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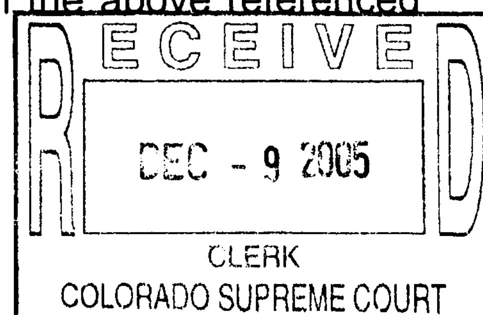
ORIGINAL

SUPREME COURT, STATE OF COLORADO Two East 14th Avenue Denver, Colorado 80203 CERTIFICATION OF QUESTION OF LAW UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO, 05CV1495-AP (JLK) BANKRUPTCY CASE NO. 02-29116 EEB, Chapter 7	FILED IN THE SUPREME COURT DEC - 9 2005 OF THE STATE OF COLORADO SUSAN J. FESTAG, CLERK
In re: **Debtor:** PHILLIP EUGENE PHILLIPS	
Plaintiff-Appellant: TOM H. CONNOLLY, Chapter 7 Trustee, v. **Defendants-Appellees:** ENGLEWOOD POST NO. 322 VETERANS OF FOREIGN WARS OF THE UNITED STATES, INC., MARGARET M. PHILLIPS, TROY BRACKEEN, RAMONA BRACKEEN, PHILSAX INCORPORATED, ACTION PROPERTIES, INC., AND PHILLIP EUGENE PHILLIPS.	▲COURT USE ONLY▲
Attorneys for Plaintiff-Appellant: Jeffrey A. Weinman, #7605 William A. Richey, #13438 730 17th Street, #240 Denver, CO 80202-3506 Telephone: (303) 572-1010 Facsimile: (303) 572-1011 E-mail: jweinman@epitrustee.com E-mail: wrichey@weinmanpc.com	Case No. 05SA316

OPENING BRIEF

Tom H. Connolly, Chapter 7 Trustee ("Trustee"), through his counsel Weinman & Associates, P.C., hereby submits the following Opening Brief in the above referenced Colorado Supreme Court case.



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B. STATEMENT OF THE QUESTION CERTIFIED TO THE COLORADO SUPREME COURT FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO

Under Colorado law and with respect to the alter ego doctrine, may a creditor of a shareholder of a closely held corporation and/or another shareholder of the closely held corporation "reverse pierce" the corporate veil of the closely held corporation to fasten liability on and thereby eventually reach the assets of the corporation owned by the shareholder. Such question is asked under circumstances where the creditor of a shareholder or another shareholder of the closely held corporation is seeking to avoid fraudulent conveyances of property of the closely held corporation where it is determined to be the alter ego of the shareholder; where there are no innocent third party creditors of the closely held corporation (other than the creditor seeking to pierce the corporate veil); there are no other non-culpable shareholders of the corporation; the shareholder is the party against which the doctrine is being invoked; and, such shareholder is the actor in a course of conduct constituting an abuse of the corporate privilege.

C. STATEMENT OF THE CASE

The Trustee hereby submits his statement of the case.

1. <u>Nature of the case in the Bankruptcy Court</u>.

Debtor Phillip Eugene Phillips ("Debtor") filed a voluntary Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the District of Colorado. Trustee Tom H. Connolly ("Trustee") is the duly appointed Chapter 7 Bankruptcy Trustee of the bankruptcy estate

of Debtor. Trustee commenced Adversary Proceeding No. 04-1989 EEB naming the Appellees as Defendants therein seeking to avoid as fraudulent transfers under 11 U.S.C. §544 and C.R.S. 38-8-101, *et seq.*, transfers of the Debtor's shareholder interest in an entity identified as Philsax, Inc. ("Philsax"), two (2) parcels of real property located on South Broadway in Englewood, Colorado, owned by Philsax and personal property owned by Philsax. The Debtor was, prior to the transfer of the Debtor's majority equitable interest in Philsax, the majority shareholder in Philsax. The Trustee alleges that the transfer of the Debtor's majority shareholder interest and the transfers of the real property were without consideration and were made with the intent to hinder, delay and defraud creditors of the Debtor. Additionally, the Trustee alleges that Philsax (as well as Action Properties, Inc. ("Action Properties")) is the alter ego of the Debtor and that the Court should "reverse pierce" the corporate veil of Philsax and avoid the transfers of real property and personal property assets which were owned by Philsax.

