UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

In re: CASE NO. 3:11-bk-6868-JAF

BIG FOOT PROPERTIES, INC.,

Debtor.
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FIRST FEDERAL BANK,

Plaintiff,

v. Adversary No.3: 12-ap-168

DANIEL E. FOOTMAN and
BIG FOOT PROPERTIES, INC.,

Defendants.
______________________________/

ORDER DISMISSING ADVERSARY PROCEEDING

This proceeding came before the Court upon Big Foot Property Inc.'s Motion to Dismiss and Response of First Federal Bank in Opposition to Defendants' Motion to Dismiss. Upon a review of the Motion, the Response, and the applicable law, the Court finds it appropriate to dismiss this adversary proceeding.

Background

On September 19, 2011 Big Foot Properties, Inc. ("Big Foot") filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code. On February 24, 2012 First Federal Bank ("First Federal") filed this adversary proceeding. The Complaint makes the following allegations. First Federal holds a judgment in excess of $1 million against

Daniel Footman, the holder of a 1% interest in Big Foot. Big Foot owns a number of real properties. After First Federal acquired its judgment but before Big Foot filed its bankruptcy petition, Footman provided First Federal with written correspondence wherein he stated that he owned Big Foot's real property and/or assets. Footman also provided First Federal with information concerning his personal financial condition and assets, which included ownership of Big Foot's real property and/or assets. Footman offered to turn over Big Foot's real property and/or assets to satisfy the judgment against him.

Count I of the Complaint seeks the entry of an order: (i) declaring that Footman is the alter ego of Big Foot; and (ii) declaring that pursuant to 11 U.S.C. § 105, substantive consolidation of the assets and liabilities of Big Foot and Footman is appropriate. Count II of the Complaint seeks the entry of an order: (i) declaring that Footman is the alter ego of Big Foot; and (ii) declaring that, as a result, the corporate distinction between Big Foot and Footman should be disregarded and therefore the liabilities for which Footman is personally liable to First Federal should be liabilities of the bankruptcy estate of Big Foot.

Motion to Dismiss Standard

A motion to dismiss pursuant to Rule 12(b) tests the sufficiency of a complaint and asks the court to determine whether the complaint sets forth sufficient factual allegations to establish a claim for relief. When evaluating whether a plaintiff has stated a claim, a court must determine whether the complaint satisfies Rule 8(a)(2) of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Bankruptcy Rule 7008. Rule 8(a)(2) requires "a short and plain statement of the claim showing that the pleader is entitled to relief." To survive a Rule 12(b) motion, the complaint must contain enough factual matter (taken as true) to "raise [the] right to relief above the speculative level." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 555 (2007). "[N]aked assertions devoid of further factual enhancement" will not satisfy Rule 8(a)(2)'s requirement of a short plain statement of the claim showing the pleader is entitled to relief. Ashcroft v. Iqbal, 129 S.Ct. 1937, 1949 (2009) (citing Twombly, 550 U.S. at 557) (internal quotations omitted). A "formulaic recitation of the elements of a cause of action will not do." Id. Thus, a plaintiff must plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the conduct alleged." Twombly, 550 U.S. at 555.

A mere possibility that the defendant acted in contravention of the law will not suffice. Id. Although a court must accept all well pleaded facts as true, it is not required to accept legal conclusions. Sinaltrainal v. Coca-Cola Co., 578 F.3d 1252, 1260 (11th Cir. 2009). A complaint must contain sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face. Iqbal, 129 S.Ct. at 1949.

Defendant asserts that Plaintiff failed to allege sufficient facts to state a claim for substantive consolidation or for piercing the corporate veil.

Analysis

Count I

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." Eastgroup Props. v. Southern Motel Ass'n, Ltd., 935 F.2d 245, 248 (11th Cir. 1991). "[A] 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." Id. A bankruptcy court's power to substantively consolidate related bankruptcy cases arises from its general equitable powers. Id.

Prior to determining whether the allegations in Count I adequately state a claim that is plausible on its face under Twombly and its progeny, the Court must address a threshold issue, which Defendant failed to raise. That is, whether substantive consolidation of a non-debtor with a debtor is permissible. Whether a bankruptcy court has the authority to substantively consolidate a non-debtor's assets and liabilities with that of a bankrupt debtor's estate is subject to disagreement among courts. In re Pearlman, 462 B.R. 849, 854 (Bankr. M.D. Fla. 2012) (collecting cases). The court in Pearlman held that substantive consolidation is purely a bankruptcy remedy and does not extend to non-debtors. Pearlman, 462 B.R. at 854. The court based its decision on the following factors. First, while § 105 gives bankruptcy courts authority to do what is necessary to accomplish the goals of the Bankruptcy Code, such power is not "unfettered". Id. Secondly, permitting substantive consolidation under the rubric of § 105 circumvents the strict requirements and the protections relating to involuntary bankruptcy cases, as set forth in § 303 of the Bankruptcy Code, and therefore contravenes the Code. Id. Finally, to the extent that a party can show that a non-debtor is an alter ego of a debtor, state law permits the party to pierce the corporate veil. Id. at 855. Such remedy is an alternative to substantive consolidation and protects a non-debtor's identity without usurping the Bankruptcy Code's protections. Id. The Court agrees with the reasoning in Pearlman and holds that substantive consolidation does not extend to non-debtors.

