Honorable Gary Spraker
United States Bankruptcy Judge

Entered on Docket
October 05, 2016

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

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In re: WILLIAM WALTER PLISE, Debtor.	Case No: 12-14724-GS Chapter 7
SHELLEY D. KROHN, Chapter 7 Trustee, Plaintiff, vs. GY PROPERTY HOLDINGS, LLC, a Nevada Limited Liability Company; NIELSEN INVESTMENTS, LLC, a Nevada Limited Liability Company; DAVID SENIOR, an individual; et al., Defendants.	Adv. Proceeding No.: 14-01075-GS **Date: May 10, 2016** **Time: 2:30 p.m.**

MEMORANDUM ON DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT, AND TRUSTEE'S COUNTERMOTION FOR PARTIAL SUMMARY JUDGMENT[1]

Plaintiff Shelley Krohn, chapter 7 trustee in the main bankruptcy case, has sued the defendants to recover various prepetition payments as fraudulent transfers under Nevada law, made applicable herein under 11 U.S.C. § 544(b). The challenged payments, however, were not

[1] In this Order, all references to "ECF No." are to the numbers assigned to the documents filed in the case as they appear on the docket maintained by the clerk of the court.

made by the debtor, but by his nondebtor business entities. The Trustee seeks to substantively consolidate those nondebtor transferors with the debtor, nunc pro tunc to the petition date, to address this issue. The merits of substantive consolidation remain to be considered another day, but the defendants contend that even if the transferors are substantively consolidated with the debtor, the trustee still cannot prove an essential element of her claims under § 544(b): an actual, unsecured creditor of the transferor that existed prior to the bankruptcy. The trustee replies that if the transferors are consolidated with the debtor effective as of the petition date, she can rely upon any unsecured creditor of the consolidated estate to satisfy this element. For the reasons stated below, the court holds that substantive consolidation may redefine the debtor within the main bankruptcy case. If the nondebtor transferor entities are substantively consolidated with the debtor as of the petition date, any unsecured creditor of these consolidated entities could qualify as the predicate creditor necessary under § 544(b). The court, therefore, will deny in part the defendants' motion for partial summary judgment, and grant the Trustee's countermotion for partial summary judgment on this limited issue.[2]

FACTS

The facts material to the instant motion are limited and undisputed. Both parties rely exclusively on the allegations set forth in the Second Amended Complaint. William Walter Plise, a real estate developer in Las Vegas, Nevada, voluntarily filed a chapter 7 petition on April 23, 2012. Prior to his filing, Mr. Plise operated his business through a plethora of related business entities. One of his wholly owned entities, Aquila Investments, purchased 126 acres of real property in Henderson, Nevada in 2002 for development.[3] This property was transferred to Sage Mountain I, another entity created by the debtor. Sometime between 2002 and 2003, Defendants GY Property Holdings, LLC, Nielsen Investments LLC and David Senior became

[2] In her Fourth Claim for Relief, the trustee also asserts a claim that the challenged transfers unjustly enriched the defendants as members of the Yamagata group. The defendants have moved for summary judgment on this claim as well, and the trustee has conceded that summary judgment is appropriate on this count. The court will partially grant the defendants' summary judgment motion and dismiss the Fourth Claim for Relief, which asserts unjust enrichment.

[3] Second Am. Compl., ECF No. 256, ¶ 48.

members of Sage Mountain I.[4] These investors have been referred to throughout this litigation as the Yamagata Group.

The Trustee alleges that Plise and the Yamagata Group intended to develop the 126 acres as a mixed use development. Towards this end, the real property was subdivided into eight (8) parcels. Of these parcels, twenty acres were transferred into Playa Del Sol, LLC, an entity in which Aquila Investment owned 85% ownership and the Yamagata Group owned 15%.[5] The remaining seven parcels were transferred into individual entities referred to collectively as the Sage Mountain Entities.[6] Aquila Investments was the sole owner of Sage Mountain Parcel Nos. 2, 3, and 8.[7] The Yamagata Group owned 80% of each of the remaining four Sage Mountain Entities, while Aquila Investment owned the remaining interest in them.[8]

The Trustee alleges that the defendants asked that their interests in the Sage Mountain Entities and Playa Del Sol be "retired" at the end of 2006. This request resulted in the execution of a Redemption Agreement that committed Playa Del Sol and the various Sage Mountain Entities to begin making payments to the defendants on account of their interests in those entities. The Redemption Agreement required a total of $24,000,000.00 to be paid to the defendants beginning on March 9, 2007, and continuing through December 31, 2007.

Even before the defendants sought to have their interests bought out, they are alleged to have received substantial payments exceeding the amounts provided in the Redemption Agreement. Beginning on January 6, 2006, Sage Mountain I made seven payments to GY Property Holdings totaling $34,769,737.08. Additionally, it made seven payments to Nielsen Investments totaling $818,866.01, and four payments to David Senior totaling $1,085,359.01. Between January 6, 2006 and April 13, 2007, Sage Mountain I made a total of 18 transfers,

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[4] *Id.*, ¶ 50.

