitted to avail itself of the February 23, 1984, filing date. Only by doing so will all creditors be protected.

These facts are analogous to the reality of Bonham's Ponzi operations. The creditors dealt principally with her, and she arbitrarily assigned WPI or APFC to the investment contract.

In re Kroh Brothers Development Co.- In *In re Kroh Brothers Development Co.*, 117 B.R. 499 (W.D.Mo.1989), the court affirmed a decision by the bankruptcy court which, after applying the *Auto-Train* test, nonetheless found that substantive consolidation *nunc pro tunc* was approved. The court said, *Id.* at 502:

> Nunc pro tunc consolidation would make it possible for a trustee to pursue an action under § § 547 and 548, so the first requirement [of the *Auto-Train* test], benefit to the estate, is satisfied.

The *Kroh* court then considered whether the objecting party had relied on the independent credit of a non-debtor entity which was later consolidated without objection. If the date of the *nunc pro tunc* application were used, the payment to the objecting creditor would have been within the preference period. If the later date, when substantive consolidation was granted, were used, the payment would have been safe from the avoidance action.

The bankruptcy court found that the original debtor, and

the non-debtor who was consolidated at a later date, had a practice of commingling their bank accounts. They had virtually no independent existence from one another. The subsequently added non-debtor had no employees, office, or separate bank account. It derived all its income from dealings with the original debtor. No evidence was offered by the objecting creditor that he or she had relied on the credit of the subsequently added non-debtor.

In the *Bonham* case, the *BRA* defendants are hard put to say that they relied on WPI or APFC, and not Bonham. This was a key person operation, and all investments were handled by Bonham personally. Funds were indiscriminately transferred back and forth between WPI and APFC. Creditors who sent the check in might use WPI's name as payee only to have it endorsed over to APFC at Bonham's whim. This whim apparently was guided in part by her hope of avoiding state securities regulations.

Investors who did have a contract with one entity, e.g., WPI, were often paid by the other, APFC. Even under the *Auto-Train* test, there was no realistic reliance solely on the credit of either WPI or APFC. Since those entities are *alter egos* of RaeJean Bonham, the effective date of the substantive consolidation should be the date of the involuntary proceeding, December 19, 1995.

The clients of attorneys George Goerig, John Burns, Michael MacDonald, Bruce Davison, Brad Ambarian, and Rebecca Copeland filed boiler-plate declarations asserting a reliance, but giving no details. Therefore, I credit them with little weight. *See,* ¶¶ 2.12.4-2.12.8.

There were two businesses run by Bonham: a ticket sales business that did no better than break even (*see,* ¶ 2.4), and an investment business which turned over large sums of money (*see,* ¶ 2.6). If the facts were that the *BRA* defendants in fact invested funds that were used in the ticket sales business and had been paid by the ticket sale business, they would have a good argument for avoiding a *nunc pro tunc* consolidation. In reality, however, their investment was, knowingly or unknowingly, in an illegal Ponzi scheme. If they were not paid by a legitimate ticket sales business, but by the pyramid of funds from subsequent Ponzi scheme investors, then their situation is different than Ronsco in *Auto-Train.* There is fairness in treating the Targets like the Claimants, and allowing the equitable distribution features of the Bankruptcy Code to operate ***102** for both Claimants and Targets rather than have the Claimants bear the entire burden of Bonham's Ponzi scheme.

I conclude that consolidation of WPI and APFC should be effective as of December 19, 1995.

5. *CONCLUSION*- Substantive consolidation of WPI and APFC with the Bonham estate will be ordered effective as of December 19, 1995.

The court will enter a separate order to accomplish this, but first seek the advice of the parties at the next *BRA* status conference regarding the form of the order and such issues as to whether additional notices are necessary to the creditors of WPI and APFC, and what the form should be.

APPENDIX A-OUTLINE OF PLEADINGS REGARDING TRUSTEE'S MOTION FOR SUBSTANTIVE CONSOLIDATION

On January 22, 1997, Cabot Christianson, special counsel for the trustee, filed a *Trustee's Motion For Order Confirming That Assets And Liabilities Of Bonham, World Plus And Atlantic Pacific Funding Corp Are Subject To Administration, For Joint Administration And For Substantive Consolidation Of Estates And To Amend Caption* (Docket Entry 731) [*"Motion to Consolidate"*]. This motion is supported in part by the *Affidavit of Larry D. Compton* (Docket Entry 732), Exhibits to the *Affidavit,* Nos. 1 through 82 (Docket Entry 733), and the *Supplemental Affidavit Of Larry D. Compton* with attached Exhibits 84 through 100 (Docket Entry 1281). The trustee's motion was vigorously opposed by *pro se* creditors/investors, as well as members of the Joint Defense Committee (JDC). The trustee supplemented his motion and responded to the oppositions. The table listed below sets forth all the relevant pleadings regarding the trustee's motion.

DE #	FILED	TITLE	FILED BY

731	01/22/97	Trustee's Motion For Order Confirming That Assets And Liabilities Of Bonham, World Plus And Atlantic Pacific Funding Corp Are Subject To Administration, For Joint Administration And For Substantive Consolidation Of Estates And To Amend Caption ["*Motion to Consolidate* "]	Cabot Christianson for Trustee
732	01/22/97	Affidavit Of Larry D. Compton	Larry Compton, Trustee
733	01/22/97	Exhibits To *Motion to Consolidate*	Cabot Christianson for Trustee
746	01/24/97	Opposition To *Motion To Consolidate*	William Satterberg
895	02/21/97	Opposition To *Motion To Consolidate*	William Satterberg
905	03/03/97	Opposition To *Motion To Consolidate*	Robert Darling, *Pro Se*
906	03/03/97	Memorandum In Support Of Opposition To *Motion To Consolidate.*	Robert Darling, *Pro Se*
914	03/10/97	Response To Opposition To *Motion To Consolidate*	Kenneth & Donna *Wooten, Pro Se*
1032	03/17/97	Joint Defense Counsel's Procedural Objection To *Motion To Consolidate*	John Burns
1051	03/24/97	Response And Objection To *Motion To Consolidate*	Randy Haines for Carter, Dunlap, et al
1105	04/21/97	Supplemental Memorandum In Opposition To *Motion To Consolidate* Re: Alter Ego Issues	Randy Haines for Carter, Dunlap, et al
110	04/21	Appendix Of Supplemental Authorities Re:	Ronald Goss

7	/97	Opposition To *Motion To Consolidate*	
110 8	04/21 /97	Joinder And Supplement To Response And Objection To *Motion To Consolidate*	Brad Ambarian
115 0	05/05 /97	Trustee's Reply To Procedural Objections To *Motion To Consolidate* [Re: DE# 1032, 1051, 1105, & 1108]	David Bundy for Trustee
115 1	05/05 /97	Trustee's Reply To Objections To *Motion To Consolidate* [Re: DE # 746, 895, 905, 914, 1032, 1051, 1105, 1107, & 1108]	David Bundy for Trustee
117 0	05/16 /97	Delta Air Lines, Inc.'s Partial Joinder In *Motion To Consolidate*	Jon Dawson for Delta Air Lines
117 7	05/21 /97	Trustee's Supplemental Memorandum Re: *Motion To Consolidate*	Cabot Christianson for Trustee
117 8	05/21 /97	Statement Of Genuine Issues Of Material Fact Re: *Motion To Consolidate*	Brad Ambarian
128 1	05/23 /97	Supplemental Affidavit Of Larry D. Compton	Cabot Christianson for Trustee
130 4	05/28 /97	Statement Of Uncontested Facts	Cabot Christianson fo r Trustee
131 9	06/06 /97	Trustee's Proposed Findings of Fact and Conclusions of Law	Gary Spraker for Trustee
132 8	06/20 /97	Objections To Trustee's Proposed Findings of Fact	Brad Ambarian
132 9	06/20 /97	Defendants' Proposed Findings of Fact and Conclusions of Law Re: *Motion To Consolidate*	Lewis & Roca George Goerig
134 2	07/03 /97	Trustee's Reply To Objection To Proposed Findings Of Fact And Objection To Defen-	Cabot Christianson for

226 B.R. 56
(Cite as: 226 B.R. 56)

dants' Proposed Findings And Conclusions Trustee
Re: *Motion To Consolidate*

Bkrtcy.D.Alaska,1998.
In re Bonham
226 B.R. 56

END OF DOCUMENT

Bracaglia v. Manzo (In re United Stairs Corp.),
176 B.R. 359 (Bankr. D.N.J. 1995).

176 B.R. 359, 32 Collier Bankr.Cas.2d 1908
(Cite as: 176 B.R. 359)

United States Bankruptcy Court,
D. New Jersey.

In re UNITED STAIRS CORPORATION, Debtor.
John F. BRACAGLIA, Chapter 7 Trustee for United Stairs Corporation and First Fidelity Bank, N.A., Plaintiffs,
v.
Louis MANZO, Excel Cabinet Corporation, Spiral Leasing Corporation, Lisa Manzo, Stacia Manzo, Mary DiNonno, Dorothy Davis and Diana Manzo, Defendants.
Bankruptcy No. 92-31066.
Adv. No. 92-3137TG.

Jan. 11, 1995.

Chapter 7 trustee and undersecured creditor of debtor filed adversary complaint against affiliated **nondebtor** entities seeking to avoid fraudulent transfers and seeking substantive extension and consolidation of debtor's case to certain **nondebtor** corporate defendants. After settlement was reached between trustee and one **nondebtor** entity, the Bankruptcy Court, William H. Gindin, Chief Judge, held that: (1) settlement agreement did not foreclose creditor's rights against **nondebtor** entity; (2) individual creditor had standing to bring action for substantive consolidation against **nondebtor** entity; (3) under test of balancing of equities, **nondebtor** entities that were debtor's **alter ego** and **instrumentality** of debtor would be **substantively consolidated** with debtor; and (4) court did not have to address requirements of involuntary bankruptcy in order to order substantive consolidation of **nondebtor** entities with debtor.

So ordered.

West Headnotes

[1] Bankruptcy 51 2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases
Settlement agreement between Chapter 7 trustee and transferee of debtor's equipment, an affiliated nondebtor entity, in adversary proceeding seeking to void fraudulent transfers and seeking substantive extension and consolidation of debtor's case with nondebtor entities did not foreclose mortgagee's rights against transferee pursuant to adversary complaint, even assuming that debtor's former attorney believed parties intended that settlement would preclude mortgagee from proceeding, where actions and statements of attorney and all other parties were in conflict with this alleged intention.