2. Course of Proceedings in the Bankruptcy Court.

Following the filing of an Adversary Proceeding by the Trustee, Trustee duly served each of the Defendants a copy of the Summons and Complaint. Each of the Defendants failed to file an answer or otherwise respond to the Trustee's Complaint and the Bankruptcy Court entered a Show Cause Order directing the Trustee to seek an entry of default against the Defendants, or alternatively, to seek alias summonses to have the Defendants served a copy of the alias summons and Complaint.

The Trustee filed a Motion for Default Judgment Against All Defendants

accompanied by supporting documentation and an Affidavit in support thereof filed by counsel for Trustee. Following the filing of Trustee's Motion for Default Judgment, certain of the Defendants filed an Answer which was struck by order of the Bankruptcy Court.

Subsequent to the filing of the Motion for Default Judgment, the Bankruptcy Court directed the Trustee to file a legal brief to address certain concerns of the Court in connection with the Trustee's request for entry of default judgment. The Trustee filed his Legal Brief and a Supplemental Legal Brief to address the concerns of the Bankruptcy Court. Subsequent to the filing of the Legal Brief, the Court entered default against all Defendants, and entered default judgment, in part, in favor of the Trustee and against the Defendants, and, in part, in favor of the Defendants and against Trustee.

3. Disposition in Bankruptcy Court and Appeal to the U.S. District Court for the District of Colorado.

a. The Bankruptcy Court entered default against all Defendants and entered default judgment against certain of the Defendants avoiding the transfers of the Debtor's shareholder interest in Philsax and dismissed the Trustee's alter ego claims resulting in a denial of the Trustee's request to avoid the transfers of the real property and personal property assets owned by Philsax to certain of the Defendants.

b. The Trustee appealed the dismissal of the Trustee's alter ego claims to the U.S. District Court for the District of Colorado which certified the question to the Colorado Supreme Court.

4. Statement of Facts.

a. Introduction.

The Trustee filed his Complaint on October 19, 2004. By his Complaint, the Trustee seeks a judgment from the Bankruptcy Court avoiding various fraudulent transfers pursuant to the provisions of 11 U.S.C. §544 and C.R.S. §38-8-101 *et seq.*, made by the Debtor individually and through entities identified as Philsax and Action Properties, both Colorado corporations, which were alter egos of the Debtor to the various Defendants for the purposes of hindering, delaying and defrauding legitimate creditors of the Debtor, without receiving adequate consideration and at a time when such entities and/or the Debtor were insolvent or were rendered insolvent by such transfers.

The Trustee requested that the Bankruptcy Court enter an equitable order piercing the corporate veil of Philsax, and determine that Philsax is the alter ego of the Debtor, and that the actions of Philsax in fraudulently transferring the real and personal property were the actions of the Debtor.

Pursuant to Orders entered by the Bankruptcy Court in the underlying Chapter 7 case, the Trustee was authorized to take and did take Rule 2004 examinations (Rule 2004 F.R.B.P.) of the Debtor, Defendant Margaret M. Phillips ("Margaret"), and representatives and officers of Defendant Englewood Post No. 322 Veterans of Foreign Wars of the United States, Inc. ("VFW"). In addition, pursuant to the Bankruptcy Court's Orders with respect to the Rule 2004 examinations, documents were produced and authenticated by the various Defendants in connection with such Rule 2004 examinations. These investigations of the Debtor's financial affairs were undertaken prior to the Trustee filing his Complaint in

the Adversary Proceeding.

As a result of the investigations of the Trustee, the Trustee filed in his Complaint and sought default judgment against all the Defendants. The Trustee attached a transcript of the Rule 2004 examination of the Debtor and included as exhibits, copies of certain of the documents produced at the various Rule 2004 examinations, which were attached to the Trustee's Motion for Default Judgment.

b. The following facts established by the Trustee's investigation were included in support of the Trustee's Motion for Default Judgment.

The Debtor filed his voluntary Chapter 7 bankruptcy petition on November 22, 2002.

Prior to May 2000, the Debtor was the purported principal shareholder of Philsax, a Colorado corporation, holding a 51%[1] shareholder interest in Philsax. In March 2002, the Debtor transferred 43% of his shareholder interest in Philsax, leaving his total shareholder interest in Philsax at 8%.

Prior to March 2000, Margaret purportedly held a 49% shareholder interest in Philsax. In March 2000, Margaret acquired additional shareholder interest from the Debtor which increased her ownership interest in Philsax to a 52% shareholder interest in Philsax and decreased the Debtor's shareholder interest in Philsax to an 8% interest.