[5] *Id.*, ¶¶ 56, 57.

[6] *Id.*, ¶¶ 56, 59.

[7] Second Am. Compl., ECF No. 256, ¶ 58.

[8] *Id.*, ¶ 57.

totaling $36,683,962.10, in the aggregate, to the defendants.

In March 2007, when the Redemption Agreement provided for payments to the Yamagata Group to begin, the real property was subdivided again into fifteen (15) separate Nevada limited liability companies known as the City Crossing 1-15 Entities. Aquila Investments is alleged to have owned all of the interests in the City Crossing Entities. On April 13, 2007, four of the City Crossing Entities made individual payments to GY Property Holdings totaling $3,846,558.00.

The Trustee alleges that the funds for the payments to the Yamagata Group were misappropriated loan proceeds earmarked for a development project.

After the Redemption Agreement was entered, the Sage Mountain Entities were merged into the City Crossing Entities.[9] Slightly more than a year after the last transfers to the Yamagata Group, the City Crossing Entities were merged and dissolved into City Crossing 1, LLC. Less than two weeks after the entities were merged, City Crossing 1 filed a petition under Chapter 11 to reorganize. The trustee does not state the outcome of City Crossing 1's bankruptcy.

The debtor filed his individual chapter 7 petition slightly more than five years after the last transfer was made. The Trustee commenced this action to recover the challenged transfers made by Sage Mountain 1 and the City Crossing Entities under NRS Chapter 112, and alleges that they were "made with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted."[10] Because the transfers occurred well beyond the two year reach back period provided by § 548(a), the Trustee instead relies upon § 544(b), which permits the Trustee

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[9] *Id.*, ¶ 65.

[10] *Id.*, ¶ 169. NRS 112.180(1)(a) provides:

> 1. A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (a) With actual intent to hinder, delay or defraud any creditor of the debtor[.]

to avoid transfers to the extent that an unsecured creditor could do so under "applicable law." The defendants challenge the Trustee's ability to prove that a qualifying creditor (also referred to as a predicate creditor) exists, as required under § 544(b).

ANALYSIS

A. Summary Judgment Standards.

A brief discussion of the procedural posture of the motion is warranted before turning to the merits. The defendants have previously filed several motions to dismiss. As a result of these motions, the Trustee now asserts a claim for substantive consolidation, and was required to specifically identify her predicate creditor(s) for purposes of maintaining her avoidance claims under § 544(b). Through their cross-motions the parties each seek summary judgment pursuant to Fed. R. Civ. P. 56, made applicable to adversary proceedings pursuant to Fed. R. Bankr. P. 7056. Under Rule 56, summary judgment is appropriate if "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law."[11] A fact is material only if it is one that "under the governing substantive law . . . could affect the outcome of the case."[12] A factual issue is genuine if "a jury could reasonably find in the nonmovant's favor from the evidence presented."[13]

It is worth repeating that the moving party bears the initial burden of showing that there is no genuine issue of material fact.[14] This burden is met if the movant identifies "those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with

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[11] Fed. R. Civ. P. 56(a).

[12] *Caneva v. Sun Communities Operating Ltd. P'ship (In re Caneva)*, 550 F.3d 755, 760 (9th Cir. 2008)(citing *Thrifty Oil Co. v. Bank of America Nat'l Trustee & Savings Ass'n*, 322 F.3d 1039, 1046 (9th Cir. 2003)).

[13] *Emeldi v. Univ. of Oregon*, 698 F.3d 715, 730 (9th Cir. 2012)(citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251-52 (1986)); *see also Villiarimo v. Aloha Island Air, Inc.*, 281 F.3d 1054, 1061 (9th Cir. 2002).

[14] *In re Caneva*, 550 F.3d at 755; *see also Leisek v. Brightwood Corp.*, 278 F.3d 895, 898 (9th Cir. 2002).

the affidavits, if any,'" that demonstrate the absence of a genuine issue of material fact.[15] If the movant satisfies this burden, the non-moving party must "go beyond the pleadings" to set forth specific facts showing that a genuine issue of material fact remains for trial.[16] Both parties must support their positions by "citing to particular parts of materials in the record."[17] All evidence is viewed in the light most favorable to the non-moving party.[18]

The cross-motions before the court differ from most in that neither party has submitted any supplemental evidence, such as depositions, affidavits, or admissions, into the record. Rather, the defendants rely on the allegations found in the Second Amended Complaint, and argue that, even if these are accepted as true, there is no genuine dispute that the Trustee cannot identify any qualifying predicate creditor as required to state a claim under § 544(b).[19] Not surprisingly, the Trustee does not dispute the facts as set forth by the defendants, which the court has largely set forth above.[20] In short, the parties seek a ruling on a specific question of law, based exclusively upon the allegations of the Second Amended Complaint. This leaves not only the merits of substantive consolidation, but also the question of whether any of the named creditors factually qualify as a predicate creditor of the debtor, for another day.