[2] Corporations 101 1.6(5)

101 Corporations
101I Incorporation and Organization
101k1.6 Particular Occasions for Determining Corporate Entity
101k1.6(5) k. Insolvency, bankruptcy, and receivership. Most Cited Cases
Nondebtor affiliated entity, transferee of debtor's assets, had no existence independent from debtor but was mere instrumentality for debtor, where transferee existed merely to service debtor and debtor's successor corporation, debtor provided purchase money for transferee to commence its operations, president of transferee could point to no repayment terms for alleged loans from debtor, transferee shared office space with debtor and did not pay rent or utility bills, and there were numerous transfers of assets without formalities.

[3] Corporations 101 1.6(5)

101 Corporations
101I Incorporation and Organization
101k1.6 Particular Occasions for Determining Corporate Entity
101k1.6(5) k. Insolvency, bankruptcy, and receivership. Most Cited Cases
Nondebtor affiliated entity was merely extension of

Chapter 7 debtor, where nondebtor entity essentially took over debtor's operations and purchased location of debtor's business for consideration of $1, nondebtor entity's employees were former employees of debtor, and nondebtor entity's president, daughter of sole shareholder of debtor, actually had no idea how these employees were paid.

[4] Judgment 228 ⚿707

228 Judgment
228XIV Conclusiveness of Adjudication
228XIV(B) Persons Concluded
228k706 Persons Not Parties or Privies
228k707 k. In general. Most Cited Cases

Judgment 228 ⚿725(1)

228 Judgment
228XIV Conclusiveness of Adjudication
228XIV(C) Matters Concluded
228k723 Essentials of Adjudication
228k725 Facts Necessary to Sustain Judgment
228k725(1) k. In general. Most Cited Cases

Bankruptcy court's ruling on motion of one nondebtor affiliated entity to dismiss adversary proceeding brought by Chapter 7 trustee and mortgagee to avoid as fraudulent transfers of debtor's assets to nondebtor entities, that mortgagee of debtor had independent standing to bring adversary complaint, did not collaterally estop second nondebtor affiliate entity from raising same issue after settlement of action between trustee and first nondebtor entity; court's finding in ruling on motion to dismiss prior to settlement of case that mortgagee had independent standing was dicta and was not necessary to decision to deny motion, and second nondebtor entity was not party to motion made by first nondebtor entity.

[5] Bankruptcy 51 ⚿2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases

Equitable powers conferred on bankruptcy court, under Bankruptcy Code provision authorizing bankruptcy courts to issue any order necessary or appropriate to carry out provision of Title 11, allow courts to hear application for substantive consolidation by individual creditors. Bankr.Code, 11 U.S.C.A. §§ 105, 1109(b).

[6] Bankruptcy 51 ⚿2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases

Where alter egos are sought to be consolidated with debtor "sufficient reasons" exist to allow creditor to act in lieu of trustee. Bankr.Code, 11 U.S.C.A. §§ 105, 1109(b).

[7] Bankruptcy 51 ⚿2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases

Mortgagee of debtor did not have to request debtor to bring action, as required by *Society Bank* decision, to have standing to seek substantive consolidation or recovery of fraudulent transfers with respect to nondebtor entity that was alter ego of debtor, where Chapter 7 trustee was still plaintiff in action against that entity.

[8] Bankruptcy 51 ⚿2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured

Creditors
51k2702.1 k. In general. Most Cited Cases
Mortgagee's objections to settlement between Chapter 7 trustee and nondebtor affiliated entity, a transferee of debtor's assets, in suit to recover fraudulent transfers and for substantive consolidation were in fact request to trustee to pursue mortgagee's claims against nondebtor entity, and thus, requirement of *Society Bank* decision, that creditor's committee can bring action to recover preference only if committee asks debtor in possession to pursue claims and request is refused was satisfied, even though there was no per se request to pursue nondebtor entity.

[9] Bankruptcy 51 2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases
Requirement that trustee or debtor in possession abuse his or her discretion before court can interfere and permit creditors' committee to bring action to recover preference was inapplicable to mortgagee's suit to avoid fraudulent transfers against nondebtor affiliated identity, a transferee of debtor's assets, where parties intended that mortgagee be able to pursue action against transferee after settlement of action between nondebtor entity and trustee, and trustee did not object to mortgagee's actions in continuing proceeding so that there was no danger of court usurping trustee's discretion.

[10] Bankruptcy 51 2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases
Rationale for requirement that trustee or debtor in possession abuse his or her discretion before court will interfere and permit creditors committee to bring preference action is that court should not interfere with trustee's right to use his or her discretion to pursue some claims and settle others.

[11] Bankruptcy 51 2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases
Mortgagee, as individual creditor of Chapter 7 debtor, had standing to bring action for substantive consolidation against nondebtor affiliated entity.

[12] Bankruptcy 51 2702.1

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2702 Rights of Debtor or Injured Creditors
51k2702.1 k. In general. Most Cited Cases
Mortgagee, as individual creditor of Chapter 7 debtor, did not have standing to bring action for substantive consolidation against nondebtor affiliated entities with respect to whom trustee was still plaintiff in case.

[13] Bankruptcy 51 2723

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2723 k. Parties. Most Cited Cases
Nondebtor entity to which Chapter 7 debtor transferred assets and second **nondebtor** entity to which assets were then leased were, respectively, **instrumentality** and **alter ego** of debtor and could be **substantively consolidated** with debtor under balancing of equities test, where creditors would be severely prejudiced if **nondebtor** entities were to remain essentially separate from debtor, and consolidation would cause little or no economic prejudice to credi-

tors. Bankr.Code, 11 U.S.C.A. § 105(a).

[14] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In general. Most Cited Cases
(Formerly 51k2159.1)
It is accepted that nondebtor entity may be consolidated with debtor under appropriate circumstances. Bankr.Code, 11 U.S.C.A. § 105(a).

[15] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In general. Most Cited Cases
Consolidation is power that should be used sparingly; substantive consolidation is to be considered with extreme caution and granted only in extraordinary situations.

[16] Bankruptcy 51 2084.1

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.1 k. In general. Most Cited Cases
(Formerly 51k2159.1)
Consolidation is not instrument of procedural convenience, but measure vitally affecting substantive rights.

[17] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and objections; factors considered. Most Cited Cases
(Formerly 51k2159.1)
Where debtor and nondebtor entities are alter egos of each other extraordinary circumstances are present, justifying substantive consolidation.

[18] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and objections; factors considered. Most Cited Cases
(Formerly 51k2159.1)
Court would adopt ultimate test of balancing of equities to determine whether substantive consolidation of debtor with nondebtor's entities is appropriate; under this test, court must weigh economic prejudice of continued debtor separateness against economic prejudice of substantive consolidation and the determination must be sui generis.

[19] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and objections; factors considered. Most Cited Cases
(Formerly 51k2159.1)
Court was not required to address requirements of involuntary bankruptcy to order substantive consolidation of debtor with nondebtor entities, where nondebtor entities were alter egos of debtor, not entitled to procedural safeguards available to independent nondebtor, and where creditors would not be harmed by lack of these protections. Bankr.Code, 11 U.S.C.A. § 303(b).

[20] Bankruptcy 51 2127.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(A) In General

51k2127 Procedure
51k2127.1 k. In general. Most Cited Cases
(Formerly 51k2159.1)
Entity which is alter ego of debtor is not entitled to safeguards to which true independent nondebtor would be entitled.

[21] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and objections; factors considered. Most Cited Cases
(Formerly 51k2159.1)
Where nondebtor entities are alter egos of debtor, creditors have right to move for extension and consolidation independent from right to force those entities into bankruptcy under involuntary bankruptcy provisions of Bankruptcy Code. Bankr.Code, 11 U.S.C.A. § 303.

[22] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and objections; factors considered. Most Cited Cases
(Formerly 51k2159.1)
Legal question of whether procedural safeguards of involuntary bankruptcy provision of Bankruptcy Code are required for substantive consolidation, like question of whether substantive consolidation is proper in first place, is dependent upon equities of case at hand. Bankr.Code, 11 U.S.C.A. § 303(b).

[23] Bankruptcy 51 2723

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2723 k. Parties. Most Cited Cases
Harm caused by transfer of Chapter 7 debtor's assets to nondebtor entities would be remedied by substantive consolidation of these entities with debtor's estate, and thus, creditor could not recover against nondebtor entities for conspiracy to defraud, under New Jersey law.

[24] Fraud 184 3

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k2 Elements of Actual Fraud
184k3 k. In general. Most Cited Cases
Common-law fraud in New Jersey consists of following elements: knowing misrepresentation by defendant as to material fact; defendant's intention to induce plaintiff to rely on that misrepresentation; reliance by plaintiff on that misrepresentation; and resulting damage to plaintiff.

[25] Federal Courts 170B 13

170B Federal Courts
170BI Jurisdiction and Powers in General
170BI(A) In General
170Bk12 Case or Controversy Requirement
170Bk13 k. Particular cases or questions, justiciable controversy. Most Cited Cases
(Formerly 13k6)
Security interest in Chapter 7 debtor's assets was invalid under New Jersey law, and thus, fraudulent transfer claim brought by creditor was moot with respect to alleged security agreement, where alleged creditor attempting to receive security interest in debtor's assets did not execute security agreement and proof at trial was insufficient to prove that funds were due and owing to her. N.J.S.A. 12A:9-203(1)(b).

[26] Bankruptcy 51 2721

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2721 k. In general. Most Cited Cases
Bankruptcy court did not have jurisdiction over count of adversary proceeding alleging fraudulent transfer based on transfer of personal residence of president and sole shareholder of Chapter 7 debtor to his rela-

tives, and thus, court had to dismiss count sua sponte, where state court had already set aside transfer as fraudulent conveyance under state law.

[27] Bankruptcy 51 2727(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent transfers. Most Cited Cases
Chapter 7 trustee and creditor failed to meet burden of showing that accounts receivable of debtor were deposited into personal bank account of daughter of debtor's president by failing to show specific proof as to amount or identification of checks, and thus, trustee and creditor could not recover transfers as fraudulent. Bankr.Code, 11 U.S.C.A. § 548.

[28] Bankruptcy 51 2726.1(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2726.1 Burden of Proof
51k2726.1(3) k. Fraudulent transfers. Most Cited Cases
Burden of proof with respect to claim of fraudulent transfer is on trustee. Bankr.Code, 11 U.S.C.A. § 548.

[29] Bankruptcy 51 2721

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2721 k. In general. Most Cited Cases
Claims by Chapter 7 trustee and mortgagee against nondebtor entities and individual officers for conversions of debtor's property was mooted as result of consolidation of nondebtor entities with debtor's bankruptcy case.

[30] Trover and Conversion 389 25

389 Trover and Conversion
389II Actions
389II(A) Right of Action and Defenses
389k25 k. Persons liable. Most Cited Cases
Chapter 7 trustee and mortgagee of debtor could not recover against individual defendants for conversion of debtor's property absent proof that debtor's assets were converted for use of individual defendants.
***362** Joseph Lubertazzi,McCarter & English, Newark, NJ, for plaintiff First Fidelity Bank, N.A.