Prior to the filing of his Chapter 7 bankruptcy petition, the Debtor was the purported principal shareholder of the entity identified as Action Properties holding a 51% shareholder interest in Action Properties.

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[1]Neither Philsax nor Action Properties issued stock certificates.

Prior to the filing of the Chapter 7 bankruptcy petition of the Debtor, Margaret was a purported shareholder of Action Properties holding a 49% shareholder interest in Action Properties.

In March 2000, the Debtor had been an officer, member and a person in a position of authority with respect to the VFW.

In March 2000, Defendant Troy Brackeen ("Troy") was or became a purported shareholder and officer of Philsax and was Post Commander[2] of the VFW. Troy is the nephew by marriage of the Debtor.

In March 2000, Defendant Ramona Brackeen ("Ramona") was or became a purported shareholder in Philsax. Ramona is the wife of Troy and is a niece by marriage of the Debtor.

Margaret is the wife of the Debtor and was, in March 2000, a purported shareholder, officer and director of Philsax and Action Properties. Margaret is an auxiliary member of the VFW.

Individuals identified as Robert M. Saxton and Janet M. Saxton (the "Saxtons") are creditors of the Debtor, having obtained a state court judgment against the Debtor in the approximate amount of $135,000, which judgment arose in connection with their lawsuit filed in the Arapahoe County, Colorado District Court. The judgment had been entered

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[2]A VFW Post Commander is the key officer of the Post. He represents both the judicial branch and the executive branch of the Post. He presides over all meetings, enforces all rules, appoints committees and makes certain that the other officers and committees perform their duties.

against the Debtor in March 2000. The Debtor, Action Properties and Philsax had been served Writs of Garnishment by the Saxtons in January 2000. Thus, the Debtor was aware of the Saxtons' judgment entered against him. The Saxtons are listed as creditors holding an unsecured claim in the Chapter 7 bankruptcy proceeding of the Debtor.

Prior to March 2000, the Saxtons were shareholders, directors and officers of Philsax. In January 2000, the Saxtons were improperly removed as shareholders, directors and officers of Philsax at the direction of the Debtor, which action was supported by Margaret, Troy and Ramona.

Prior to March 2000, Philsax's primary, if not only, asset was its ownership of real property in Arapahoe County identified as:

3940-54 South Broadway (Parcel A); and

3956-60 South Broadway (Parcel B).

Philsax acquired ownership of Parcel A and Parcel B from Century 21 Action, Inc. by means of a warranty deed recorded May 6, 1992 in Arapahoe County, Colorado.

Century 21 Action, Inc. had acquired Parcel A and Parcel B from First Federal Savings which sold Parcel A and Parcel B to Century 21 Action, Inc. Century 21 Action, Inc. was indebted to First Federal Savings for the purchase of Parcel A and Parcel B. First Federal Savings secured the indebtedness by means of a deed of trust recorded against Parcel A and Parcel B.

At the time Philsax acquired Parcel A and Parcel B from Century 21 Action, Inc., Philsax assumed the liability of Century 21 Action, Inc. to First Federal Savings.

On March 8, 2000, Philsax and the VFW entered into a written agreement whereby the VFW would be added to the title on Parcel A by means of a quit claim deed. Pursuant to the terms of the written agreement, the VFW agreed to pay Philsax a total of $350,000 for Parcel A with $260,000 to be paid to Philsax in monthly payments of $2,092 evidenced by a promissory note and an additional approximately $90,000 in cash. In exchange for the payment of $350,000 to Philsax, Philsax agreed to transfer a 99.99% interest in Parcel A to the VFW.

The written agreement was signed by the Debtor and Margaret on behalf of Philsax, and by Troy as Commander of the VFW, and by individuals identified as Dennis Norris, Sr. as Vice Commander of the VFW and John Greenway as Quarter Master[3] of the VFW.

A closing on the transfer of the 99.99% interest in Parcel A from Philsax to the VFW occurred on March 12, 2000.

At the closing, and contrary to the terms of the written agreement, the VFW executed a Promissory Note (later modified) in the original principal amount of $260,000 dated March 11, 2000, payable to Margaret with monthly payments of $2,092 with the first such monthly payment due May 2000 and continuing monthly thereafter. The Promissory Note payable to Margaret was executed on behalf of the VFW by Troy as Commander of the VFW and John Greenway as Quarter Master of the VFW.

