UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

In re: Case No. 3:12-bk-1522-PMG

David H. Bull
Mary A. Bull,

Debtors. Chapter 11

ORDER ON (1) OBJECTION TO CLAIM 19 OF PAETEC COMMUNICATIONS, INC., AND (2) MOTION TO SUBSTANTIVELY CONSOLIDATE DEBTOR DAVID BULL'S WHOLLY OWNED COMPANY INTO THIS ESTATE

THIS CASE came before the Court for a final evidentiary hearing on (1) the Debtors' Amended and Supplemental Objection to Claim Number 19 of PaeTec Communications, Inc., and (2) PaeTec Communications, Inc.'s Motion to Substantively Consolidate Debtor David Bull's Wholly Owned Company Bull Communications, Inc. into this Estate. (Docs. 52, 64, 149).

The Debtor, David Bull, is the sole shareholder of Bull Communications, Inc. (BCI). BCI and PaeTec Communications, Inc. (PaeTec) are involved in a contract dispute arising from a Sales Agent Agreement entered in 1998. In the dispute, PaeTec has asserted a claim for unjust enrichment against BCI, but acknowledges that it holds no direct claim against the Debtors individually.

To assert a claim in the individual Debtors' bankruptcy case under a corporate veil-piercing theory, PaeTec must show that BCI was used for a fraudulent or improper purpose. In this case, the evidence establishes that BCI was incorporated and operated as a legitimate business concern, and PaeTec's claim against the individual Debtors should therefore be disallowed.

Additionally, PaeTec's Motion to substantively consolidate BCI into the bankruptcy estate should be denied, because the evidence does not show that there is a substantial identity between BCI and the Debtors, or that consolidation is necessary to prevent some harm or to realize some benefit.

I. Background

The Debtor, David H. Bull, is retired from the Air Force. David H. Bull and Mary A. Bull have been married for approximately twenty-three years, and moved to Florida from Schenectady, New York in 2006.

Bull Communications, Inc. (BCI) was formed in 1989 in New York. (Transcript, Vol. I, p. 77). David Bull is the president and sole shareholder of BCI. Mary Bull is the Vice President of Sales for BCI. (Transcript, Vol. I, pp. 48, 50, 127).

On October 26, 1998, BCI and PaeTec entered into a Sales Agent Agreement. (Attachment to Claim No. 19-1). Pursuant to the Agreement, PaeTec authorized BCI "to serve as a non-exclusive independent contractor to procure customers for PaeTec's various telecommunications products and services," and agreed to pay BCI certain commissions on the products and services provided by PaeTec to the customers procured by BCI.

PaeTec terminated the Agreement with BCI in November of 2008. (Transcript, Vol. I, p. 71).

In 2010, BCI filed a state court action against PaeTec in New York. In the state court action, BCI alleges that PaeTec improperly reduced the commissions that were payable to BCI under the Agreement. (Doc. 79, p. 4; Doc. 102, p. 2)

On March 8, 2012, the Debtors filed a petition under Chapter 11 of the Bankruptcy Code. On the schedule of personal property filed in the case, the Debtors listed the shares of BCI as an asset of unknown value. (Docs. 20, 148).

II. Objection to Claim

On July 23, 2012, PaeTec filed Proof of Claim Number 19 in the Debtors' bankruptcy case. The claim is for an unliquidated amount "in excess of $1,000,000.00," and is based on a "breach of contract and related torts."

The Debtors objected to PaeTec's Claim. (Docs. 52, 149). Generally, the Debtors contend that PaeTec has asserted a claim only against BCI, not the Debtors individually, and that the individual Debtors owe no debt to PaeTec.

PaeTec acknowledges that it holds no direct claim against the individual Debtors. (Transcript, Vol. I, pp. 15, 25, 28). PaeTec contends, however, that the Debtors are personally liable for BCI's debt to PaeTec because BCI is the Debtors' alter ego. (Doc. 62, p. 9). Essentially, PaeTec asserts that the corporate veil should be pierced based on the Debtors' domination and control of BCI.

A. Veil-piercing

The evidence does not establish that BCI's corporate form should be disregarded. To pierce the corporate veil under either New York law or Florida law, the evidence must show that the individuals used the corporation improperly to commit a wrong that injured the moving party. A showing that the shareholder controlled the corporation, without more, is insufficient to justify the relief.

> Under New York law, "a court may pierce the corporate veil and find an individual liable for the debts of the corporation 'where 1) the owner exercised complete domination over the corporation with respect to the transaction at issue, and 2) such domination was used to commit a fraud or wrong that injured the party seeking to pierce

the veil.'" (Citations omitted). The N.Y. Court of Appeals has explained the rule as follows:

> While complete domination of the corporation is the key to piercing the corporate veil, especially when the owners use the corporation as a mere device to further their personal rather than the corporate business, such domination, standing alone, is not enough; some showing of a wrongful or unjust act *toward plaintiff* is required. The party seeking to pierce the corporate veil must establish that the owners, through their domination, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice *against that party* such that a court in equity will intervene.