***363** John Bracaglia, Jr.,Trustee, Cohn & Bracaglia, Somerville, NJ.

Peter R. Silverman, Silverman, Collura, Chernis, P.C., New York City, for defendants.

OPINION

WILLIAM H. GINDIN, Chief Judge.

INTRODUCTION

This action was commenced by the filing of an Adversary Complaint and an Order to Show Cause by the Chapter 7 trustee, John Bracaglia, and by First Fidelity Bank, N.A. ("First Fidelity"), an undersecured creditor of debtor. The complaint seeks various types of relief including the voiding of fraudulent transfers and the substantive extension and consolidation of the debtor's case with certain non-debtor corporate defendants. This court held a trial on the return of the Order to Show Cause.

This court has jurisdiction over the matter pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157. This is a core matter pursuant to 28 U.S.C. § 157(b)(2)(A), (B), (E), (H) and (*O*).

FACTS

The debtor was engaged in the business of manufacturing and selling staircases. On September 12, 1986 and October 19, 1990 First Fidelity loaned the debtor $1,500,000 and $794,458.39 respectively. The debtor ultimately defaulted on these obligations. First Fidelity brought suit, by Order to Show Cause and Verified Complaint filed on May 6, 1991, in the Superior

Court of New Jersey, Chancery Division, Middlesex County, seeking foreclosure of its mortgages. The Order to Show Cause was heard on May 8, 1991. On May 16, 1991, the Superior Court entered an order temporarily restraining debtor from transferring its assets. These restraints were continued by an order dated May 31, 1991 and remained in effect until the debtor filed a petition for relief under Chapter 7 of the Bankruptcy Code on February 18, 1992.

One month prior to the filing of the Superior Court Complaint, and two weeks after First Fidelity had sent a demand letter to debtor, defendant Excel Cabinet Corporation ("Excel") was incorporated. The President of Excel is defendant Lisa Manzo, the daughter of Louis Manzo, the President and sole shareholder of the debtor. Excel is engaged in the business of manufacturing and selling wooden cabinets. On May 7, 1991, the day before the return of the Order to Show Cause, the debtor transferred title to certain property to Excel for the consideration of $1.00. Debtor also transferred inventory and accounts to Excel. Additionally, the evidence shows that debtor transferred equipment to defendant Spiral Leasing Corporation ("Spiral"). The President of Spiral is Diana Manzo, the sister of Louis Manzo. After May 7, 1991, the debtor essentially ceased operations and Excel occupied the premises. It should be noted that while there are some differences in the machinery or equipment used by Excel, both operations involve the construction of large wooden objects. Excel acquired some machinery apparently incompatible with stair making but the general process appears to be similar.[FN1] On May 1, 1991, Spiral leased the equipment transferred from debtor to Excel.

> FN1. At the request of the parties, the court visited the premises in question in the presence of representatives of all parties and made the observations set forth herein. While a great effort was made to emphasize differences in the machinery, it is clear that the uses are compatible and that the changeover from stairs to cabinets was, for the most part, a trivial one.

On February 4, 1992 the Superior Court entered an order appointing a custodial receiver for debtor and on February 18, 1992 entered an order extending the custodial receiver a statutory receiver. It extended the restraints imposed on debtor to defendants Excel, Spiral, Lisa Manzo, Stacia Manzo, Louis Manzo, Mary DiNonno and Dorothy Anne Davis. On February 18, 1992 the debtor filed its Chapter 7 petition.

The within adversary complaint was filed by the trustee and First Fidelity on March 12, 1992 and an Order to Show Cause with the temporary restraints set forth above was entered by this Court on March 13, 1992. The trial began on April 5, 1992 and shortly thereafter the parties began settlement negotiations. While the trial was ongoing, the trustee and Spiral reached a settlement. ***364** The trustee submitted the proposed settlement to the Court and First Fidelity responded with objections to the settlement. On October 29, 1992, the Court held a conference in connection with the objections.

[1] During the conference with the Court, the parties agreed that the settlement between the trustee and debtor would not affect First Fidelity's right to proceed in the adversary proceeding. This fact is relevant to Spiral's motion to dismiss based on the settlement agreement. Spiral argues that it was not the intention of the parties that First Fidelity be able to proceed after the settlement. In the alternative, Spiral argues that even if it was the intention of the parties for the suit to continue with First Fidelity as sole plaintiff, First Fidelity has no legal standing to pursue Spiral as First Fidelity is not the trustee and is merely an individual creditor.

Defendant Spiral conducted depositions of debtor's former attorney, Charles Mandell, and First Fidelity's attorney, Joseph Lubertazzi in connection with its argument that it was not the intention of the parties that First Fidelity be able to continue its suit after the settlement between the trustee and Spiral. Those depositions were submitted to this court along with a letter dated November 22, 1994 in which Spiral argues that the depositions support its position and specifically that Charles Mandell expressed this intention to the parties. The court has reviewed the depositions and finds that the arguments made to the court by both parties, at the time of the settlement, demonstrate that the parties intended First Fidelity would proceed with the adversary proceeding.

Spiral quotes Mr. Mandell out of context in arguing its position. Spiral argues that Mr. Mandell understood the intention of the parties to be that First Fidelity would not be able to proceed against Spiral

after the settlement between Spiral and the trustee. The depositions actually reveal that Mr. Mandell at first could not remember his own intentions, but then explained his belief that the settlement transferred the trustee's claims to Spiral, thus precluding First Fidelity from asserting the trustee's claims on behalf of the estate. (Deposition of Charles Mandell, October 17, 1994, at 15-16.) Mr. Mandell admitted that he did not express his thoughts either to the court or to First Fidelity. (Deposition of Mandell at 16-17.) Assuming arguendo that Mr. Mandell indeed believed the parties intended that the settlement would preclude First Fidelity from proceeding, the actions and statements of Mr. Mandell and all other parties were in conflict with this alleged intention. It is the factual finding of this court that the settlement agreement between the trustee and Spiral was not intended to foreclose First Fidelity's rights against Spiral. Whether First Fidelity has a legal right to pursue its claims is an issue that will be discussed below.

[2] During the testimony of Diana Manzo it became clear that Spiral was merely an instrumentality for United Stairs and that Louis Manzo, acting on behalf of United Stairs, and not Diane Manzo, was in control of Spiral's business. Diana Manzo testified that Spiral existed merely to service United Stairs and later Excel. United Stairs provided the purchase money for Spiral to commence its operations. This "loan" and later "loans" were never repaid. Diana Manzo was unable to point to any repayment terms for these loans. Spiral shares office space with United Stairs. It does not pay rent nor does it pay utility bills. Testimony demonstrated that there were numerous transfers of assets without formalities. It is clear that Spiral had no existence independent from United Stairs.

[3] The same is true with respect to Excel. Testimony demonstrated that Excel essentially took over United Stairs operations and purchased the Keyport Property (the location of the United Stairs business) for the consideration of $1.00. Excel's employees were the former employees of United Stairs. Excel's president, Lisa Manzo, actually had no idea how these employees were paid. It is clear that Lisa Manzo was merely a figurehead for her father, Louis Manzo, operating as United Stairs, and that Excel was merely an extension of United Stairs.

First Fidelity seeks to recover property transferred to the corporate defendants, arguing that these transfers were "fraudulent ***365** transfers" under 11 U.S.C. § 548. Alternatively, First Fidelity argues that the assets of Spiral and Excel should be substantively consolidated with the debtor's case. Consolidation would moot the need for recovery of fraudulent transfers made to these two corporate entities. Spiral moves to dismiss the adversary proceeding arguing that First Fidelity, an individual creditor of debtor, has no standing to seek recovery of a fraudulent transfer or to move for extension and substantive consolidation. In response to Spiral's motion to dismiss, First Fidelity argues that Spiral is collaterally estopped from arguing lack of standing.

For the reasons articulated below, Spiral's Motion to Dismiss is denied. With respect to the merits of the claim for substantive consolidation, the court finds that Excel and Spiral are alter egos of the debtor and the court will order the extension of the bankruptcy case to include the assets of Spiral and Excel.

DISCUSSION

Collateral Estoppel

[4] On June 29, 1992 this Court denied defendant Excel's motion to dismiss First Fidelity for lack of standing. First Fidelity argues that the Court's ruling in the Excel motion is the law of the case and Spiral is collaterally estopped from raising the same issue. Plaintiffs Brief in Opposition, at 16; *see also* *Matter of Resyn Corp.*, 945 F.2d 1279, 1281 (3d Cir.1991) (holding in relevant part that the doctrine of law of the case dictates that when a court decides a rule of law, that rule should continue to govern the same issues in subsequent stages in the litigation). Spiral argues that the settlement agreement between the trustee and Spiral is binding and in effect avoids directly responding to First Fidelity's law of the case argument. *See* Spiral's Memorandum in Reply to Opposition of First Fidelity, July 12, 1994.

What neither party addresses is that the factual status of the adversary proceeding was different at the time of the Excel motion. The Excel motion was heard *prior* to the settlement. At that time First Fidelity *and* the trustee were plaintiffs in the adversary proceeding against Spiral. Excel argues in its papers that the action was "brought by First Fidelity and that the trustee ... [was] ... merely a nominal party in the case."

Excel's Application in Support of Motion to Dismiss, par. 9. The Court at the Hearing of June 29, 1992 ruled that the trustee was still a party and further that First Fidelity had independent standing to bring the action and denied the motion to dismiss.

The Supreme Court has held that when a court "has decided an issue of fact or law *necessary to its judgment*, that decision may preclude relitigation of the issue in a suit on a different cause of action involving a party to the first case." *Allen v. McCurry*, 449 U.S. 90, 94, 101 S.Ct. 411, 414, 66 L.Ed.2d 308 (1980) (emphasis added); *see also* 18 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* §§ 4416 & 4421 (1981). In the motion to dismiss brought by Excel, the bankruptcy court found that the trustee was still a party to the case and that First Fidelity could join in the motion to benefit the estate. The court's finding that First Fidelity had independent standing was dicta and was not necessary to the decision to deny Excel's motion.

Additionally, United States Supreme Court has removed the mutuality requirement for collateral estoppel in *Blonder-Tongue Laboratories, Inc. v. University*, 402 U.S. 313, 91 S.Ct. 1434, 28 L.Ed.2d 788 (1971). The Court now recognizes a general limitation that the "concept of collateral estoppel cannot apply when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate that issue in the earlier case." *Allen*, 449 U.S. at 95, 101 S.Ct. at 415; *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979). In the instant case, First Fidelity seeks to assert the ruling in its favor against Spiral which was not a party to the motion made by Excel.