At the closing, and contrary to the written agreement, the VFW paid $89,673.37 to

[3]A VFW Quarter Master is responsible for all Post funds and property, and his signature validates all checks. He keeps financial records of the Post and oversees all financial transactions.

Action Properties. The payment of $89,673.37 was by check written on the VFW's checking account. The check was deposited by Action Properties in its bank account. None of the proceeds from the $89,673.37 check were paid over to Philsax by Action Properties.

To secure the repayment of the Promissory Note from the VFW to Margaret, and contrary to the terms of the written agreement, the VFW executed a deed of trust dated March 11, 2000 in favor of Margaret encumbering Parcel A.

A warranty deed dated March 11, 2000 transferred Philsax's interest in Parcel A to Philsax and the VFW. The March 11, 2000 warranty deed was recorded in Arapahoe County, Colorado on March 14, 2000. A correction warranty deed dated March 28, 2000 transferred a 99.99% interest in Parcel A to the VFW and a .01% interest to Philsax as tenants in common. The correction warranty deed was recorded on March 29, 2001 with Arapahoe County.

At a purported special meeting of the board of directors of Philsax (identified as the Debtor, Margaret, Ramona and Troy) held on March 13, 2000, the Debtor received the $89,648.37, in exchange for a transfer by the Debtor of 20% of his shareholder interest in Philsax to Troy, 20% of his shareholder interest in Philsax to Ramona, and 3% of his shareholder interest in Philsax to Margaret. As a result of these transfers, the Debtor retained 8% of his shareholder interest in Philsax, Margaret held 52% in Philsax, Troy held 20% in Philsax, and Ramona held 20% in Philsax. The transfers of the various shareholder interests of the Debtor were without consideration.

At a purported special meeting of the board of directors of Philsax (identified as the Debtor, Margaret and Ramona) held on March 8, 2000, a 99.99% interest in Parcel B was transferred to Margaret. The transfer of the 99.99% interest in Parcel B to Margaret was without consideration. Apparently by mistake, a warranty deed dated March 11, 2000 transferred Philsax's interest in Parcel B to Philsax, Margaret and Action Properties. The warranty deed was recorded on March 14, 2000 with Arapahoe County.

Following the closing on Parcel A and contrary to the terms of the written agreement, the VFW made monthly payments of $2,092.00 to or for the benefit of Margaret.

Except for the Debtor and Margaret, Troy and Ramona, there are no other purported shareholders or individuals holding equitable interest in Philsax.

The Debtor identified the creditors of Philsax to be identical to his personal creditors. Philsax had no other creditors.

A Quit Claim Deed dated March 15, 2000 purportedly transferring the VFW's 99.9% interest in Parcel A and Philsax's 0.01% interest in Parcel A to Margaret was recorded on January 26, 2005 with Arapahoe County. This Quit Claim Deed is signed by Troy as "President" and John Greenway as "Secretary" of the VFW.

c. The following facts established by the Trustee's investigation were included as support of the Trustee's Legal Brief.

In its Order of March 4, 2005, the Bankruptcy Court, citing the case of Markum v. Fay, 844 F.Supp. 594 (U.S.D.C.D.Mass. 1995) aff'd in part and rev'd in part, 74 F.3d 1347 (1st Cir. 1996), directed the Trustee to address twelve criteria set forth in Markum v. Fay to

support the Trustee's claims of alter ego. The twelve factors outlined in Markum v. Fay which the Court directed to be considered in deciding whether to pierce the corporate veil are: (1) common ownership; (2) pervasive control; (3) confused intermingling of business assets or management; (4) thin capitalization; (5) non-observance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at the time of the litigated transaction; (9) siphoning away of corporate assets by the dominant shareholder; (10) non-functioning of officers and directors; (11) use of the corporation for transactions of the dominant shareholder; and (12) use of the corporation in promoting fraud.

The twelve criteria and specific facts which support the Trustee's claim of alter ego were set forth by the Trustee in his Legal Brief. The facts which the Trustee set forth in his Legal Brief were, like those initially set forth in the Trustee's Motion for Default Judgment, developed from the Trustee's investigation of the financial affairs of the Debtor.

The facts which support the criteria set forth in Markum v. Fay are set forth below.