B. The Predicate Creditor Requirement in § 544(b).

Section 544(b)(1) authorizes the trustee to avoid:

> any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under

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[15] *In re Caneva*, 550 F.3d at 755 (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)).

[16] *Id.*

[17] Fed. R. Civ. P. 56(c)(1).

[18] *Id.* at 772; *see also Singh v. Clinton*, 618 F.3d 1085, 1088 (9th Cir. 2010).

[19] *See* Fed. R. Civ. P. 56(c)(1)(B) (a party asserting that a fact cannot be genuinely disputed may show "that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.").

[20] See Opp'n. to Defendant GY Property Holdings, LLC, Nielsen Investments, LLC, and David Senior's First Mot. for P. Summ. J. and Countermot. for P. Summ. J., ECF No. 269 at 5, n.6.

section 502(e) of this title."[21]

This section places the trustee in the "overshoes" of the debtor's unsecured creditors.[22] If the trustee can show at least one predicate creditor, § 544(b) permits her to "avoid any transfer of a debtor's property that would be avoidable by an unsecured creditor under applicable state law."[23]

The Trustee seeks to avoid transfers made by either Sage Mountain 1 or the City Crossing Entities, and has identified CB Richard Ellis as a creditor of the transferors in satisfaction of the predicate creditor requirement. The problem is that neither Sage Mountain 1, nor the City Crossing Entities, are the debtor in the main bankruptcy case. Therefore, the Trustee has not identified a "transfer of an interest of the debtor in property." Similarly, CB Richard Ellis is alleged to be a creditor of these transferors, rather than the debtor, and does not hold a claim against the estate for purposes of § 544(b).

The Trustee includes a claim for substantive consolidation of the Sage Mountain and City Crossing Entities into the debtor's bankruptcy estate to address these deficiencies. She asserts that the entities are alter egos, the funds of the entities were intermingled with Mr. Plise's funds, corporate formalities were ignored, and adherence to corporate fictions would be inequitable. She argues that substantively consolidating the Sage Mountain and City Crossing Entities will merge the transferors into the Plise bankruptcy, nunc pro tunc to his petition date. Substantive consolidation would, the Trustee argues, enable her to treat the transfers made by Sage Mountain and the City Crossing Entities as transfers made by the consolidated debtor, thus vesting her with standing to pursue her stated avoidance claims. Moreover, she maintains that substantive consolidation would necessarily redefine the creditors of the consolidated estate, and likewise enable her to rely not only upon CB Richard Ellis to satisfy the predicate creditor requirement, but also any unsecured creditors of Mr. Plise individually who could avoid the transfers under

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[21] 11 U.S.C. § 544(b)(1).

[22] *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 809 (9th Cir.1994)(citing *Hayes v. Palm Seedlings Partners (In re Agricultural Research & Tech. Group, Inc.)*, 916 F.2d 528, 534 (9th Cir. 1990).

[23] *Barclay v. MacKenzie (In re AFI Holding, Inc.)*, 525 F.3d 700, 703 (9th Cir. 2008)(citing *In re Acequia, Inc.*, 34 F.3d at 809).

Nevada law.

The defendants disagree, and argue that substantive consolidation cannot create qualifying predicate creditors where none existed prior to consolidation. To resolve the cross-motions, the court must take a closer look at how substantive consolidation affects the entities to be consolidated, and determine whether a creditor of the consolidated estate can support the Trustee's claims under § 544(b).

C. Does Substantive Consolidation Affect the Predicate Creditor Requirement?

It is now generally accepted that courts may, in appropriate situations, substantively consolidate related entities into a single bankruptcy estate.[24] Substantive consolidation is an equitable remedy that has been described as "no mere instrument of procedural convenience . . . but a measure vitally affecting substantive rights."[25] At a minimum, the effect of an order substantively consolidating entities is that "the assets and liabilities of separate legal entities are consolidated and treated as if they were merged into a single survivor."[26] The Ninth Circuit has recognized that "[o]rders of substantive consolidation combine the assets and liabilities of separate and distinct – but related – legal entities into a single pool and treat them as though they belong to a single entity."[27] Substantive consolidation serves as a check against debtors "insulat[ing] money through transfer among inter-company shell corporations with impunity."[28]

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[24] *Alexander v. Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000); *In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005); *Reider v. Fed. Deposit Ins. Corp. (In re Reider)*, 31 F.3d 1102 (11th Cir. 1994); *First Nat'l Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Serv., Inc.)*, 974 F.2d 712 (6th Cir. 1992); *First Nat'l Bank of El Dorado v. Giller (In re Giller)*, 962 F.2d 796 (8th Cir. 1992); *Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.)*, 860 F. 2d 515 (2nd Cir. 1988); *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270 (D. C. Cir. 1987).

[25] *In re Bonham*, 229 F.3d at 762.