Collateral estoppel is not applicable as the court's decision in the Excel motion was not necessary to its ruling on the motion and Spiral has not had an opportunity to litigate this issue. This court will therefore address the merits of Spiral's Motion to Dismiss for lack of standing.

***366** *Spiral's Motion to Dismiss*

[5] Spiral argues that First Fidelity has no standing to seek recovery of fraudulent transfers or to move for consolidation. Spiral asserts that an individual creditor cannot invoke the trustee's powers.

As mentioned above, the trustee entered into a settlement with defendant Spiral waiving the trustee's right to pursue recovery of the alleged fraudulent transfers to Spiral. Consequently, with respect to defendant Spiral, the settlement between the trustee and Spiral left First Fidelity as the sole plaintiff in the adversary proceeding.

The Bankruptcy Code does not specifically address the right of an individual creditor to pursue a claim on the estate's behalf in a Chapter 7 case. In a Chapter 11 case "any party in interest, including ... a creditor ... may appear and be heard on any issue in any case under this chapter." 11 U.S.C. 1109(b). There is no comparable provision under Chapter 7. Additionally, as the Third Circuit cases discussed below demonstrate, the courts of this jurisdiction have not specifically addressed this issue.

In *Official Unsecured Creditors' Committee v. Michaels* (*In the Matter of Marin Motor Oil*), 689 F.2d 445, 450 (3rd Cir.1982) the Third Circuit held that in a Chapter 11 case a creditors' committee has the right to intervene in an adversary proceeding pursuant to 11 U.S.C. 1109(b). *Id.* at 453. The *Michaels* court granted the creditors' committee's motion to intervene in the adversary proceeding brought by the trustee to, among other things, substantively consolidate non-debtors with the debtor's case. An additional issue resolved by the court was that § 1109 mandated intervention by creditors and that the court did not have discretion to deny intervention.

The Third Circuit also noted that "Congress intended a creditors' committee to have more extensive rights in a reorganization than in a liquidation." *Id.* at 450. One reading of this statement is that in contrast to a Chapter 11 creditor, a Chapter 7 creditor does not have standing to involve itself as a plaintiff seeking to consolidate non-debtors. However, another reading is that in a Chapter 11 case creditors may intervene as of right as opposed to a Chapter 7 case where the decision is left to the discretion of the court. It is not clear from the context of the quoted statement which reading reflects the intention of the court. Additionally, as this was a Chapter 11 case, the statement is *dicta.*

In a more recent opinion, *In re McKeesport Steel Castings Company*, 799 F.2d 91 (3rd Cir.1986), the Third Circuit held that the general rule "that individ-

ual creditors cannot act in lieu of the trustee is often breached when sufficient reason exists to permit the breach." *Id.* at 94. That case involved a gas company's motion for payment from the debtor for service pursuant to 11 U.S.C. § 506(c). This section of the code clearly provides that the "*trustee* may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of such property." 11 U.S.C. § 506(c) (emphasis added). Despite the fact that § 506(c) seems to give the power to recover expenses only to the trustee, the Third Circuit found that equity requires the court to allow a creditor to bring an action when the trustee does not. *Id.* This holding must be read in connection with two other factors. First, the *McKeesport* case was brought under Chapter 11. Since the Court does not mention the general right to be heard under 11 U.S.C. 1109(b), it is not clear whether the holding was meant to be applicable only to Chapter 11 cases or to Chapter 7 cases as well. Secondly, the Court considered as an important factor that the plaintiff "was the only creditor that would zealously pursue [the] claim" and "neither the debtor in possession nor a creditors' committee had reason to make the claim on behalf of [plaintiff]." *Id.* In contrast, in the instant case the trustee did have reason to bring the adversary proceeding, which it did, but chose to settle the claims against Spiral.

While *McKeesport* provides some authority for the Court to invoke its equitable powers, it is not clear whether the holding is applicable to the instant case. *Michaels* arguably supports a contrary finding, but again the Third Circuit did not specifically address a chapter 7 case involving an individual creditor.***367** Since there is no controlling decision on the particular issue presented by the instant case, this case must be treated as one of first impression in this jurisdiction.

In the majority of cases dealing with substantive consolidation the movant is the trustee or the debtor in possession. *See* *Kroh Brothers Development Co. v. Kroh Brothers Management Co.*, 117 B.R. 499 (W.D.Mo.1989); *see also* *Murphy v. Stop & Go Shops, Inc. (In re Stop & Go of America)*, 49 B.R. 743 (Bankr.D.Mass.1985). It is the rare case that presents the issue of an individual creditor seeking to consolidate the assets of non-debtors into the debtor's estate.

In the case of *In re Snider Bros., Inc.*, 18 B.R. 230 (Bankr.D.Mass.1982), the court considered a motion brought by the creditors' committee to consolidate six debtor corporations which had filed under chapter 11. While the court denied the relief finding that the equities were not in favor of consolidation, the court did not question the committee's right to bring such an action. The court in *Snider* recognized that a creditors' committee can bring such an action, and given the appropriate facts a court may grant substantive consolidation.

There are two courts which have held, based solely on equitable principles, that an individual creditor may pursue a substantive consolidation. In *In re Tito Castro Construction, Inc.*, 14 B.R. 569 (Bankr.D.P.R.1981), the Court held that "[a]ny party in interest may request that the Bankruptcy Court effectuate a consolidation." *Id.* at 571.

Judge Whelan of the District Court of the District of Columbia held that when entities sought to be consolidated with the debtor are alter egos of the debtor, individual creditors have the right to bring those entities before the Court even though the creditors may not have had the power to force an involuntary petition on such non-debtor entities. *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. 89, 96 (Bankr.D.D.C.1981). The facts of the *In re 1438 Meridian Place* parallel those of the instant case wherein the nondebtor entities, Spiral and Excel, are alter egos of United Stairs. *See* discussion *infra* at 367-68, *Extension and Substantive Consolidation.*

[6] As discussed above, the Third Circuit has held that where "sufficient reason exists" individual creditors may act in lieu of the trustee. *McKeesport*, 799 F.2d at 94. The rationale of the *1438 Meridian Place* holding is consistent with the *McKeesport* holding; where alter egos are sought to be consolidated with the debtor "sufficient reason exists" to allow First Fidelity to act in lieu of the trustee. Judge Whelan's view is persuasive and requires the holding that the equitable powers of § 105 allow the court to hear an application for substantive consolidation by an individual creditor.

Many courts have held that the right to substantive consolidation is a qualified right; i.e., the creditor must demonstrate that the actions of the trustee in *not* pursuing that right were unjustifiable or abusive of

his discretion. *See* *Society Bank, N.A. v. Sinder*, 102 B.R. 978, 983 (Bankr.S.D.Ohio 1989). In *Society Bank,* the court held that a creditors' committee could bring an action to recover a preference only if (1) the committee asked the debtor-in-possession to pursue the claim and the request was refused and (2) the debtor-in-possession abused its discretion in so refusing. *Id.* at 983.

[7] The two-part qualification set forth in *Society Bank* is inapplicable to the instant case for two reasons. First, in this case there was no need for First Fidelity to make such a request with respect to Excel, because, in fact, the trustee is still a plaintiff in the action against Excel. Hence, the first element is not applicable to Excel.

[8] With respect to Spiral, there was no *per se* request to pursue Spiral. However, at the time of the settlement, First Fidelity objected to the settlement and clearly stated its intention to continue to pursue Spiral. First Fidelity's objections to the settlement were in fact a request to the trustee to pursue its claims against Spiral. The insistence upon the settlement by the trustee was tantamount to a denial. While the second element is applicable to Spiral, it has been satisfied.

[9][10] Second, the requirement that the trustee or debtor-in-possession abuse his/her discretion before the court interferes is not ***368** applicable to either corporate defendant. The rationale for the requirement is that the court should not interfere with the trustee's right to use his/her discretion to pursue some claims and settle others. *See* *Belisle v. Anzivino (In re Plunkett)*, 128 B.R. 460, 461 (Bankr.E.D.Wis.1991) (regarding trustee's strong arm power pursuant to 11 U.S.C. § 544); *Washington Mutual Savings Bank v. James* (*In re Brooks)*, 79 B.R. 479, 480 (9th Cir. BAP 1987) (regarding trustee's avoidance power under 11 U.S.C. § 549); *see also* 11 U.S.C. §§ 544, 547, 548 and 549 (all providing that the trustee "may" avoid certain transfers of property). In this case, the parties intended that First Fidelity be able to pursue an action against Spiral after the settlement and the trustee has not objected to First Fidelity's actions in continuing the proceeding against Spiral. Consequently, there is no danger of the court usurping the trustee's discretion and it is unnecessary to determine whether the trustee's settlement with Spiral, when viewed in hindsight, was an abuse of discretion in this case. Finally, it should be noted that First Fidelity has an allowed secured claim and as the holder of such, is not represented by the trustee.

[11] This court finds that First Fidelity, as an individual creditor, has standing to bring an action for substantive consolidation against the non-debtor entity, Spiral. Spiral's motion to dismiss is therefore denied.

[12] With respect to the other defendants, the trustee is still a plaintiff in the case. No defendant has made a motion to dismiss the trustee nor has the trustee sought a voluntary dismissal. The trustee is therefore still a party to this case and co-plaintiff with First Fidelity as to all parties except Spiral.

Extension and Substantive Consolidation

[13] While the Bankruptcy Code does not specifically address the court's power to substantively consolidate, courts have held that the power is authorized under 11 U.S.C. § 105(a). *See, e.g., In re Hemingway Transport*, 954 F.2d 1 (1st Cir.1992); *Eastgroup Properties v. Southern Motel Assoc.*, 935 F.2d 245 (11th Cir.1991); *In re Augie/Restivo Baking Company*, 860 F.2d 515 (2nd Cir.1988). Pursuant to § 105 the bankruptcy court is granted equitable powers to carry out the provisions of the Bankruptcy Code and to prevent abuses of process. *See* 11 U.S.C. § 105(a). It is well established that in the appropriate circumstances the court may substantively consolidate corporate entities thereby "merg[ing] the assets and the liabilities of two or more estates, creating a common fund of assets and a single body of creditors." *In re John Cooper*, 147 B.R. 678, 682 (Bankr.D.N.J.1992); *In re Parkway Calabasas, Ltd.*, 89 B.R. 832, 837 (Bankr.C.D.Cal.1988), *aff'd* 949 F.2d 1058 (9th Cir.1991).