(1) Common Ownership. The Debtor and Margaret were the purported majority and minority shareholders of both Philsax and Action Properties. Neither Philsax nor Action Properties issued stock certificates. The Debtor held, on the date he filed bankruptcy, a 51% shareholder interest in Action Properties and an 8% shareholder interest in Philsax. Margaret held a 51% shareholder interest in Philsax and a 49% shareholder interest in Action Properties. At the time of the transfers of Parcel A and Parcel B from Philsax to the VFW, Margaret and Action Properties, the

Debtor held a 51% purported shareholder interest in Philsax.

The Debtor transferred all but 8% of his purported shareholder interest in Philsax to Margaret, Troy and Ramona without consideration and at a time when the Saxtons held a judgment against the Debtor and had served writs of garnishment on Philsax, the Debtor and Action Properties. At the time of the transfers of real property, the Debtor was a member of the VFW and previously had been Post Commander of the VFW. Troy was Post Commander of the VFW as well as a purported director of Philsax. Margaret was an auxiliary member of the VFW and a purported officer, director and shareholder of Philsax and Action Properties.

(2) Pervasive control. The Debtor was president, director and purported shareholder of both Philsax and Action Properties and a member of the VFW. The Debtor made the decision to accept the VFW's offer to acquire Parcel A. The Debtor directed that the $89,648.37 in cash, paid by the VFW as part of the purchase price for Parcel A, be paid to Action Properties rather than Philsax as had been agreed to between Philsax and the VFW. Thereafter, the Debtor diverted the funds out of the Action Properties bank account either to a bank account owned by Troy or utilized the funds to pay his own personal expenses. The Debtor provided inconsistent evidence concerning the disposition of the funds. In connection with the state court proceeding brought by the Saxtons in April 2000, the Debtor submitted a written statement to the Arapahoe County District Court advising the Court that he had used all but $17,994.21 of the funds to pay personal expenses.

The Arapahoe County District Court ordered the Debtor to deposit the $17,994.21 in the registry of the Court, which apparently, he did not do. In his Rule 2004 examination, the Debtor testified that the funds were transferred to Troy. Regardless of where the funds went, the Debtor testified that he diverted the funds to avoid the consequences of the writs of garnishment of the Saxtons.

Although ostensibly holding a 51% shareholder interest in Philsax and a 49% shareholder interest in Action Properties, Margaret could not testify under oath at her Rule 2004 examination whether she is an officer, director or shareholder of either Philsax or Action Properties and could not explain her duties and obligations as a director or officer of Philsax or Action Properties.

Written notices of meetings of the board of directors of Philsax were not prepared nor sent to other purported directors of either corporation. As a result, both Action Properties and Philsax undertook actions at the direction of the Debtor without proper notice. The Saxtons were at one time officers and directors of Philsax, however, they were removed as such at the direction of the Debtor without having received written notice of any meeting of the board of directors to remove them as directors.

In violation of the Post Bylaws of the VFW, the check in the amount of $89,648.37, was co-signed by Troy as Post Commander and by the Debtor, payable to Action Properties, not Philsax. The Debtor had no authority from the VFW to co-sign the check payable to Action Properties. The bylaws of the VFW

require that the Post Commander and the Post Quarter Master co-sign checks disbursing the funds of the VFW. Although the VFW agreed to purchase Parcel A from Philsax, the purchase and sale contract was signed by the Debtor and Margaret in their individual capacity as owners of Parcel A and not as representatives of Philsax.

The Debtor drafted the sale documents, closing documents, settlement sheet, promissory note, deed of trust and various deeds transferring Parcel A to the VFW. He mistakenly prepared the deed transferring Parcel B to Margaret, Action Properties and Philsax. A title company did not handle the closing, which was conducted by the Debtor. No title insurance was acquired in connection with the sale of Parcel A to the VFW.

(3) Confused Intermingling of Business Assets and/or Management. Philsax had and has no corporate bank account. Financial transactions involving Philsax were run through the bank account of Action Properties. The Debtor and Margaret had and have signatory authority with respect to the Action Properties bank account. Funds in the Action Properties bank account were utilized to pay personal expenses of the Debtor or diverted to an account owned by Troy. Although the cash payment of $89,648.37 for Parcel A was to be paid by the VFW to Philsax, the check from the VFW was made payable to Action Properties and not Philsax. Although an agreement was entered into between the VFW and Philsax for Philsax to sell Parcel A to the VFW in exchange for cash and a $260,000 promissory

note and security interest, the VFW executed the $260,000 promissory note made payable to Margaret rather than Philsax and granted a security interest in Parcel A to Margaret, not Philsax. The transfer of Parcel B from Philsax to Margaret was ostensibly for the purpose of paying for personal services which Margaret had provided to Action Properties and not Philsax. Margaret paid Philsax nothing for Parcel B nor for the $260,000 secured promissory note. As a result of the various transfers of cash, the promissory note, deed of trust and real property, Philsax was left as nothing more than a corporate shell since Philsax owned no assets other than Parcels A and B.