In re JMK Construction Group, Ltd., 502 B.R. 396, 405-06 (Bankr. S.D.N.Y. 2013)(quoting Morris v. New York State Dep't of Taxation & Fin., 82 N.Y.2d 135, 603 N.Y.S.2d 807, 623 N.E.2d 1157, 1161 (1993))(Emphasis in original). In other words, to prevail under a veil-piercing theory in New York, the evidence must show that the individual used his control over the corporation to commit "a wrongful or unjust act specifically directed" to the moving party. In re JMK Construction Group, Ltd., 502 B.R. at 406.

Similarly, "Florida's high regard for corporate ownership requires a showing that the corporation was specifically organized or used to mislead creditors or to perpetrate fraud before a party can pierce a corporation's veil." In re Cordia Communications Corp., 2012 WL 379776, at 4 (Bankr. M.D. Fla.). Under Florida's veil-piercing law, a creditor may pursue a corporation's shareholder only where:

> (i) the corporate shareholder dominated and controlled the corporation to such an extent that the shareholder was, in fact, the alter ego of the corporation; (ii) the corporate form was used fraudulently or for an improper purpose; and (iii) the fraudulent or improper use of the corporation caused injury to the party seeking to pierce the corporate veil.

In re Checiek, 492 B.R. 918, 920 (Bankr. M.D. Fla. 2013). "Under Florida law, courts are permitted to disregard the corporate form (and pierce the corporate veil) only in the most extraordinary cases. Simply stated, veil piercing is an equitable remedy used to prevent the fraudulent or improper use of the corporate form from injuring the party seeking to pierce the corporate veil." In re Checiek, 492 B.R. at 920(Emphasis supplied).

B. Fraudulent or wrongful purpose

In this case, it is clear that the Debtor, David Bull, controls BCI. David Bull is the president and sole shareholder of BCI, and the Debtors are the only officers of the corporation. In fact, David Bull testified that he alone controls and makes the decisions for BCI, and that he is the officer who authorizes and determines the amount of the monthly disbursements from BCI to the Debtors. (Transcript, Vol. I, pp. 83, 113-14, 145, 148).

There is no evidence, however, that the Debtors used BCI's corporate form to commit any wrongful or improper act that injured PaeTec.

First, BCI was formed and operated for a legitimate business purpose. Specifically, BCI was organized in 1989 for the purpose of marketing telecommunications services. BCI's marketing efforts were directed primarily to health care providers and hospitals in New York and Massachusetts, because the Debtor, Mary Bull, had previously worked as a telecommunications sales representative in those areas, and had developed significant contacts and relationships in the health care industry. (Doc. 62, Exh. A, ¶¶ 2-8).

On October 26, 1998, BCI entered into a Sales Agent Agreement with PaeTec. Pursuant to the Agreement, BCI was authorized "to procure customers for PaeTec's various telecommunications products and services." After BCI entered the Agreement, it marketed PaeTec's products and services to hospitals and health care providers in the northeast United States. (Doc. 62, Exh. A, ¶¶ 11-12). According to Mary Bull, BCI and PaeTec worked together in a successful business relationship for a number of years, until PaeTec terminated the Agreement in November of 2008. (Transcript, Vol. I, p. 71; Vol. II, p. 120).

Under these circumstances, it appears that the Debtors formed and operated BCI for the legitimate business purpose of marketing telecommunications services. There is no evidence that BCI's corporate form was used as "a mere device or sham to accomplish some ulterior purpose," such as to defraud PaeTec or commit an illegal act. Bookworld Trade, Inc. v. Daughters of St. Paul, Inc., 532 F.Supp. 2d 1350, 1361 (M.D. Fla. 2007).

C. Injury to PaeTec

Second, there is no evidence in this case that the Debtors' use of BCI's corporate form caused any injury to PaeTec.

According to PaeTec's designated representative, PaeTec does not assert that the Debtors' relationship with BCI was improper, that the Debtors operated BCI improperly, or that PaeTec was damaged by the manner in which the Debtors operated BCI. (Transcript, Vol. I, pp. 33-34, 44). The representative did not identify any use of the corporate structure that harmed PaeTec during the course of its contractual relationship with BCI.

PaeTec acknowledges that it engaged in an "extensive course of performance" with BCI under the Agreement, and that BCI's marketing efforts on behalf of PaeTec resulted in sales that generated "substantial commissions." (Attachment to Claim No. 19).

In conclusion, the evidence does not establish that the Debtors used BCI's corporate form fraudulently or for an improper purpose, or that the Debtors' use of the corporate form caused any injury to PaeTec. Accordingly, BCI's corporate veil should not be pierced, and PaeTec's claim in the Debtors' individual Chapter 11 case should be disallowed.

