

## Assets of closely aligned LLC subject to bankruptcy claims

### Judge orders 'consolidation' to satisfy debtor's creditors

By: Pat Murphy December 29, 2016



A federal judge has determined that the assets of a limited liability company closely related to a construction business in Chapter 7 bankruptcy could be reached to satisfy the claims of the creditors of the bankruptcy estate.

The decision resolves an adversary complaint filed by the bankruptcy trustee to disregard the corporate form of the defendant, Cameron Construction, LLC, for the benefit of the creditors of the debtor, Cameron Construction & Roofing Co. The

defendant argued that it was a separate corporate entity, and, therefore, its assets were not subject to distribution to the debtor's creditors.

But U.S. Bankruptcy Court Judge Joan N. Feeney concluded that the trustee was entitled to the equitable remedy of "substantive consolidation" given evidence that both entities had been controlled by the same individual, there was a commingling of assets, and the two entities observed only "minimal" corporate formalities.

Feeney said consolidation was necessary "to realize a benefit to the Debtor's bankruptcy estate, particularly where it is unlikely that any creditor of the Defendant would be prejudiced and the benefits of consolidation heavily outweigh the harm."

The 17-page decision is *In Re: Cameron Construction & Roofing Co., Inc.*, Lawyers Weekly No. 04-068-16. The full text of the ruling can be found [here](#).

#### 'Breaking new ground'

Bankruptcy trustee Donald R. Lassman of Needham said the decision shows trustees that disregarding corporate "separateness" to pursue assets held by related companies should not be viewed as an insurmountable obstacle in bankruptcy cases.

"The significance of the case is [the lesson] that following corporate formalities is not sufficient, and in substance there has to be separateness," he said. "When you looked at what was going on [here], you would see that the two corporations were really one and the same."

Andover attorney Jesse I. Redlener represented trustee Lassman in the adversary proceeding. Redlener said he found it important that Feeney adopted substantive consolidation in the context of a relationship between a debtor and non-debtor, an approach adopted by courts in other jurisdictions.

"These types of decisions are always going to be highly fact-intensive just because of the nature of the remedy requested, which is fairly extreme," Redlener said.

Counsel for the defendant, Stephen A. Lechter of Attleboro, said his client is weighing its options. He characterized the decision as "breaking new ground" and said both the judge and the trustee were concerned with the level of interaction between the two companies.

"The judge's conclusion was that that interaction made them one corporation," Lechter said. "Our view was that there was nothing wrong with what they did."

Lechter said it is not unusual for the owner of a business to set up separate corporations to operate the business and own the real property from which the business is run.

“The problem with this kind of a decision is that any [business owner] that owns real estate in one name and operates a business in another name is theoretically subject to this kind of interpretation and being treated as one company,” he said.

But Carter G. Bishop, a professor at Suffolk University Law School, said the primary owner of the two companies in the case “did not respect their separate legal existence as it exists under Massachusetts law.”

The benefit of Feeney’s ruling is that the creditors in the bankruptcy case, who stood to recover virtually nothing from the debtor to satisfy \$176,000 in claims, can now pursue claims against a related company that has a significant asset in the form of real property.

“If you want bankruptcy courts and other creditors of related entities to respect the separate liability shields that you have in your separate organizational structure, then those entities when they deal with each other should try and deal on an arms-length basis,” he added.



*“When you looked at what was going on, you would see that the two corporations were really one and the same.”*

— Donald R. Lassman, Needham

## Close ties

According to court records and evidence adduced at trial, Wilfred G. Cameron started the debtor’s roofing business in the early 1970s. Cameron later formed the debtor as a corporation in 2000. At the time of his death in 2013, Cameron owned 99 percent of the debtor.

In 2002, Cameron formed the defendant as an LLC. Cameron owned 99 percent of the defendant, with the debtor having a 1 percent stake.

The defendant’s primary asset was real property in Attleboro from which the debtor operated its roofing business. In its annual reports to the secretary of state, the defendant declared that its primary purpose was “owning, managing and developing real estate.”

However, the parties never executed a lease agreement for the defendant’s use of the debtor’s property. And although the debtor paid “rent,” it typically exceeded the fair market value for the property. For example, while the property is currently being rented for \$1,500 a month, in 2011 the debtor paid the defendant more than \$176,000 for rent.

The debtor employed approximately 15 employees between 2011 and 2013. The defendant employed approximately 17 employees during the same period. Although the defendant’s employees regularly performed work that benefitted the debtor, the defendant never submitted invoices for that work, nor did the parties enter into written subcontractor agreements for those services.