(4) Thin Capitalization. In March 2000, the only asset of Philsax was Parcel A and Parcel B. As a result of the transfers of the assets of Philsax to the VFW, Margaret and Action Properties, Philsax was rendered insolvent. Philsax was, at the time of the transfers, obligated to First Federal Savings (now Commercial Federal Savings) which held a note in the original principal amount of $189,824.16, payable by Philsax, secured by a first deed of trust on both Parcels A and B.

(5) Non-Observance of Corporate Formalities. Philsax had no written bylaws, provided no written notice to directors and/or shareholders with respect to meetings of directors and shareholders, and maintained no written financial statements including no balance sheets. Philsax issued no shares of stock and did not have a stock transfer book. Action Properties issued no shares of stock nor did Action Properties have a stock transfer book. There were no written resolutions of

the board of directors or meetings of the board of directors to add or remove directors of Philsax. Directors were removed and added at the direction of the Debtor. There was no written notice to the board of directors with respect to the sale of the real property from Philsax to the VFW. The purchase and sale contract entered into between Philsax and the VFW was signed by the Debtor and Margaret in their individual capacity and not as representatives of Philsax.

(6) Absence of Corporate Records. As indicated above, Philsax had no written bylaws, no financial statements, no written resolution of the board of directors with respect to the sale and transfer of its sole asset, Parcels A and B, to the VFW and Margaret, Action Properties and Philsax respectively. Philsax had no bank account, and neither Philsax nor Action Properties issued shares of stock or maintained a stock transfer book.

(7) No payment of Dividends. It is not known whether Philsax or Action Properties paid dividends to its shareholders.

(8) Insolvency at the Time of the Litigated Transaction. The transfer of Parcels A and B from Philsax to the VFW and to Margaret rendered Philsax insolvent. The real property was the sole asset of Philsax which was subject to the encumbrance of First Federal Savings, now Commercial Federal Savings. The Debtor testified at his Rule 2004 examination that at the time of the transfer of the real property, Parcel A was worth approximately $500,000, and Parcel B was worth $120,000, and as a result of the transfers, Philsax now has no value. However,

Philsax remained subject to the indebtedness owing to Commercial Federal Savings, the successor of First Federal Savings in the original principal amount of $189,824.16. The $89,648.37, which should have been paid to Philsax, instead was paid to Action Properties, which was then transferred at the direction of the Debtor to either Troy or to the Debtor for personal use. The $260,000 promissory note which was to provide Philsax with monthly payments of $2,092, and which should have been made payable to Philsax, instead was made payable to Margaret. The actions of the Debtor rendered Philsax insolvent. The Debtor testified at his Rule 2004 examination that, except for some used business furniture, Action Properties has no assets.

(9) Siphoning Away Corporate Assets by Dominant Shareholder. The actions of the Debtor resulted in the transfer of Parcel A to the VFW with no consideration for Parcel A being paid to Philsax. Cash of $89,648.37 ended up being transferred to or for the benefit of the Debtor. A $260,000 secured promissory note was made payable to Margaret, not Philsax. Parcel B was transferred to Margaret for no consideration, ostensibly for the purpose of rewarding Margaret for services which she had provided to Action Properties, not Philsax.

(10) Non-Functioning of Officers and Directors. Under oath at her Rule 2004 examination, Margaret could not positively testify that she was a director, officer or shareholder of Philsax or Action Properties. In addition, she could not identify the officers, shareholders and directors of either Philsax or Action

Properties. Ostensibly she owns a 49% shareholder interest in Action Properties, and at that time held a 51% shareholder interest in Philsax. Margaret could not testify as to the scope of her duties as an officer or director of either Philsax or Action Properties. Truthfully, she did testify that Philsax and Action Properties were "Phil's [Phillip Eugene Phillips] companies", meaning that the Debtor dominated and completely controlled both entities.

(11) Use of the Corporation for Transactions of the Dominant Shareholder. The Debtor manipulated both Philsax and Action Properties by transferring assets and his shareholder interest to hinder and delay the Saxtons in an attempt to collect their judgment against the Debtor. Corporate assets of Philsax were transferred for no benefit to Philsax. Cash deposited in Action Properties' bank account belonging to Philsax was diverted by the Debtor for either his own benefit or to Troy.