III. Motion for Substantive Consolidation

PaeTec also filed a Motion for substantive consolidation "to administer BCI's asset and related liabilities as part of the Debtors' bankruptcy estate." According to PaeTec, substantive consolidation is appropriate because BCI has "no other on-going business or purpose but to resolve the litigation and provide the net proceeds, if any, from the lawsuit to fund the Debtors' reorganization." (Doc. 64, p. 3).

A. Authority to consolidate a non-debtor

BCI is not a debtor in any bankruptcy case. In the Eleventh Circuit, the law is unsettled as to "whether a bankruptcy court has the authority to substantively consolidate non-debtors' assets and liabilities into a bankrupt debtor's estate." In re Cordia Communications Corp., 2012 WL 379776, at 3.

In Cordia Communications, the Court determined that it lacked the authority to substantively consolidate non-debtors with debtors for three reasons: (1) first, §105 empowers the Court to do what is necessary or appropriate to carry out the provisions of the Bankruptcy Code, but not to bring non-debtors into a bankruptcy forum solely for purposes of expedience or the assistance of a particular party; (2) second, such consolidation "circumvents the stringent procedures and protections relating to involuntary bankruptcy cases imposed by §303 of the Bankruptcy Code," and (3) third, "state law provides remedies for parties who can establish that a non-debtor entity truly is an 'alter ego' of a voluntary debtor." In re Cordia Communications Corp., 2012 WL 379776, at 3-4.

In In re S&G Financial Services of South Florida, Inc., 451 B.R. 573 (Bankr. S.D. Fla. 2011), on the other hand, the Court determined that it had both the jurisdiction and the power to order substantive consolidation of non-debtors and debtors, where (1) such consolidation would have a conceivable effect on the bankruptcy case, and where (2) the affairs of the non-debtor were "so closely assimilated" with the affairs of the debtor as to negate the non-debtor's independence. In re S&G Financial Services of South Florida, Inc., 451 B.R. at 580-82(quoting Sampsell v. Imperial Paper and Color Corp., 313 U.S. 215, 218, 61 S.Ct. 904, 85 L.Ed. 1293 (1941)).

In this case, it is unnecessary to determine whether the Court is authorized to substantively consolidate a non-debtor into a debtor's bankruptcy estate, because the evidence does not establish that substantive consolidation would be appropriate under any standard. In other words, the remedy is not available in this case under the traditional test for substantive consolidation, regardless of whether the Court is empowered to apply the test to non-debtors.

B. General standard for substantive consolidation

Substantive consolidation is not expressly provided in the Bankruptcy Code, but is an equitable remedy that involves "the pooling of the assets and liabilities of two or more related entities," and the satisfaction of all of the affected entities' liabilities from the common pool of assets created by consolidation. Because substantive consolidation may affect the distribution received by the creditors of all entities, the remedy should be applied sparingly. Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 248 (11th Cir. 1991).

In the Eleventh Circuit, substantive consolidation may be granted only where "(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." In re Pearlman, 462 B.R. 849, 853 (Bankr. M.D. Fla. 2012)(quoting Eastgroup Properties, 935 F.2d at 249). The party moving for substantive consolidation must satisfy the two-prong test by establishing that a substantial identity exists between the entities at issue, and that the entities should be consolidated in order to avoid harm and realize a benefit. In re S&G Financial Services of South Florida, 451 B.R. at 583.

1. Substantial identity

In this case, neither prong of the two-part test is satisfied.

First, the evidence does not show that there is substantial identity between the Debtors and BCI. Although the Debtor, David Bull, is its sole shareholder and controls its decisions, BCI has maintained its separate corporate identity since its inception.

David Bull testified at trial, for example, that (1) BCI is currently a Florida corporation; (2) BCI files annual reports with the state of Florida; (3) BCI has a certified public accountant, and the accountant has advised BCI with respect to tax issues; (4) BCI retained an attorney when it converted from a New York corporation to a Florida corporation; (5) BCI maintains bank accounts that are separate from the Debtors' bank accounts; (6) during its operation, BCI incurred debts to third parties that are not debts of the Debtors; (7) BCI receives a monthly payment from PaeTec in its bank account, pays its expenses from the deposit, and then pays the Debtors; (8) BCI files corporate tax returns; (9) BCI, and not the Debtors, engaged a subcontractor and lobbying group in connection with its operations; and (10) BCI has not transferred any property to the Debtors, other than the monthly payments for their expenses. (Transcript, Vol. I, pp. 52-58; Vol. II, pp. 108-09; Debtors' Exhibits 5, 6).

BCI, and not the Debtors, entered into the Sales Agent Agreement with PaeTec, and BCI is the sole plaintiff in the action pending against PaeTec in New York. According to David Bull, only BCI is entitled to the proceeds of the lawsuit against PaeTec. (Transcript, Vol. I, p. 103).