[26] *In re Bauman*, 535 B.R. 289, 295 (Bankr. C.D. Ill. 2015) (citing *In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005)).

[27] *In re Bonham*, 229 F.3d at 764 (citing *Fed. Deposit Ins. Corp. v. Colonial Realty Co.*, 966 F.2d 57, 58-59 (2d Cir. 1992), and *Eastgroup Properties v. S. Motel Assoc., Ltd*, 935 F.2d 245, 248 (11th Cir. 1991)).

[28] *In re Bonham*, 229 F.3d at 764; *see also In re Owens Corning*, 419 F.3d at 205 ("The concept of substantively consolidating separate estates begins with a commonsense deduction. Corporate disregard as a fault may lead to corporate disregard as a remedy.").

As an equitable tool that may significantly affect the rights of the bankruptcy estate, its creditors, and even adversary defendants, courts have consistently recognized that substantive consolidation must be used sparingly.[29]

While courts may have the ability to substantively consolidate entities, what that means for a specific case is less clear.[30] This is particularly so when substantive consolidation is sought within a chapter 11 reorganization rather than a chapter 7 liquidation. Considering such a situation involving the voluntary substantive consolidation of corporate entities within a chapter 11 reorganization, the court in *In re Standard Brands Paint Co.* noted that "[c]aselaw is vague as to what exactly happens to corporate form in substantive consolidation."[31] There, the court was asked to substantively consolidate the debtor parent corporation with four subsidiaries in separate bankruptcies, but ordered that the five corporations would continue their separate existence post-confirmation to avoid adverse tax consequences that would otherwise result from the cancellation of intercompany debt or merger. The *Standard Brands* court analogized substantive consolidation to corporate mergers, but rejected it as a perfect analogy, believing that to do so would limit the court's ability to fashion equitable relief as necessary. For this reason, the court concluded that, "[t]hough it may be the norm that subsidiaries are merged out of existence in consolidation, the bankruptcy court has authority to alter the norm if it determines the benefits of allowing this outweigh any harm."[32] Based upon the equitable nature of

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[29] *In re Bonham*, 229 F.3d at 767. *See also In re Owens Corning*, 419 F.3d at 208-09 ("No court has held that substantive consolidation is not authorized, though there appears nearly unanimous consensus that it is a remedy to be used 'sparingly.'").

[30] S*ee generally In re R & S St. Rose Lenders, LLC*, 553 B.R. 814, 866 (Bankr. D. Nev. 2016) ("While substantive consolidation may permit the merger or pooling of assets, it does not create additional assets for distribution to creditors.").

[31] *In re Standard Brands Paint Co.*, 154 B.R. 563, 569 (Bankr. C.D. Cal. 1993).

[32] *Id.* at 570. *See also Moran v. Hong Kong & Shanghai Banking Corp. (In re Deltacorp, Inc.*), 179 B.R. 773, 778 (Bankr. S.D.N.Y. 1995)("In many cases substantive consolidation will be accompanied by merger of the legal entities, but that is not invariable."); *In the Matter of Genesis Health Ventures, Inc.*, 280 B.R. 95 (Bankr. D. Del. 2002)(substantive consolidation through plan confirmation of chapter 11 debtors provided for continued legal existence of the consolidated entities post-confirmation).

substantive consolidation, the court modified the relief "to fit the needs of this specific case."[33]

The defendants seize upon those decisions which emphasize that substantive consolidation does not work a corporate merger. In their view, notwithstanding substantive consolidation, the Trustee must still identify a creditor of the transferor to state a claim under § 544(b). With equal certainty, the Trustee views substantive consolidation as a merger of the consolidated entities that redefines the debtor consistent with its prepetition reality, including the estate's attendant rights and assets. According to the Trustee, this merger also necessarily redefines the debtor's creditors, including those available to qualify as a predicate creditor for the estate under §544(b).

1. Cases Finding that Substantive Consolidation May Not be Used to Redefine the Predicate Creditors for § 544(b).

The defendants' view of substantive consolidation finds support in two recent bankruptcy cases that have discussed the effect of substantive consolidation on the predicate creditor requirement contained in § 544(b). In *In re Bauman*, 535 B.R. 289 (Bankr. C.D. Ill. 2015), the chapter 7 trustee sought to substantively consolidate the bankruptcy estate of a corporation into the bankruptcy estate of its sole shareholder in an effort to recover transfers made by the corporation. However, the court found that the trustee had failed to make even a *prima facie* case for substantive consolidation, and rejected consolidation merely to provide a remedy for the dissipation of assets.[34] Addressing the trustee's efforts to preserve the state law avoidance actions for the consolidated estate, the court disagreed that consolidation would

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[33] *In re Standard Brands Paint Co.*, 154 B.R. at 573. *See also In re Bonham*, 229 F.3d at 769 (noting that the court may order "less than complete substantive consolidation," or place conditions as may be required by the facts and circumstances of a case).