(12) Use of Corporation to Promote Fraud. In March 2000, a judgment had been entered in favor of the Saxtons against the Debtor. Writs of garnishment had been served on the Debtor, Philsax and Action Properties by the Saxtons. The transfer of the Debtor's majority shareholder interest in Philsax resulted in the Debtor holding a minimal shareholder interest (8%) in Philsax, which resulted in minimizing his exposure to the collection activities of the Saxtons. In addition, the transfer of the real property assets of Philsax to the VFW and Margaret, plus the execution of the promissory note and deed of trust to Margaret, resulted in the diminution of the value of the shareholder interest of the Debtor in Philsax. The

actions of the Debtor in transferring his shareholder interest in Philsax and the transfer of the assets owned by Philsax and Action Properties constitute "badges of fraud" as identified in C.R.S. 38-8-105, and support the Trustee's assertion that these transfers constituted fraudulent conveyances avoidable under C.R.S. 38-8-101 *et seq*. by the Trustee. Such badges of fraud include the following: (1) Transfers to insiders: The Debtor transferred his majority shareholder interest in Philsax to Margaret, Troy and Ramona without consideration. These individuals are all related to the Debtor. Philsax transferred its real property assets to the VFW (of which, the Debtor was a member and had previously been Post Commander) and Margaret without consideration; (2) the Debtor retained possession and control over the real and personal property transferred; (3) before such transfers, the Debtor had been sued by the Saxtons; (4) the transfers resulted in a transfer of literally all the assets of Philsax; (5) the assets of Philsax were transferred for no consideration; (6) the transfers rendered Philsax insolvent; and (7), the transfers occurred when the Debtor had been sued and judgment had been entered in favor of the Saxtons.

D. ARGUMENT

1. Summary of Argument.

The Court should adopt the doctrine of reverse piercing of the corporate veil under the circumstances as presented to it by the U.S. District Court for the District of Colorado ("District Court") because its application would be consistent with the use of standard reverse-piercing of the corporate veil under Colorado law; the doctrine of reverse piercing

would be applied cautiously and in limited circumstances; and, not to apply the doctrine of revere piercing would result in the sanctioning of fraud, wrong, injustice and violation of the public convenience.

2. Argument.

Jurisdictions which have adopted the doctrine of reverse piercing of the corporate veil require that the same factors which must be considered in standard piercing of the corporate veil likewise be considered when the reverse piercing doctrine is applied. Fletcher CYC. Corp., Section 41.7 (Perm.Ed.) 1999, and cases cited therein. In a reverse pierce claim, either a corporate insider or a person with a claim against a corporate insider is attempting to have the insider and the corporate entity treated as a single entity for some purpose. In a standard piercing of the corporate veil, a creditor of a corporation is attempting to have the corporate existence disregarded between an insider of the corporation and the corporate entity to fasten liability on the insider. Gregory S. Crespi, The Reverse Pierce Doctrine: Applying Appropriate Standards, 16 J.Corp.L. 33 (1990). The use of the reverse piercing doctrine requires a showing that the corporate entity sought to be reverse pierced is controlled or used by an insider to evade personal obligation, perpetrate fraud or crime, commit an injustice, or gain an unfair advantage. To apply the doctrine requires a consideration of the impact of reverse piercing on non-culpable shareholders, its impact on innocent, secured or unsecured creditors of the corporation, and the availability of other remedies. C.F. Trust, Inc., et al. v. First Flight Limited Partnership, 266 Va. 3, 580 S.E. 2d 806 (Va. 2003).

In C.F. Trust, Inc., et al. v. First Flight Limited Partnership, the Court recognizes that to ignore the separate existence of the corporate entity and impose personal liability upon shareholders is an extraordinary undertaking to be done only when necessary to promote justice. The Virginia Court is reluctant to permit veil piercing, but when appropriate, concludes that there is no logical basis upon which to distinguish between traditional veil piercing and reverse piercing action. In both cases, a claimant requests that the court disregard the normal protections accorded a corporate structure to prevent abuse of such structure. Id., page 810.