[14] While many consolidation cases involve the consolidation of entities already in bankruptcy, it is accepted that a non-debtor entity may be consolidated with a debtor under appropriate circumstances. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S.Ct. 904, 85 L.Ed. 1293 (1941); *see also* *In re 1438 Meridian Place, N.W., Inc.*, 15 B.R. 89 (Bankr.D.D.C.1981); and *In re Crabtree*, 39 B.R. 718 (Bankr.E.D.Tenn.1984). In *Sampsell* the Supreme Court found that substantive consolidation of a non-debtor corporation with the individual bankrupt's estate was proper where the transfer of property to

the non-debtor corporation was not in good faith but was made for the purpose of placing it beyond the reach of the original debtor's creditors, and where the effect of the transfers was to hinder, delay or defraud the individual's creditors. *Id.* 373 U.S. at 218-19, 61 S.Ct. at 906-07; *see also* Patrick C. Sargent, *Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue*, 44 Bus.Law 1223, 1233-36 (1989) (discussing the consolidation of debtor subsidiaries).

[15][16] Consolidation, of course, is a power that should be used sparingly. *Snider Bros.*, 18 B.R. at 234. This power is not an "instrument of procedural convenience, but a measure vitally affecting substantive rights." *Id. See Matter of Flora Mir Candy Corp.*, 432 F.2d 1060, 1062 (2nd Cir.1970); *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2nd Cir.1966). Substantive consolidation should be considered with extreme ***369** caution and granted only in extraordinary situations. *In re Lease-A-Fleet, Inc. v. Robins Le-Cocq, Inc.*, 141 B.R. 869, 872-73 (Bankr.E.D.Pa.1992).

[17] While this court is mindful of the seriousness of the remedy of consolidation, this is a case where extraordinary circumstances exist and an examination of the equities requires extension and substantive consolidation. Where the debtor and non-debtor entities are alter egos of each other extraordinary circumstances are present. *Lease-A-Fleet*, 141 B.R. at 872-73. In this case, no one but Louis Manzo, acting as president of United Stairs, had any knowledge of the operations of the various businesses. Manzo treated each of them as an instrumentality; using raw materials, employees, physical space, telephone and even stationary as needed regardless of the corporate niceties. Similar to the debtor's actions in *Sampsell*, the transfers of property to Spiral and Excel were not in good faith but were made for the purpose of placing United Stairs' assets beyond the reach of its creditors. *Sampsell*, 313 U.S. at 218-19, 61 S.Ct. at 906-07.

[18] A number of bankruptcy courts have established a multi-element test for determining whether substantive consolidation is appropriate. *See, e.g., In re Augie/Restivo Baking Company*, 84 B.R. 315, 321 (Bankr.E.D.N.Y.1988); *Pension Benefit Guaranty Corp. v. Quimet Corp.*, 711 F.2d 1085, 1093 (1st Cir.1983), *cert. denied*, 464 U.S. 961, 104 S.Ct. 393, 78 L.Ed.2d 337 (1983); *see also* Baker Ostrin, *A Proposal to Limit the Availability of Substantive Consolidation of Solvent Entities with Bankrupt Affiliates*, 91 Com.L.J. 351, 354-58 (1986) (setting forth the different multi-element tests for consolidation and arguing for the limitation of the substantive consolidation of solvent entities). No specific elements have been applied in the district of New Jersey and while such tests may be helpful in some analyses this court adopts the ultimate test of balancing of the equities. In doing so, the court must weigh the economic prejudice of continued debtor separateness against the economic prejudice of substantive consolidation. *In re Cooper*, 147 B.R. 678, 682 (Bankr.D.N.J.1992); *In re Snider Bros., Inc.*, 18 B.R. 230, 234 (Bankr.D.Mass.1982). This determination must be *sui generis*. *In re Augie/Restivo*, 84 B.R. at 321, *quoting* 5 Collier on Bankruptcy, ¶ 1100.06, p. 1100-33 (15th Ed.1985).

Creditors would be severely prejudiced if Excel and Spiral were to remain as entities separate from debtor. Louis Manzo has attempted to circumvent liabilities incurred by United Stairs while continuing his business in the form of Excel and transferring assets to Excel and Spiral. United Stairs is, as a result, a debtor with very few assets and its creditors have a slim chance of any recovery. Without consolidation, the following claims would most likely remain unpaid: tax claims of approximately $400,000, trade claims of approximately $400,000 and bank claims in excess of $2,500,000.

On the other hand, consolidation will cause little or no economic prejudice to creditors. Diana Manzo has testified that Spiral has only one creditor, a bank with a secured claim on one of Spiral's vehicles. The trade creditors of Excel are essentially the same as the trade creditors of United Stairs. In this case consolidation would yield "an equitable treatment of creditors without undue prejudice to any particular group." *In re Richton International Corp.*, 12 B.R. 555, 558 (Bankr.S.D.N.Y.1981).

This court finds that plaintiffs have met their burden of proving that Excel is the alter ego and Spiral the instrumentality of United Stairs. The balancing of equities makes it proper and necessary to treat debtor, Excel and Spiral as one entity in this proceeding. *In re Continental Vending Machine Corp.*, 517 F.2d 997, 1000 (2d Cir.1975).

Involuntary Bankruptcy of Non-Debtor Entities

[19] Defendants argue that the court cannot impose consolidation without a finding that plaintiffs have met the requirements of involuntary bankruptcy as to the defendants. *See* 11 U.S.C. 303(b). For the reasons articulated below, § 303 is not applicable to these plaintiffs.

[20][21] An entity which is the alter ego of a debtor is not entitled to the safeguards to which a true independent non-debtor ***370** would be entitled. *In re 1438 Meridian Place*, 15 B.R. at 95-96 (holding that the debtor corporation's creditors, who could not comply with § 303(b) with respect to the non-debtors affiliates because the creditors did not have a claim against the affiliates directly, nonetheless could bring them before the court where such affiliates were alleged to be the alter egos of the debtor). Where the non-debtor entities are alter-egos of the debtor, the creditors have the right to move for extension and consolidation independent from the right to force those entities into bankruptcy pursuant to 11 U.S.C. § 303. *In re Crabtree*, 39 B.R. 718, 722 & n. 1 (Bankr.E.D.Tenn.1984).

Not all courts accept the argument that § 303(b) need not be satisfied in a substantive consolidation case. In *In re Alpha & Omega Realty*, 36 B.R. 416 (Bankr.D.Idaho 1984), the court declined to follow *1438 Meridian* and held that a nondebtor could not be declared an involuntary debtor through a consolidation motion and that either an adversary proceeding or involuntary petition under § 303 with their attendant protections was required. *Alpha & Omega*, 36 B.R. at 417. The facts of the instant case are distinguishable as the *Alpha & Omega* court specifically found that the nondebtor entities in that case were *not* alter egos of the debtor. *Id.* Indeed, the *Alpha & Omega* court notes this same distinction between its case and the *1438 Meridian* case. *Id.*

[22] The legal question of whether the procedural safeguards of § 303 are required, like the question of whether substantive consolidation is proper in the first place, is dependent on the equities of the case at hand. *Crabtree* 39 B.R. at 722; *In re Miller*, 262 F.Supp. 298, 300 (E.D.Ill.1967). As discussed above, the continued independence of Spiral and Excel would be a greater hardship on the creditors than the consolidation with debtor. Similarly, no prejudice results to the creditors by virtue of allowing First Fidelity to amend the caption in this bankruptcy case rather than requiring them to file a new separate petition against Spiral and Excel. *Crabtree* 39 B.R. at 722; *In re Miller*, 262 F.Supp. at 300. If Spiral and Excel have any defenses, they can raise them as well in the consolidated case as they could have in an independent proceeding. *Crabtree* 39 B.R. at 722; *In re Miller*, 262 F.Supp. at 300. If they have no defenses, then it would have been an unnecessary expense to the creditors to bring an entirely new bankruptcy proceeding. *Crabtree*, 39 B.R. at 722; *In re Miller*, 262 F.Supp. at 300; *see also Meridian*, 15 B.R. at 97-98 (no prejudice to creditors).

As this is a case involving alter egos where the non-debtor entities are not entitled to procedural safeguards and creditors will not be harmed by the lack of these protections, the court need not address the requirements of § 303(b) to order substantive consolidation. For the reasons stated above, debtor's estate shall be substantively consolidated with non-debtors Excel and Spiral.

Fraudulent Transfers, Fraud and Conversion

Since the court has ordered the substantive consolidation of debtor, Spiral and Excel, the counts of the complaint requesting recovery of fraudulent transfers from these entities are moot. Counts I, II, V, VI, VII and VII need not be addressed by the court. In addition, Counts XI and XII are also moot as they request turnover of property from Spiral and/or Excel and payment for use and occupancy of the debtor's property from Spiral and/or Excel.

[23][24] As to Count XIV of the Complaint, Conspiracy to Defraud, this court finds in favor of defendants because plaintiffs have not proven the requisite elements of fraud. The elements of common law fraud in New Jersey consists of the following elements: knowing misrepresentations by defendants as to a material fact, defendants' intention to induce plaintiffs to rely on that misrepresentation, reliance by plaintiff on that misrepresentation and resulting damage to plaintiff. *Gutman v. Howard Savings Bank*, 748 F.Supp. 254 (D.N.J.1990); *see also Agathos v. Starlite Motel*, 977 F.2d 1500 (3rd Cir.1992); *Nolan by Nolan v. Lee Ho*, 120 N.J. 465, 577 A.2d 143 (1990).

The court need not address each of these elements as it is clear that the last element, proof of damages, cannot be demonstrated. Plaintiffs were able to demonstrate that ***371** there was a scheme to defraud creditors through a transfer of assets from United Stairs to Spiral and Excel. While there were additional allegations of fraud resulting in the transfer of debtor property to the individual defendants, the proofs at trial were insufficient. The harm that was caused by the transfer of assets to Spiral and Excel will be remedied by the substantive consolidation of these entities with the debtor's estate. Hence, the court finds in favor of defendants on Count XIV of the complaint.

[25] Plaintiffs allege in Counts IX and X that fraudulent transfers were made to Stacia Manzo. The specific allegations developed at trial with respect to Stacia Manzo personally were that she attempted to receive security interests in assets of United Stairs and that a portion of the residential property of Louis Manzo was transferred to her from him. With respect to the security interest, Stacia Manzo did not execute a security agreement and the proof at trial was insufficient to prove that funds are due and owing to her. The security interest is invalid, N.J.S.A. 12A:9-203(1)(b); *In re Marin Aviation, Inc.*, 53 B.R. 497, 501 (Bankr.D.N.J.1984), and consequently the fraudulent transfer claim in Count IX is moot with respect to the alleged security agreement.

[26] With respect to Count X, the transfer of the personal residence of Louis Manzo to Stacia Manzo is outside the jurisdiction of the bankruptcy court. In fact, the Superior Court, Chancery Division, has already set aside the transfer as a fraudulent conveyance under state law. *Midlantic National Bank v. Manzo*, No. F-5890-91, letter op. at 21 (N.J.Super.Ct.Ch.Div. Sept. 15, 1993). While there has been no motion to dismiss, without jurisdiction, the court must dismiss this count *sua sponte*.