[34] *In re Bauman*, 535 B.R. at 298-99. The bankruptcy court specifically distinguished the case before it from the Ninth Circuit's decision in *Alexander v. Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000), "a case involving the consolidation of a debtor with nondebtor entities, where corporations had been used in furtherance of a Ponzi scheme and were determined to be mere instrumentalities of the debtor, lacking any separate existence of their own. That is hardly the case here where MIDWEST operated a legitimate and profitable paving business, separate from the DEBTOR's farming operation." *See also id.* ("Thus, in *Auto-Train*, the consolidation order rests on the foundation that the two entities were not, in substance, separate entities, a proposition that is not true of the DEBTOR and MIDWEST.").

permit the trustee of the individual's estate to avoid transfers made by the corporation:

> In this Court's view, such claims are not affected in any way by the consolidation of the bankruptcy estates. The applicable petition date does not change. Neither are the elements of the cause of action altered. A trustee must still prove each of the elements of the claim the same as if consolidation had not occurred. In this Court's view, a trustee who lacks standing to prosecute an avoidance action arising in a case where estate assets exceed allowed claims, cannot reacquire standing via consolidation with an insolvent estate. This follows from the fact that substantive consolidation affects the distribution of assets, but not the collection of assets. Collection of assets still occurs as a function of each separate estate without regard to consolidation, except for the elimination of intercompany claims and constructively fraudulent transfer avoidance claims as described above.[35]

Pertinent to the instant matter, the court observed that "[o]perating to combine the estates of separate debtors, substantive consolidation is inconsistent with the individual ownership of property that avoiding powers must recognize."[36]

More recently, the bankruptcy court in *In re Petters Company, Inc.*, similarly concluded that substantive consolidation "of the bankruptcy estates would not affect the substantive merits of any right of avoidance brought into the pooling of the estates' fortunes."[37] The debtor in *Petters Company* was part of a large Ponzi scheme orchestrated by its principal. The entities involved in the Ponzi scheme filed separate chapter 11 bankruptcies. In a prior proceeding, the court substantively consolidated these entities, expressly preserving the estate's avoidance actions.[38]

The chapter 11 trustee sued the defendants to avoid numerous transfers made by the debtor entities' enterprise structure.[39] The avoidance defendants specifically challenged the trustee's ability to maintain claims under § 544(b) for failure to identify a qualifying creditor

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[35] *In re Bauman*, 535 B.R. at 301.

[36] *Id*.

[37] *Kelley v. Opportunity Finance, LLC (In re Petters Co., Inc.)*, 550 B.R. 438, 456 (Bankr. D. Minn. 2016),

[38] *See In re Petters Co., Inc.*, 506 B.R. 784 (Bankr. D. Minn. 2013).

[39] *In re Petters Co., Inc.*, 550 B.R. at 442-43 n.8.

capable of maintaining an action for fraudulent transfer under state law. As here, the trustee in *Petters Company* urged that substantive consolidation effectively merged the consolidated entities into the debtor's estate for all purposes, including avoidance actions and determination of the predicate creditor for his claim brought under § 544(b). The court succinctly summarized the question before it, and now facing this court:

> in application of the state law of fraudulent transfer, after the substantive consolidation of the estates of multiple debtors, may the trustee use the standing of a pre-petition creditor of *one* of those debtor-entities to satisfy the predicate creditor requirement for the avoidance of a pre-petition transfer made by *another* of the debtor-entities, where the proposed predicate creditor itself had no pre-petition claim against the transferor-debtor?[40]

Although the *Petters Company* court does not cite *Bauman*, it reaches the same conclusion: "There must be an actual unsecured creditor of the debtor in the bankruptcy case in which the trustee is suing, that holds an allowable unsecured claim against *that* debtor's bankruptcy estate, and that could have sued the transferee under some law of fraudulent transfer."[41] In rejecting the merger analogy, the court held that

> [t]he substantive consolidation of the cases and estates . . . had no effect on the Plaintiff's standing as Trustee to maintain suit under 11 U.S.C. § 544(b) on any of the transfers by any of the debtors that he seeks to avoid in this adversary proceeding, and it had no effect on the trustee's case in fact and law as to the avoidability of any such transfer.[42]

In reaching this conclusion, the court characterized the trustee's argument as seeking "the transference of predicate creditor standing."[43] It rejected the trustee's argument that substantive consolidation merged the affected entities into a single debtor whose bankruptcy estate was vested with the collective rights that survived the consolidation process. The court identified

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[40] *In re Petters* Co., 550 B.R. at 446-47 (emphasis in original).

[41] *Id.* at 447 (Bankr. D. Minn. 2016)(emphasis in original)(citing earlier decisions of *In re Petters Co., Inc.*, 494 B.R. 413, 440-41 (Bankr. D. Minn. 2013), and *In re Petters Co., Inc.*, 495 B.R. 887, 895-96 (Bankr. D. Minn. 2013)).

[42] *In re Petters* Co., 550 B.R. at 457.