Many courts, which have permitted the substantive consolidation of a debtor with a non-debtor, rely on Sampsell v. Imperial Paper and Color Corp., 313 U.S. 215 (1941). In that case Downey, an individual who operated an unincorporated business, incurred a debt. Id. Thereafter, he formed a corporation of which he, his wife and son were the sole stockholders, directors, and officers. Id. Downey then transferred his business assets to the corporation. Id. at 216. Imperial Paper extended credit to the corporation. Id. Thereafter, Downey filed bankruptcy. Id. The bankruptcy trustee found that Downey transferred the property to the corporation to place it beyond the reach of his creditors and ordered that the property of the corporation was property of the bankruptcy estate and that it be administered for the benefit of Downey's creditors. Id. at 217. That order was not appealed. Id.

Imperial Paper, which was not a party to the prior proceeding, filed a claim seeking a prior right to distribution of the funds, which the bankruptcy trustee had received from liquidating the corporation's assets. Id. The bankruptcy referee found that Imperial Paper knew of Downey's indebtedness and was instrumental in getting him to form the corporation and had knowledge of its fraudulent character. Id. The referee disallowed Imperial Paper's claim as a prior claim but allowed it as a general unsecured claim. Id. That order was appealed. The Ninth Circuit Court of Appeals reversed, holding that Imperial Paper's claim was a priority claim. Id.

The Supreme Court reversed the Court of Appeals. While the Court acknowledged that the consolidation order entered by the referee was not on appeal, it implicitly approved the consolidation, stating:

> Mere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors…Hence, Downey's corporation was in no position to assert against Downey's trustee that it was so separate and insulated from Downey's other business affairs as to stand in an independent and adverse position.

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Id. (internal citations omitted). Such language is dicta and does not provide a sound precedent for non-debtor substantive consolidation. See In re Horsley, 2001 WL 1682013 at *7 (Bankr. D. Utah August 17, 2001) (noting implicit recognition of substantive consolidation of debtor and non-debtor in Sampsell but disallowing it); In re Lease-A-Fleet, Inc., 141 B.R. 869, 874 (Bankr. E.D. Pa. 1992) (noting that consolidation order in Sampsell was not appealed and "hence its validity was not in issue").

Because the Complaint does not (and cannot)[1] allege that Footman is a debtor in this Court, Count I of the Complaint fails to state a claim and will be dismissed with prejudice.

Count II

Count II seeks to have the Court declare that Footman is the alter ego of Big Foot and to pierce the corporate veil. Ordinarily, the result of piercing the corporate veil is

[1] The Court takes judicial notice that Footman is not a debtor in this Court.

that a corporation's shareholder(s) become(s) liable for the corporate liabilities. Estudios, Proyectos e Inversiones de Centro Americo, S.A. (EPICA) v. Swiss Bank Corp., (Overseas) S.A., 507 So. 2d 1119, 1120 (Fla. 3d DCA 1987), review denied, 518 So. 2d 1274 (Fla. 1987). In order to pierce the corporate veil a plaintiff must prove that: 1) a corporation is a mere instrumentality of the shareholder, i.e. the shareholder dominated and controlled the corporation to such an extent that it did not have an independent existence and the shareholder was in fact an alter ego of the corporation; 2) the shareholder engaged in improper conduct, i.e. the corporate form was used fraudulently or for an improper purpose; and 3) and the fraudulent or improper use of the corporate form caused injury to the claimant. Priskie v. Missry, 958 So. 2d 613, 614-615 (Fla. 4th DCA 2007). Conversely, a corporation may be held liable for the debts of controlling shareholders, a remedy known as reverse corporate piercing, when the shareholders have formed or used the corporation to secrete assets and thereby avoid pre-existing personal liability. Estudios, 507 So. 2d at 1120; Braswell v. Ryan Invs., Ltd., 989 So. 2d 38, 40 (Fla. 3d DCA 2008) (denying reverse veil piercing because the act of taking title to assets in corporate name preceded the claims and obligations sued upon). To state a claim for reverse piercing, Plaintiff must set forth factual allegations which, if proven, would establish that Big Foot is a mere instrumentality of Footman. Additionally, Plaintiff must allege that Footman created Big Foot or used Big Foot to secrete his assets to avoid a pre-existing liability to First Federal. Because the Complaint contains no allegations as to the latter, Count II must be dismissed. It is

ORDERED:

1. Count One of the Complaint is dismissed with prejudice.

2. Count Two of the Complaint is dismissed without prejudice to the filing of an amended complaint within fourteen days of the date of this Order.

3. If an amended complaint is filed, Defendant has thirty days from the filing of the amended complaint to plead thereto.

DATED this 25 day of May, 2012 at Jacksonville, Florida.

/s/ Jerry A. Funk

JERRY A. FUNK
United States Bankruptcy Judge