The debtor filed for Chapter 7 protection in 2014. Prior to filing for bankruptcy, the debtor’s primary assets were tools and vehicles used in its roofing business.

The bankruptcy trustee subsequently filed an adversary complaint to disregard the corporate form of the defendant and “preserve the assets of the Defendant for distribution to the creditors of the Debtor’s estate.”



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— Stephen A. Lechter, Attleboro

## Substantive consolidation ordered

In opposing the trustee's complaint, the defendant argued that it was undisputed that the debtor and the defendant were formed separately in accordance with state law, that the two companies filed separate tax returns, and that each entity had separate employees who received W-2s from their respective employers.

According to the defendant, Cameron's control of both businesses, without more, did not constitute a sufficient basis to ignore corporate formalities, particularly without proof of a fraudulent purpose.

But Judge Feeney found the trustee was entitled to the equitable remedy of "substantive consolidation" of the defendant's assets with those of the debtor. Unlike piercing the corporate veil to hold a shareholder liable for the debts of a debtor, substantive consolidation involves a bankruptcy judge combining related entities for the purpose of pooling their assets to satisfy liabilities, she said.

While the 1st U.S. Circuit Court of Appeals has approved substantive consolidation in cases involving multiple debtors, Feeney said, it has yet to recognize the doctrine in cases involving non-debtors like the defendant.

Feeney concluded that substantive consolidation was an appropriate remedy in the debtor's bankruptcy case under the 1st Circuit's decision in a 1992 case, *In re Hemingway Transportation, Inc.*

In *Hemingway*, the court held that consolidation is permitted "only if it is first established that the related debtors' assets and liabilities are so intertwined that it would be impossible, or financially prohibitive, to disentangle their affairs."

Feeney concluded the trustee met his burden of proof under *Hemingway*, finding that evidence showed there was "substantial identity" between the entities to be consolidated.

"The Debtor initially contributed \$12,000 of capital for a 1 percent interest in the Defendant, whereas Cameron's contribution of \$108,000 for a 99 percent interest in the Defendant was disproportionate," Feeney wrote. "The capital structure was unfair to the Debtor, which should have been entitled to a greater percentage of ownership in the Defendant given its 10 percent capital contribution."

Feeney also emphasized that the debtor rented the defendant's property without a written lease and without regular rental payments. The judge further noted that the defendant did not engage in business in accordance with its declared business purpose.

"Its business went beyond the ownership, management and development of real estate," the judge wrote. "The Defendant's seventeen employees worked exclusively for the Debtor in performing services in the Debtor's business during 2011, 2012 and 2013. Thus, the work of the Defendant's employees was outside the scope of the stated business purpose of the Defendant's business as a real estate holding company."

Finally, the judge found there was a demonstrable benefit to consolidation given that the defendant had "de minimis debt" relative to the value of its real property.

Feeney pointed out that her decision was buttressed by state law, in particular the Supreme Judicial Court's decision in a 1968 case, *My Bread Baking Co. v. Cumberland Farms, Inc.*

In *My Bread Baking*, the SJC held that although common ownership of stock and common management, standing alone, will not give rise to liability on the part of one corporation for the acts of another corporation, additional facts may support the conclusion that an agency or similar relationship exists between separate entities for purposes of imposing liability.

In identifying factors to consider, the *My Bread Baking* court said judges should look to whether there is: (1) "active and direct participation by the representatives of one corporation, apparently exercising some form of pervasive control, in the activities of another and there is some fraudulent or injurious consequence of the intercorporate relationship;" or (2) "a confused intermingling of activity of two or more corporations engaged in a common enterprise with substantial disregard of the separate nature of the corporate entities."

Feeney concluded that the trustee also sustained his burden under the *My Bread Baking* veil-piercing factors.

“The evidence established that there was common ownership of the Debtor and the Defendant by Cameron, who controlled the two entities and there was intermingling assets,” the judge wrote. “The Debtor was thinly capitalized, and the two entities observed only minimal corporate formalities by filing separate tax returns and Annual Reports. There was no evidence of other corporate record keeping or payments of dividends.”

### In Re: Cameron Construction & Roofing Co., Inc.

**THE ISSUE:** Could the assets of a limited liability company closely related to a construction business in Chapter 7 bankruptcy be reached to satisfy the claims of the creditors of the bankruptcy estate?

**DECISION:** Yes (U.S. Bankruptcy Court)

**LAWYERS:** Jesse I. Redlener of Dalton & Finegold, Andover (for plaintiff Chapter 7 trustee)

Stephen A. Lechter of Attleboro (defense)

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