[43] *Id.* at 448.

three reasons to preclude the treatment advanced by the trustee. First, substantive consolidation ignored the separate prepetition existence of the entities and their separate estates. Second, consolidation, as ordered in *Petters Company*, did not change the status of the entities under nonbankruptcy law but rather the structure of their bankruptcies. Third, the court found that substantive consolidation may not be used to alter the substantive merits of any right of avoidance. For these reasons, the court concluded that "[t]he law still requires the trustee's standing to be anchored in the actual history of the transferor-debtor, and substantive consolidation does not and could not remake that history."[44]

2. *Bonham* Permits Courts to Treat Substantive Consolidation as a Merger in Appropriate Cases.

The Ninth Circuit has not addressed the exact question presented by the cross-motions. But, it has specifically approved the substantive consolidation of nondebtors, nunc pro tunc to the petition date, for the express purpose of preserving a bankruptcy estate's avoidance claims where the nondebtor entities were "mere instrumentalities" of the debtor. In *In re Bonham*,[45] Raejean Bonham was involuntarily placed into bankruptcy by unpaid investors in her business, World Plus, Inc. Upon appointment, the chapter 7 trustee quickly concluded that Ms. Bonham was using World Plus, together with another wholly owned corporation, Atlantic Pacific Funding Corporation, to operate a far-reaching Ponzi scheme. Ms. Bonham had few assets, and her bankruptcy estate had little other than avoidance claims to recover the Ponzi payments made by the nondebtor entities. The chapter 7 trustee filed numerous adversary cases to recover transfers made by the two business entities under §§ 544(b), 547 and 548 of the Bankruptcy Code. The investor defendants moved to dismiss the avoidance actions for lack of standing on the ground that the trustee could not establish a transfer from the debtor necessary for each avoidance action because the challenged payments were made by nondebtor entities. In response, the trustee sought to substantively consolidate the nondebtor transferors into Bonham's bankruptcy estate,

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[44] *Id.* at 455.

[45] *Alexander v. Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000).

nunc pro tunc to her petition date, for the express purpose of enabling the trustee to pursue his avoidance actions.[46]

The bankruptcy court substantively consolidated the nondebtors with Bonham's bankruptcy estate.[47] In a detailed opinion, the bankruptcy court traced the historical foundations of substantive consolidation which arose "as a device to combat the commission of fraud upon creditors which might go uncorrected in its absence."[48] The court distinguished consolidation from existing state law alter ego remedies that imposed liability on shareholders for corporate debts in certain situations. Rather, the bankruptcy court viewed substantive consolidation as more akin to:

> the corporate law notion of enterprise liability because substantive consolidation does not seek to hold shareholders liable for the acts of their incorporated entity. 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.[49]

The bankruptcy court made detailed factual findings supporting its conclusion that the business entities were the mere instrumentalities of Bonham, used to perpetuate fraud, and "[a]s such, the three [entities] should be treated as one entity and consolidated."[50] Moreover, due to arbitrary dealing among Bonham and her entities, the court also found that no creditor had relied

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[46] *In re Bonham*, 229 F.3d at 759-60.

[47] *In re Bonham*, 226 B.R. 56 (Bankr. D. Alaska 1998), *aff'd* 229 F.3d 750 (9th Cir. 2000).

[48] *Id*. at 77. *See also Fish v. East*, 114 F.2d 177, 191 (10th Cir. 1940)(noting that the "mere instrumentality" rule applied, and that the corporate entity would be disregarded "where not to do so will defeat public convenience, justify wrong or protect fraud.").

[49] *In re Bonham*, 226 B.R. at 77 (quoting J. Stephen Gilbert, Note: *Substantive Consolidation in Bankruptcy: A Primer*, 43 Vand.L.Rev. 207, 218 and fn. 77-81); *see also Clark's Crystal Springs Ranch, LLC, v. Gugino (In re Clark)*, 548 B.R. 246, 253-54 (B.A.P. 9th Cir. 2016)("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."). Significant to the instant cross-motions, in *In re Clark*, the B.A.P. noted that "the law of substantive consolidation is federal bankruptcy law and is not dependent on state law concepts." *In re Clark*, 548 B.R. at 253.

[50] *In re Bonham*, 226 B.R. at 96-97 (collecting cases).

upon the separate credit of any entity.