[27] Plaintiffs allege in Counts III and IV that fraudulent transfers were made to Lisa Manzo. Specifically, plaintiffs allege that accounts receivable of United Stairs were deposited into the personal bank account of Lisa Manzo. Lisa Manzo admits that this occurred but claims that in each instance she transferred these funds from her personal account to the business account of Excel. Plaintiffs have failed to offer proofs to dispute Ms. Manzo's claim.

[28] The burden of proof with respect to a claim of fraudulent transfer under 11 U.S.C. § 548 is on the trustee. *Pereira v. Kaiser* (*In re Big Apple Scenic Studio, Inc.*), 63 B.R. 85, 89 (Bankr.S.D.N.Y.1986); *McColley v. Jacobs* (*In re North American Dealer Group, Inc.*), 62 B.R. 423, 428-29 (Bankr.E.D.N.Y.1986). The plaintiffs have failed to meet this burden. While plaintiffs have demonstrated, through admissions, that some checks were deposited into Lisa Manzo's personal account, there is no specific proof as to the amount or identification of the checks. Therefore, judgment is entered in favor of defendant and against plaintiffs on Counts III and IV of the Complaint.

[29][30] Plaintiffs have alleged, in Count XV, conversion of debtor property by Spiral, Excel and the individual defendants. The proofs at trial demonstrated that certain accounts receivable and inventory were transferred from United Stairs to Excel and Spiral through the actions of the individual defendants. Plaintiffs did not prove, however, that the debtor's assets were converted for the use of the individual defendants. With respect to the corporate defendants this count is moot as a result of the consolidation. As to the individual defendants, judgment is entered in favor of defendants due to plaintiffs failure to provide sufficient proofs.

CONCLUSION

Defendant Spiral's motion to dismiss is denied. Judgment is entered in favor of plaintiffs on Count XIII of the Complaint and accordingly the estates of Spiral and Excel will be substantively consolidated with debtor's estate. Counts I, II, V, VI, VII, VIII, IX, XI and XII are moot. Counts XIV and XV are moot as to the corporate defendants and judgment is entered in favor of the individual defendants. Judgment is entered in favor of defendants on Counts III and IV. Count X is dismissed with prejudice.

Bkrtcy.D.N.J.,1995.
In re United Stairs Corp.
176 B.R. 359, 32 Collier Bankr.Cas.2d 1908

END OF DOCUMENT

In re Baker & Getty Financial Services, Inc.,
78 B.R. 139 (Bankr. N.D. Ohio 1987).

78 B.R. 139
(Cite as: 78 B.R. 139)

H

United States Bankruptcy Court,
N.D. Ohio.

In the Matter of BAKER & GETTY FINANCIAL SERVICES, INC., Baker & Getty Diversified, Inc., and Baker & Getty Securities, Inc., Debtors.
Bankruptcy No. B87-00074-Y.

Sept. 8, 1987.

Creditors filed motion for substantive consolidation of estates of individual debtors with estates of corporate debtors. The Bankruptcy Court, William T. Bodoh, J., held that adequate cause existed to order consolidation.

Motion granted.

West Headnotes

[1] Bankruptcy 51 ⚿2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases
(Formerly 51k2084, 51k19)
Seven factors to be considered in application of balancing process to determine whether substantive consolidation is appropriate in bankruptcy proceeding are difficulty in segregating assets, presence of consolidated financial statements, profitability of consolidation at single location, commingling of assets and business functions, unity of interest in ownership, existence of intercorporate loan guarantees, and transfer of assets without observance of corporate formalities. Bankr.Code, 11 U.S.C.A. § 105(a).

[2] Bankruptcy 51 ⚿2084.10

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.10 k. Particular Cases. Most Cited Cases
(Formerly 51k2084, 51k19)
Adequate cause existed to order substantive consolidation of individual debtors' estates with estates of corporate debtors; extensive and unrestricted commingling of corporate and personal assets, combined with inadequate substantiation of certain transfers, would have compromised accuracy of any segregation of assets, and advantages of consolidation outweighed any prejudice that might have been experienced by only objecting personal creditor of individual debtors. Bankr.Code, 11 U.S.C.A. § 105(a).
***140** Russell A. Kelm, Daniel R. Swetnam, Schwartz, Kelm, Warren & Rubenstein, Columbus, Ohio, George J. Limbert, Mitchell, Mitchell & Reed, Youngstown, Ohio, for petitioning creditors.

Robert Morrow, Means, Bichimer, Burkholder & Baker Co., L.P.A., Columbus, Ohio, for The First National Bank of Barnesville.

Carl D. Rafoth, Youngstown, Ohio, trustee.

Dwight A. Packard, Cincinnati, Ohio, for Suzan Cordek.

ORDER ON CREDITORS' MOTION FOR SUBSTANTIVE CONSOLIDATION

WILLIAM T. BODOH, Bankruptcy Judge.

This cause came on for consideration upon the Motion of the Petitioning Creditors for substantive consolidation of the estates of PHILIP CORDEK and SUZAN BIERMAN CORDEK with the estates of the Corporate Debtors. Upon review, the Court determines that substantive consolidation is appropriate in this case.

FACTS

There are three Corporate Debtors involved in this

case. BAKER & GETTY FINANCIAL SERVICES, INC., ("BGFS") was formed August, 1985 to effect transactions in securities and to operate as a broker dealer. In fact, BGFS held itself out as a fully licensed broker dealer and a member of the Securities Investment Protection Corporation, although it apparently never became fully licensed. The second Debtor implicated in this case is BAKER & GETTY DIVERSIFIED, INC. ("BGD"). This entity was formed in December, 1985 to locate and develop real estate investment opportunities for customers of the brokerage firm and to loan funds to BGFS. BAKER & GETTY SECURITIES, INC., ("BGS") was formed in June, 1986 to replace both BGFS and BGD. BGS subsequently filed an application to become a licensed broker dealer in August, 1986, but its application was later withdrawn. Nevertheless, it held itself out as a licensed broker dealer.

PHILIP CORDEK was a director of the three corporations and was the sole signatory on the corporations' various bank accounts. In November, 1986, he admitted that he had undertaken activities as part of a plan to defraud investors. The deception appears to be a classic Ponzi scheme whereby investors were told that CORDEK's uncle in New York had large blocks of stock available for sale at a discount. The investors were told that the stock would be immediately sold at a profit and that they would quickly realize a handsome return on their principal investment. However, instead of purchasing the stock with the investor's money, the funds were used to pay off previous investors. By November 1, 1986, investors appear to have been defrauded of an estimated 3.5 million dollars.

There were five bank accounts which were used by CORDEK for business and personal matters. Three of the accounts were opened in the name of "BAKER & GETTY DIVERSIFIED". Two of the accounts were personal accounts of CORDEK. On numerous occasions, corporate ***141** funds were used for personal matters. For example, corporate funds were used by CORDEK to: (1) purchase automobiles; (2) repay his educational loans; (3) purchase a boat which was eventually titled in his wife's name; (4) buy furniture, jewelry and other personalty; (5) pay for a home located near Cleveland, Ohio, and improvements to that home; and (6) pay for hotel rooms for guests attending his wedding. Conversely, personal funds were used to satisfy corporate obligations. [*See* Petitioning Creditors Exhibits 8C, 8D, 8I, 12A, 2G, 12I, 12J, 12M-120, and 12Q.] CORDEK testified at a hearing on this Motion that the bank accounts were used interchangeably.

In August, 1986, Mr. Byron Rice, who was a regular business customer of the Bank, approached the FIRST NATIONAL BANK OF BARNESVILLE to obtain a loan. He represented to Mr. Charles Bradfield, President of the Bank, that the purpose of the loan was to permit him and CORDEK to purchase various investments which would be sold a short time later. The proceeds of the sale would then be applied to the loan balance. In his testimony, Bradfield admitted that while he was aware that CORDEK was associated with the BAKER & GETTY corporate entities, he considered his dealings with CORDEK to be personal in nature. However, Bradfield also testified that the Bank did not rely upon CORDEK's creditworthiness nor upon his assets in approving the loan. The Bank was satisfied with the pledge of Rice's assets as security for the loan because of the long relationship which the Bank had enjoyed with Rice. In spite of this fact, Bradfield stated that Rice had insisted that CORDEK be a signatory to the note. Thus, in August 1986, CORDEK and Rice obtained a loan from the Bank in the amount of 1.1 million dollars, which was used to purchase various securities. The securities were sold within days and the proceeds transferred to CORDEK's account. No part of the proceeds was ever used in repayment of the loan.

On January 17, 1987, involuntary Petitions were filed against the three BAKER & GETTY corporate entities. The Petitions were not contested, and Orders for Relief were entered on February 18, 1987. On May 26, 1987, the Court entered an Order substantively consolidating the estates of the three corporate debtors. The Order was entered without objection by any party in interest.

On April 9, 1987, the Petitioning Creditors filed a Motion seeking to join PHILIP CORDEK and SUZAN BIERMAN CORDEK as affiliates in this action. Once again, the Motion was not opposed by any party in interest, and an Order joining them as affiliates was entered on April 28, 1987.

On May 22, 1987, the instant Motion for substantive consolidation was filed. The relief sought is not opposed by PHILIP and SUZAN CORDEK. In fact, the

only party opposing the Motion is the Bank. The Bank claims that if the Motion is sustained, the Bank will be severely prejudiced because the payments received in partial satisfaction of the loan (approximately Two Hundred Thousand & 00/100 Dollars ($200,000.00)) and the perfection of security interests in certain of CORDEK's property might be deemed to be within the 90-day preference period established by 11 U.S.C. Sec. 547, since these transactions took place within 90 days of the involuntary filings against the corporate entities.

LAW

Substantive consolidation is the merger of separate entities into one action so that the assets and liabilities of both parties may be aggregated in order to effect a more equitable distribution of property among creditors. The authority to order such consolidation arises from the Court's equity jurisdiction pursuant to 11 U.S.C. Sec. 105(a), which provides in part:

> a) the court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this Title.

In re Richton Int'l. Corp., 12 B.R. 555, 557 (Bankr.S.D.N.Y.1981). Furthermore, substantive consolidation must be cautiously applied in order to prevent the potential for impairment of important substantive rights ***142** of the creditors of the non-debtor entity. *In re Snider*, 18 B.R. 230, 234 (Bankr.D.Mass.1982); *In re DRW Property Co. 82*, 54 B.R. 489, 494 (Bankr.N.D.Tex.1985).