Based on this evidence, the Court cannot find that there is a substantial identity between BCI and the Debtors. On the contrary, it appears that BCI was effectively formed and maintained as a corporation, that it separately entered into the contract with PaeTec to sell PaeTec's products and services, that it hired its own professionals to maintain its corporate existence, that it hired its own contractors to perform its business, that it received payment from PaeTec in its own bank accounts, and that it then paid the Debtors for their individual sales efforts.

There is no indication in the record that BCI was established as a sham corporation to mislead PaeTec or any other creditors. See In re S&G Financial Services of South Florida, Inc., 451 B.R. at 580, 584. There is not a "substantial identity" between the Debtors and BCI.

2. Benefit or harm

Second, the evidence does not show that substantive consolidation of BCI into the Debtors' bankruptcy estate is necessary to avoid some harm or realize some benefit. To satisfy this prong of the test for substantive consolidation, the evidence must show that "consolidation yields benefits offsetting the harms it inflicts on objecting parties." Eastgroup Properties, 935 F.2d at 248, 251.

PaeTec appears to assert that the benefit to be gained by substantive consolidation consists of bringing BCI's claim against PaeTec into the bankruptcy estate, so that the proceeds of the claim will be used to pay BCI's creditors and the Debtors' creditors in a single proceeding. (Doc. 64, ¶ 6).

Bringing the claim into the estate, however, is not necessary to realize any benefit within the meaning of the two-prong test for substantive consolidation.

First, consolidation is not required to sort out the financial transactions of BCI and the Debtors. The affairs of the Debtors and the affairs of BCI are not so intertwined that it is difficult to segregate the assets and liabilities of the individuals from the assets and liabilities of the corporation. See In re S&G Financial Services of South Florida, Inc., 451 B.R. at 581, 584.

The claim against PaeTec clearly belongs to BCI, and not to the Debtors individually. BCI is the party that contracted with PaeTec, and BCI is the sole plaintiff in the state court action against PaeTec. The claim is BCI's only significant asset, and is being fully litigated in the state court in which it was filed.

Additionally, the evidence does not show that the assets of BCI must be disentangled from the assets of the Debtors as a result of any transfers that occurred before the bankruptcy petition was filed. David Bull testified that BCI did not transfer any property to the Debtors, other than payment for their sales efforts, and PaeTec's representative testified that he was not aware of any improper transfers between the BCI and the Debtors. (Transcript, Vol. I, pp. 37, 39, 58).

Second, the liabilities of BCI are not intertwined with the liabilities of the Debtors. For the reasons shown above, PaeTec has asserted a claim against BCI, but is not a creditor of the individual Debtors.

Further, the evidence does not show that the creditors of the individual Debtors looked to BCI for payment of their claims, or that the Debtors' creditors are also the creditors of BCI. In other words, the claimants in the bankruptcy case have asserted claims only against the individuals, and are not "uncertain as to where the liability should be allocated." In re Cordia Communications Corp., 2012 WL 379776, at 2.

For these reasons, the Court finds that there is no substantial identity between the Debtors and BCI, and consolidation is not necessary to avoid some harm or to realize some benefit. Accordingly, substantive consolidation is not appropriate in this case under the standard established by the Eleventh Circuit.

IV. Conclusion

This case is before the Court on the Debtors' objection to the claim of PaeTec, and PaeTec's Motion for substantive consolidation of BCI into the Debtors' bankruptcy estate.

The Debtor, David Bull, is the sole shareholder of BCI. BCI and PaeTec are the parties to a Sales Agent Agreement entered in 1998. The Debtors, individually, are not parties to the Agreement.

To assert a claim in the individual Debtors' bankruptcy estate under a corporate veil-piercing theory, PaeTec must show that BCI was used for a fraudulent or improper purpose. In this case, the evidence establishes that BCI was incorporated and operated as a legitimate business concern, and PaeTec's claim against the individual Debtors should therefore be disallowed.

Additionally, PaeTec's Motion for Substantive Consolidation should be denied, because the evidence does not show that there is a substantial identity between BCI and the Debtors, or that consolidation is necessary to prevent some harm or realize some benefit.

Accordingly:

IT IS ORDERED that:

1. The Debtors' Amended and Supplemental Objection to Claim Number 19 of PaeTec Communications, Inc. is sustained, and Claim Number 19 of PaeTec Communications, Inc. is disallowed in this Chapter 11 case.

2. PaeTec Communications, Inc.'s Motion to Substantively Consolidate Debtor David Bull's Wholly Owned Company Bull Communications, Inc. into this Estate is denied.

DATED this 6 day of May, 2014.

BY THE COURT

Paul M. Glenn

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PAUL M. GLENN
United States Bankruptcy Judge