Recognizing that, absent consolidation, the creditors of each entity would receive nothing, the bankruptcy court held that preservation of the avoidance claims based on the nondebtor's transfers warranted substantive consolidation of the nondebtors into the Bonham bankruptcy estate nunc pro tunc to her petition date to permit the trustee of the individual debtor to pursue avoidance actions based upon those transfers. In doing so, the court specifically rejected the loss of litigation defenses as a basis for denial of consolidation. In a separate order, "the bankruptcy court enumerated the terms and conditions of its order of substantive consolidation, which specifically reserved to the trustee the power to exercise the avoidance rights of the consolidated entities under 11 U.S.C. § 544, 547, and 548."[51]

On appeal, the Ninth Circuit affirmed the bankruptcy court's decision to substantively consolidate the nondebtor entities into Bonham's bankruptcy estate.[52] The court observed that substantive consolidation "enabl[es] a bankruptcy court to disregard separate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation."[53] As to this point, the court also found that "[t]he bankruptcy court's findings support its conclusion that Bonham, WPI, and APFC 'were but instrumentalities of the bankrupt with no separate existence of their own.'"[54]

The defendants attempt to limit the holding of *Bonham*, and urge the court to read it narrowly. They concede that substantive consolidation may alter the rights and liabilities of entities to permit or preserve direct avoidance actions under the Bankruptcy Code such as preference claims raised under § 547(b), or fraudulent transfers under § 548. They contend,

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[51] *In re Bonham*, 229 F.3d at 760.

[52] The Bankruptcy Appellate Panel recently rejected an argument that substantive consolidation is no longer a viable remedy in light of the Supreme Court's decision in *Law v. Siegel*, __ U.S. __, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014). *In re Clark*, 548 B.R. at 252-53.

[53] *In re Bonham*, 229 F.3d at 764 (quoting *James Talcott, Inc. v. Wharton (In re Continental Vending Machine Corp.*), 517 F.2d 997, 1000 (2d Cir.1975)).

[54] *In re Bonham*, 229 F.3d at 766-67 (citing *Soviero v. Franklin Nat'l Bank of Long Island*, 328 F.2d 446, 448 (2d Cir. 1964)).

however, that it cannot similarly affect derivative, state law avoidance claims brought under § 544(b).[55] However, nothing within the Ninth Circuit's discussion of substantive consolidation suggests that actions under § 544(b) are carved out from, or otherwise immune to, the impact of substantive consolidation. Quite the opposite; the Ninth Circuit affirmed the substantive consolidation of nondebtor entity transferors into a bankruptcy estate, nunc pro tunc to the individual's petition date, where the primary purpose was to allow the trustee "to pursue avoidance actions."[56] The only assets to be pooled for the benefit of the consolidated creditors in *Bonham* were the avoidance actions under all applicable theories:

> the benefits of substantive consolidation in this appeal are clear. As the bankruptcy court recognized, *nunc pro tunc* consolidation will make it possible for [the trustee] to pursue avoidance actions under §§ 544(b) and 548, benefitting the creditors of Bonham, WPI and APFC. See *In re Bonham*, 226 B.R. at 101 (citing *In re Kroh*, 117 B.R. at 502). Without consolidation, claimants who have received no payments from WPI and APFC will recover no funds invested in either of those entities. In short, substantive consolidation will allow a truly equitable distribution of assets by treating the corporate shells as a single economic unit.[57]

Given the Ninth Circuit's reliance on the equitable distribution to be generated by permitting the trustee to pursue avoidance actions, it defies logic why potential recoveries under § 544(b) would be excepted from the scope of substantive consolidation.

Relevant to the defendants' instant motion, the Ninth Circuit squarely rejected the investors' objection that consolidation nunc pro tunc eliminated various defenses to the

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[55] The defendants base their reading of *Bonham* on the following language found within the Ninth Circuit's opinion:

> With substantive consolidation *nunc pro tunc*, the trustee will be able to recover fraudulent transfers made by [the nondebtor entities] within the one year prior to the filing of the involuntary petition against Bonham and to redistribute the recovered assets equitably to all of Bonham's creditors. *See* 11 U.S.C. § 548(a)(1); *see also* 11 U.S.C. § 547(b).

In re Bonham, 229 F.3d at 768.

[56] *Id.*

[57] *Id*. at 767-68.

avoidance actions. When weighed against the benefits to be gained by permitting the avoidance actions, the Ninth Circuit wrote:

> The "harm" usually measured is the harm to the entity which is being substantively consolidated. Here, the only "harm" is that third parties may have greater exposure to risk because they may lose a legal defense to what would otherwise be viable claims of fraudulent transfer. In short, the alleged "harm" is that fraudulent transfers of money will be recovered, the estates will be equitably administered and the assets equitably distributed. The bankruptcy court did not err in this aspect of its analysis.[58]

In rejecting the loss of legal defenses as an obstacle to substantive consolidation, the court also noted that "bankruptcy courts have sanctioned the substantive consolidation of two or more entities *nunc pro tunc* in order to allow a trustee or creditors to attack fraudulent transfers or avoidable preferences made by the debtor or consolidated entities as of the date of filing of the initial bankruptcy petition."[59]

Bonham stands in stark contrast to the limited, administrative effect attributed to substantive consolidation by the courts in *Bauman* and *Petters Company*.[60] Instead, it solidly supports the Trustee's argument that substantive consolidation may, in appropriate cases, be used to define the bankruptcy debtor to include nondebtor entities used as mere instrumentalities. Just as courts may substantively consolidate entities while still preserving their post-confirmation identities, so may they disregard the separate existence of mere instrumentalities. *Bonham* dramatically demonstrates that, in such instances, the result is to merge the entities into a single bankruptcy estate for all purposes, circumscribed as it may be by the order of consolidation, after giving full consideration to the facts and circumstances of that case. The purpose, and specific

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[58] *Id.* at 767.