[1] The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant inquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition." *Holywell Corp. v. Bank of N.Y.*, 59 B.R. 340, 347 (Bankr.S.D.Fla.1986). In *In re Vecco Construction Ind., Inc.*, 4 B.R. 407, 410 (Bankr.E.D.Va.1980), a seven-factor test was developed to assist in the application of the balancing process. *Id.* at 410. This test has met with considerable support in those courts which have considered the question of substantive consolidation. *Holywell Corp. v. Bank of N.Y., supra*; *In re DRW Property Co. 82, supra*; *In re Donut Queen*, 41 B.R. 706, 709 (Bankr.E.D.N.Y.1984). While the test is normally applied to related corporations, it can still offer some focus in the balancing of equities in this case. The seven factors consist of:

1. difficulty in segregating assets;

2. presence of consolidated financial statements;

3. profitability of consolidation at a single location;

4. commingling of assets and business functions;

5. unity of interests in ownership;

6. existence of intercorporate loan guarantees; and

7. transfer of assets without observance of corporate formalities.

In re Vecco Construction Ind. Inc., 4 B.R. at 410.

[2] The Court is strongly persuaded that adequate cause exists to order that the CORDEKs' estate be substantively consolidated with the estate of the Corporate Debtors. The extensive and unrestricted commingling of corporate and personal assets, combined with the inadequate substantiation of certain transfers, would compromise the accuracy of any segregation of assets. Furthermore, many major assets owned by the CORDEKs were purchased with corporate funds. Equity demands the inclusion of these assets in the Corporate Debtors' estate. It would be unfair to insulate these assets from claims of the Corporate Creditors because of the corporate fiction. This is especially true where, as here, the funds were transferred without adhering to corporate formalities. As the sole-required signatory on all corporate accounts, Mr. Cordek also exercised pervasive control over the financial affairs of all debtors. It is abundantly clear from the totality of facts in this proceeding that the Debtor Corporations are the alter ego of PHILIP and SUZAN CORDEK. Accordingly, it is clear that substantive consolidation would be desirable in this case.

However, this interest must be balanced against the potentiality for prejudice to the CORDEKs' personal creditors. Most of the major creditors of the CORDEKs are also creditors of the Corporate Debtors. After notice and an opportunity for a hearing, neither

the creditors of the Corporate Debtors nor the CORDEKs voiced any objection to the proposed consolidation. The only objection was filed by THE FIRST NATIONAL BANK OF BARNESVILLE ("Bank"), which contended it would be prejudiced by such a consolidation because it had relied on CORDEK's individual assets in approving the loan to he and Rice. However, according to uncontroverted testimony, the Bank relied wholly on Mr. Rice's assets and reputation and not on Mr. Cordek's assets or reputation in approving the August, 1986 loan. It is only now that the Bank declares their reliance on Mr. Cordek's personal assets. Furthermore, the Bank's actions fail to validate their claim of reliance on CORDEK's individual assets. The Bank failed to: (1) timely perfect its liens; (2) perform an adequate title search; or (3) conduct a sufficient credit investigation of Mr. Cordek. The Bank's failure to take these actions is inconsistent with their alleged dependence upon Mr. Cordek's assets. Thus, the Bank will not suffer severe prejudice from a consolidation order since there is no showing it relied on CORDEK's assets in consenting to the loan.

***143** However, even if the Bank were deemed to be prejudiced by the consolidation, the Corporate Creditors appear to be similarly situated, making it equitable to treat them the same. The advantages of consolidation outweigh any prejudice the Bank might experience.

The possibility of prejudice to other personal creditors of the CORDEKs is more problematical. The personal creditors of the CORDEKs must have notice and an opportunity to be heard. However, both notice and the opportunity for hearing can be accorded these creditors in the context of the consolidated proceeding.

Therefore, the Court grants the Motion for consolidation and the claims of any creditors, who can prove reliance on the consolidatee's assets or credit, will be resolved in the consolidated proceedings.

IT IS SO ORDERED.

Bkrtcy.N.D.Ohio,1987.
Matter of Baker & Getty Financial Services, Inc.
78 B.R. 139

END OF DOCUMENT

In re Tureaud, 45 B.R. 658 (Bankr. N.D. Ok. 1985).

45 B.R. 658, 12 Bankr.Ct.Dec. 723
(Cite as: 45 B.R. 658)

United States Bankruptcy Court,
N.D. Oklahoma.

In re Kenneth E. TUREAUD, a/k/a Kenneth E. Tureaud d/b/a Saket Petroleum Co., a/k/a Kenneth E. Tureaud d/b/a Kesat a/k/a Saket Petroleum Company, Debtor.
Bankruptcy No. 82-01269.

Jan. 10, 1985.

In Chapter 11 case, trustee applied for substantive consolidation of certain affiliate corporations within the case. The Bankruptcy Court, Mickey D. Wilson, J., held that circumstances warranted disregarding purportedly separate existence of nondebtor corporate entities and granting trustee's application for substantive consolidation of the affiliate corporations of individual debtor within the Chapter 11 case, given evidence that, inter alia, individual organized the affiliates and exercised control over them merely as a front to raise money for his own purposes and to hinder and delay judgment creditors, together with relative absence of prejudice to any secured or unsecured creditors.

Application granted.

West Headnotes

[1] Bankruptcy 51 2084.5

51 Bankruptcy
51I In General
51I(D) Venue; Personal Jurisdiction
51k2084 Transfer and Consolidation of Cases
51k2084.5 k. Grounds and Objections; Factors Considered. Most Cited Cases
(Formerly 51k2084, 51k219)
Under its general equitable powers, bankruptcy court may substantively consolidate affiliate corporations within pending case when the assets and liabilities of different entities are dealt with as if the assets were held by, and the liabilities incurred by, a single entity. Bankr.Code, 11 U.S.C.A. § 105(a).

[2] Corporations 101 1.6(5)

101 Corporations
101I Incorporation and Organization
101k1.6 Particular Occasions for Determining Corporate Entity
101k1.6(5) k. Insolvency, Bankruptcy, and Receivership. Most Cited Cases
Circumstances warranted disregarding purportedly separate existence of nondebtor corporate entities and granting trustee's application for substantive consolidation of the affiliate corporations of individual debtor within Chapter 11 case, given evidence that, inter alia, individual organized the affiliates and exercised control over them merely as a front to raise money for his own purposes and to hinder and delay judgment creditors, together with relative absence of prejudice to any secured or unsecured creditors. Bankr.Code, 11 U.S.C.A. §§ 105(a), 1101 et seq.
***658** Gary McDonald and Leonard I. Pataki of Doerner, Stuart, Saunders, Daniel & Anderson, Tulsa, Okl., for trustee.

Craig Blackstock, Tulsa, Okl., for Walter E. Heller.

***659** Reuben Davis and John A. Burkhardt of Boone, Smith, Davis & Hurst, Tulsa, Okl., for Commerce Bank.

Timothy T. Trump, for firm of Hall, Estill, Hardwick, Gable, Collingsworth & Nelson.

ORDER SUBSTANTIVELY CONSOLIDATING ESTATES

MICKEY D. WILSON, Bankruptcy Judge.

This matter is presently before the Court upon the application of the trustee, R. Dobie Langenkamp, (Trustee) for substantive consolidation of certain affiliate corporations (Affiliates) within this pending Chapter 11 case. The Affiliates as to which consolidation is sought are:

Saket Development Corporation, an Oklahoma

corporation, (Saket Development),

Linda Vista Corporation, a Florida corporation, (Linda Vista),

Saket Development Corporation, a New Mexico corporation, now Deer Park, Inc., (Deer Park),

Saket Realty, Inc., an Arizona corporation, (Saket Realty),

Southern Lakes Development Corporation, an Oklahoma corporation, (Southern Lakes),

River Ridge Development Corporation, a Florida corporation, (River Ridge), and

ASAP Corporation, a Michigan corporation, (ASAP).

None of the Affiliates is a debtor in a pending proceeding in any bankruptcy court. The Affiliates filed a combined response wherein said entities adopted and consented to the application.

The application came on for hearing on the 30th day of November, 1984, and the 3rd day of December, 1984. The Trustee appeared in person and by his counsel, Gary M. McDonald and Leonard I. Pataki, of Doerner, Stuart, Saunders, Daniel & Anderson; objector, Walter E. Heller and Company Southeast, Inc. (Heller), appeared through its counsel, Craig Blackstock; Commerce Bank, an Oklahoma corporation, appeared through its counsel, Reuben Davis and John A. Burkhardt; and objector, Hall, Estill, Hardwick, Gable, Collingsworth and Nelson (Hall, Estill), appeared by Timothy T. Trump. The Trustee orally withdrew his application to consolidate as to ASAP Corporation, the ownership of ASAP and its assets having been previously resolved.

The Trustee announced he would stipulate that the effective date of consolidation for purposes of avoidance powers would be June 7, 1983, the date the application was filed. Bank of Commerce and Hall, Estill withdrew their objections to the application, subject to the terms of the stipulation. Heller did not enter into said stipulation but offered to stipulate and withdraw its objection if the effective date of consolidation for purposes of avoidance powers would be November 30, 1984. This offer to stipulate by Heller was not accepted by the Trustee.

The Court finds that notice of the hearing on the application was given to every known creditor of the Affiliates and that such notice was proper and sufficient. No objections were filed by any unsecured creditor of Tureaud or the Affiliates, other than Hall, Estill.

FINDINGS OF FACT

Upon consideration of the documentary and testimonial evidence properly presented, after hearing arguments of counsel, and being fully advised, the Court makes the following findings of fact.

It is abundantly clear from the evidence that all of the corporate Affiliates were, in fact, the alter ego of the debtor, Kenneth E. Tureaud. The debtor, one individual, dominated and controlled the Affiliates. The business affairs and financial transactions of and among the Affiliates were controlled solely by Tureaud. The debtor directed the transfer of funds and assets by and among the Affiliates with a total disregard for the separate nature of the Affiliate entities.

***660** Each of the six Affiliates were created by Tureaud for his and his family's benefit. Tureaud used the assets of the Affiliates as his own, and he operated the Affiliates as one economic unit with unity of ownership and management. The stock of each Affiliate is either wholly owned by, or substantially owned by Tureaud. In his December 31, 1981, financial statement, (exhibit 1A), Tureaud lists himself as the “Chief Executive and Controlling Owner” of the Affiliates.