[59] *Id.* at 765 (citing cases).

[60] In its memorandum on substantive consolidation, the *Petters Company* court predicted that "[u]nder the authority of several extant opinions, consolidation could overcome this defect [regarding identification of the predicate creditor] with a claim against any of the previously-separate estates, the creditor from which the Trustee would derive standing, post-litigation. *E.g. In re Bonham*, 229 F.3d at 765; *In re DBSI*, 447 B.R. 243, 246 (Bankr. D. Del. 2011)." *In re Petters*, 506 B.R. at 849 n.90. In its most recent decision concerning § 544(b), the *Petters Company* court does not discuss *Bonham* in any depth. *See In re Petters Co.*, 550 B.R. at 450 n.22 and 453 n.27.

effect, of consolidation in *Bonham* was to permit the trustee of the individual's bankruptcy case to maintain avoidance actions under §§ 547, 548, and 544(b) to recover transfers made by two nondebtor entities, using a reach back period beginning with the individual debtor's petition date. Such holding nullified the avoidance defendants' arguments that the trustee was unable to prove the statutorily required transfer of property of the debtor. Additionally, consolidation eliminated numerous limitations defenses under each statutory cause of action pursued by the trustee. In reaching this decision, the Ninth Circuit rejected the limitations the defendants now seek to impose on the equitable remedy of substantive consolidation.

Importantly, substantive consolidation does not alter the statutory requirements of § 544(b). Section 544(b)(1) permits a trustee to "avoid a transfer of an interest of the debtor . . . that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502[.]"[61] It does not, however, define who is the debtor. *Bonham* establishes that in appropriate situations, substantive consolidation may be utilized to disregard corporate fiction, particularly where the entities to be consolidated are the mere instrumentalities of the debtor used for fraudulent purposes. It is only after defining the substantively consolidated debtor that the requirements of § 544(b) are applied.

If the Trustee successfully achieves substantive consolidation in the instant proceeding, she may redefine the debtor in bankruptcy to include the nondebtor transferors for all bankruptcy purposes, including all avoidance actions. Assuming that the Trustee can meet the standards adopted in *Bonham*, substantive consolidation may permit her to bring the nondebtor transferors into Mr. Plise's bankruptcy estate nunc pro tunc to the petition date, to preserve the bankruptcy estate's ability to pursue any and all avoidance actions claims authorized under the Bankruptcy Code. While this result is not immutable, substantive consolidation does permit the court to redefine the debtor in bankruptcy to include the nondebtor transferors. This necessarily includes expanding the creditors of the consolidated estate to encompass the creditors of each consolidated entity. Assuming the creditors identified by the Trustee could maintain an

[61] 11 U.S.C. § 544(b)(1).

avoidance action under applicable law, the Trustee steps into their shoes and assumes those rights. Based upon the record before the court, summary judgment in favor of the defendants on this issue is, therefore inappropriate, as they have failed to demonstrate that they are entitled to judgment in their favor as a matter of law.

D. The Trustee has Identified a Creditor of the Transferor Entities.

Although the Trustee has identified, and relies upon, several creditors of Mr. Plise individually to serve as the predicate creditor, she has also identified CB Richard Ellis as an existing creditor of the Sage Mountain and City Crossing Entities as of Mr. Plise's petition date.[62] The Trustee alleges that this creditor was owed $36,000.00 on this date. As noted above, the defendants offer no evidence to challenge these allegations, or the creditor's ability to bring an avoidance action under Nevada law. It is unclear why, even under the defendants' view, this allegation does not sufficiently identify an existing creditor of the transferor. For this reason alone, the defendants' motion for summary judgment must be denied.

CONCLUSION

For the reasons stated above, the court shall deny the defendants' First Motion for Partial Summary Judgment (ECF No. 263) on the § 544(b) issue raised therein, whether substantive consolidation can transform the Plise predicate creditors into creditors of transferring entities, and grant the trustee's Countermotion for Partial Summary Judgment (ECF No. 269) on this issue. However, the court shall grant partial summary judgment to the defendants as to the second ground for relief asserted in their motion, and shall dismiss the Trustee's Fourth Claim for Relief for Unjust Enrichment asserted in the Second Amended Complaint (ECF No. 256).[63]

An order shall be entered consistent with this memorandum.

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[62] Second Am. Compl., ECF No. 256, ¶ 98. *See also* Defendant GY Property Holdings, LLC, Nielson Investments, LLC and David Senior's Statement of Undisputed Facts in Support of Motion for Partial Summary Judgment, ECF No. 264 at ¶ 10.

[63] The Trustee does not oppose this relief. *See* Opp'n to Defendants' First Mot. for Partial Summ. J. and Countermotion, ECF No. 269 at 2:16-17.

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