It is clear that Tureaud organized the Affiliates merely as a front to raise money for his purposes, and to hinder and delay judgment creditors. Tureaud transferred property to the Affiliates and among the Affiliates for the sole purpose of placing property beyond the reach of creditors. Tureaud has numerous unsatisfied, personal judgments against him dating back to 1974. From 1979 to 1982, Tureaud transacted business through at least nineteen different corporations. The Trustee testified that the only real property held in Tureaud's name consisted of some mineral interests and realty owned in connection with the

operations of Saket Petroleum, a sole proprietorship of Tureaud. Property held in the name of Affiliates includes residences utilized by Tureaud and his family in the states of Michigan, Florida and New Mexico. In his December 31, 1981, Financial Statement, Tureaud listed the real estate held in the names of Affiliates as a personal asset.

From April of 1980 through June of 1982, the debtor entered into a series of promissory notes with the Penn Square Bank, with an aggregate principal balance of $22,980,515.91. Tureaud used substantial portions of the Penn Square Bank funds as well as funds raised from investors in connection with his oil and gas operations to make cash advances to the Affiliates and for their day-to-day operating expenses. Tureaud's advances to Affiliates were in excess of $3,000,000.00; Tureaud's transfers to Affiliates were approximately in the sum of $6,534,664.00 and Affiliates' transfers to Tureaud were approximately in the sum of $3,700,009.00. When Tureaud made these cash advances to the Affiliates, Tureaud had no substantial source of income other than borrowed funds or investor funds. Transfers of funds by check, cashier's check and wire transfers were made by Tureaud to the Affiliates by George Pretszch and by Alex Ellioff. Hundreds of such transfers took place, frequently and routinely, and always pursuant to Tureaud's instruction. No promissory notes were executed in connection with these transfers.

Transfers of funds by and among the Affiliates were also done at Tureaud's instructions on an as-needed basis. None of the Affiliates ever showed a profit with the exception of River Ridge which showed a small profit early in its existence. Pursuant to Tureaud's instructions, funds were transferred by and among the Affiliates in a complex and confusing manner. Tureaud often took title to real property in the name of one Affiliate while the contracts had been entered into by another Affiliate. Additionally, Tureaud created corporate entities with similar or the same names in different states followed by the transfer of property between Affiliates without any consideration. During the period of time from February, 1980, to August, 1984, the sum of $3,330,758.80 was transferred from proceeds of loans from Heller to Tureaud's own accounts, or to Tureaud controlled accounts and charged to Linda Vista, River Ridge or Southern Lakes.

Funds and property of the Affiliates were personally utilized by Tureaud and his family for their own benefit and enjoyment, with essentially no compensation to the Affiliates for such use, and without any reasonable accounting for such use. During a period of less than 120 days during 1981, approximately $470,000 debited by Heller to Linda Vista was expended by Tureaud from these accounts for Tureaud's own personal expenses and other expenses unconnected with the business of Linda Vista, River Ridge and Southern Lakes. Tureaud and his family used a 14-bedroom mansion in Palm Beach, titled in the name of Saket Realty, as their own residence ***661** with no accounting to Saket Realty for such use. Condominiums in Florida held in the name of River Ridge and condominiums in New Mexico held in the name of Saket Development were used as residences for Tureaud's relatives, friends, and employees without any compensation or accounting to River Ridge or Saket Development for such use. Alex Ellioff, a relative of Tureaud used a house located on Jupiter Island, Florida, held in the name of Linda Vista, without any compensation to or accounting to Linda Vista for such use.

The cross-pledges of the assets of the Affiliates, the guarantees by and among the Affiliates, the guarantee by Tureaud of practically all the debts incurred by the Affiliates, and the payment of operational expenses of Affiliates by Tureaud and other Affiliates on an as-needed basis, without regard to the source of such funds or any adequate documentation of such payments, conclusively show that Kenneth E. Tureaud and the Affiliates existed as, and were treated as, one economic unit.

The evidence clearly shows an almost total disregard of the corporate fiction; the corporations are a sham-functionally indistinguishable from each other with commingling of assets and business functions. The corporations served merely as a conduit for Tureaud. The directors and officers of the Affiliates did not act independently and in the interest of the Affiliates, but rather in the interest of the debtor and his family. Many of the Affiliates during the period of time when the affiliates were controlled by Tureaud, failed to file tax returns and other reports required by law, and three of the Affiliates, Saket Realty, Linda Vista, and Southern Lakes, were suspended by the States of Arizona, Florida and Oklahoma for failure to make required filings.

The Trustee employed accounting and business personnel to attempt to determine the financial affairs and transactions of the debtor and the Affiliates. The Trustee and his personnel examined all available books and records of the debtor and Affiliates and determined that intercompany transactions were not conducted on an arms-length basis and that accounting records of transfers of funds by and among the Affiliates are often non-existent or grossly inaccurate. Separate books were kept but no actual distinction was made between transactions of the respective companies. Consequently, there are serious accounting problems in evaluating the debtor and Affiliate accounts and determining the assets and liabilities of each Affiliate. The property of the Affiliates were hopelessly commingled and funds were used indiscriminately by all of the entities. It is impossible to accurately trace all transfers of funds and to untangle and unravel the affairs of the Affiliates and Tureaud.

It is clear, based on the inability of the Court and the creditors to reconcile and separate the financial affairs of the debtor and affiliated corporations, that consolidation will not work an injustice on the secured or unsecured creditors. The Court has carefully considered all the factors in this regard and has determined that in fact consolidation will not prejudice the secured or unsecured creditors.

Substantive consolidation will simplify and facilitate administration of the assets of the Affiliates and will maximize the prospects for realization of any potential equity in the Affiliates' assets. No substantial prejudice or injury will occur to the interest of Heller, or any other secured party, as a result of an order of substantive consolidation, inasmuch as their mortgages, security interests and liens to the extent valid, will be preserved. Consolidation will not eliminate the security interests of creditors or change the status of secured creditors to unsecured creditors. Consolidation will not eliminate guarantees by one debtor to pay for the debts of another debtor.

CONCLUSIONS OF LAW

[1] The Court must consider a number of relevant factors where consolidation of non-debtors within an individual debtor's estate is sought. After review of the testimony and documentary evidence received ***662** in this proceeding, the Court is well satisfied that the Trustee has sustained by concrete and cogent evidence the required standard for disregarding the separate corporate entities to allow substantive consolidation of the Affiliates with the debtor's estate.

Under its general equitable powers, 11 U.S.C. § 105(a), a bankruptcy court may substantively consolidate affiliate corporations within a pending case when the assets and liabilities of different entities are dealt with as if the assets were held by, and the liabilities were incurred by a single entity.

[2] The United States Supreme Court addressed the issue of consolidation in the case of *Sampsell v. Imperial Paper Corp.*, 313 U.S. 215, 216, 61 S.Ct. 904, 906, 85 L.Ed. 1293 (1941). In *Sampsell v. Imperial*, the Court held that a non-debtor corporation may be "covered into" the estate of the debtor where the affairs of the corporation are so closely assimilated to the affairs of the debtor dominant shareholder that in substance it is little more than his corporate pocket; where the corporation was formed to continue the debtor's business for the benefit of himself and his family; and where the debtor transfers property to the corporation for the purpose of placing the property beyond the reach of his creditors.

The law in this circuit was laid down in *Fish v. East*, 114 F.2d 177 (10th Cir.1940); and *F.D.I.C. v. Hogan (In the Matter of Gulfco)*, 593 F.2d 921 (10th Cir.1979). In these cases, the Tenth Circuit established the following relevant factors to be considered in a determination of whether to disregard the existence of separate corporate entities and order consolidation: Parent corporation owns all or a majority of the capital stock subsidiary; parent corporation and subsidiary have common directors and officers; parent corporation finances subsidiary; parent corporation is responsible for the incorporation of the subsidiary; subsidiary has grossly inadequate capital; parent corporation pays salaries or expenses or losses of subsidiary; subsidiary has substantially no business except with parent corporation or no assets except those conveyed to it by parent corporation; parent refers to subsidiary as such or as a department or division; directors or executives of subsidiary do not act in the interests of subsidiary, but take directions from the parent; and the formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

The Court is cognizant of the instruction given by Circuit Judge Doyle in *F.D.I.C. v. Hogan,* the holding in that case being clearly distinguishable upon its facts. In *F.D.I.C. v. Hogan,* the subsidiaries were not the instrumentality of the parent corporation, the subsidiaries were not organized fraudulently, the outward appearance of the companies was that they were not regarded as a department or division of the parent, the corporations each were independent, each had its own personnel and each paid its own salaries and expenses and had other characteristics of a separate legal entity, and the assets were not hopelessly commingled. The Court remanded for further proceedings finding that more information on a separate entity basis is essential before a determination of whether consolidation is appropriate. The Court held that consolidation could not be used to eliminate the secured status of creditors and that consolidation could not be used to eliminate guarantees made by one of the debtor corporations to pay for the debt of another. As mentioned in the above findings, these are not the facts in the case at bar.

In *Fish v. East,* the Court found that the insolvent parent organized the subsidiary as a front to raise money from public subscription in order to finance the parent and to hinder and delay creditors. The Court further found that the two corporations had been operated as a single enterprise, that the property was hopelessly commingled and funds raised by the subsidiary were used indiscriminately by both corporations, that one individual dominated and managed both corporations, and that the directors and officers of the subsidiary did not act independently and in the interest of ***663** the subsidiary. The Court held that the subsidiary was the mere instrumentality of the debtor and that the corporate entity should be disregarded because not to do so would defeat public convenience, justify wrong or protect fraud.

Applying these principles to the instant case, Tureaud formed affiliate corporations for his own use and benefit, and controlled all operations of the Affiliates. The relationship between Tureaud and the affiliated corporations is analogous to the relationship of parent and subsidiary present in the *Fish v. East* case, and it is clear that the majority of the factors identified in *Fish v. East* are present in the instant case.

The facts surrounding the creation, existence, and relationship of the affiliates to Tureaud are clear. There can be no doubt that the debtor and the affiliates were operated as one economic unit and that all of the operations were subject to the complete direction and control of Tureaud.

Any potential prejudice to creditors of the estate of Tureaud and the Affiliates that may result from substantive consolidation of the Affiliates within the pending case is greatly outweighed by the much greater potential for prejudice, harm and waste if substantive consolidation is not ordered. Substantive consolidation will preserve the secured status of valid mortgages, liens and security interests not otherwise avoidable by the Trustee while allowing unsecured creditors to share in all other assets without the increased costs of administering separate estates.

Upon consideration of the evidence, the Court concludes that June 7, 1983, the date the Trustee filed the application and mailed notice to interested parties, should be utilized as the effective date of consolidation for purposes of calculating the time period for the various avoiding powers available to the Trustee. For all the reasons hereinabove set forth the objections to the Application for Substantive Consolidation are denied; the separate corporate entities are disregarded; and the Affiliates are substantively consolidated within this pending case.

AND IT IS SO ORDERED.

Bkrtcy.Okl.,1985.
In re Tureaud
45 B.R. 658, 12 Bankr.Ct.Dec. 723

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