Reverse piercing of the corporate veil is further refined and characterized as either "insider" or "outsider" reverse piercing. In "insider" reverse piercing, a corporate insider or someone claiming through such individual is attempting to pierce the corporate veil from within so that the corporate entity and the individual will be considered one and the same. In "outsider" reverse piercing of the corporate veil, a creditor of the insider is attempting to meld the insider and the corporation into one entity. Fletcher CYC. Corp., Section 41.7 (Perm.Ed.) 1999.

Jurisdictions that recognize the reverse piercing doctrine hold that it is not available to an entity that abuses the corporation for his, her or its own benefit. The same is true under the traditional piercing of the corporate veil doctrine. Colorado Finance Co. v. B.F. Bennet Oil Co., 110 Colo. 1, 129 P.2d 299 (Colo. 1942). However, courts do not hold that a shareholder or someone claiming through such shareholder can never use the reverse piercing doctrine under any circumstances. For example, the bankruptcy court in In re

Schuster, 132 B.R. 604 (Bankr.D.Minn. 1991), held that the insider reverse piercing doctrine is appropriate to support a bankruptcy trustee's invocation of the remedy to benefit the creditors of an individual debtor who was the shareholder of a closely held corporation.

The ultimate questions in utilizing reverse piercing are: does the use of the reverse piercing doctrine further equitable concerns or establish an "equitable justification" for its use, such as to prevent, fraud, illegality, injustice or contravention of public policy. Is the public convenience is being served by the utilization of the doctrine, such as where the state has an interest in assuring that a state judgment creditor is not prevented by the wrongful acts of his debtor from satisfying his judgment. Sweeney, Cohn, Stahl & Vaccaro v. Kane, 6 A.D. 3d 72, 773 N.Y.S. 2d 420 (2004).

Reverse piercing of the corporate veil is characterized by some courts as a variation of the classic standard piercing of the corporate veil doctrine because the end result under both traditional and reverse piercing is the same: two separate entities are merged into one for liability purposes. The acts of one become the acts of the other. If it is shown that the individual shareholder and the corporation are alter egos, the court will reverse pierce the corporate veil to treat the individual and the corporation as one and the same. Zahra Spiritual Trust v. United States, 910 F.2d 240, 244 (5th Cir. 1990).

Reported Colorado decisions have long recognized the doctrine of alter ego and piercing of the corporate veil or, disregarding the corporate entity, as a method to fasten liability on either a shareholder or director of a corporation if equity so requires. Micciche v. Billings, 727 P.2d 367 (Colo. 1986) (shareholder); La Fond v. Basham, 683 P.2d 367

(Colo.App. 1984) (director). The alter ego doctrine provides the means by which the corporate veil is pierced to hold shareholders and/or directors liable for the obligations of the corporation. E.B. Roberts Const. Co. v. Concrete Contractors, Inc., 704 P.2d 859 (Colo. 1985). Where it is determined that the alter ego doctrine is applicable, Colorado courts will disregard the separateness of the corporate entity (pierce the corporate veil) and consider the actions ostensibly taken by the corporation to be actions of the shareholder. Gorsich v. Double B Trading Co., Inc., 893 P.2d 1357, rehearing denied, and certiorari denied.

To establish the alter ego doctrine, Colorado Courts require a showing that the shareholder or director used the corporate "fiction" as a mere instrumentality for the transaction of their own affairs without regard to the separateness and independent nature of the corporate existence, or for the purpose of defeating or evading important legislative policy, perpetrating a fraud on another, injuring another, defeating the public interest or justifying or protecting a wrong, fraud or crime. Micciche v. Billings, supra; Great Neck Plaza, L.P. v. Le Peep Restaurants, LLC, 37 P.3d 485, certiorari denied; La Fond v. Basham, supra.

Piercing the corporate veil is recognized as an extraordinary remedy which is not appropriate under all circumstances. Sipma v. Massachusetts Cas. Ins. Co., 256 F.3d 1006 (10th Cir. 2001). The corporate veil is pierced reluctantly and cautiously. Cherry Creek Card & Party Shop, Inc. v. Hallmark Marketing Corp., 176 F.Supp.2d 1091 (D.C.D. Colo. 2001). It is necessary to show that the corporation is used to perpetuate a fraud or

to defeat a rightful claim. Jarnagin v. Busby, Inc., 867 P.2d 63 (Colo.App. 1993). The mere informality of the conduct of the corporation's business is not a basis for piercing the corporate veil, rather, there is a need for evidence of fraud or some other wrong being perpetrated. Contractors Heating and Supply Co. v. Scherb, 163 Colo. 584, 432 P.2d 237 (Colo. 1967). Piercing the corporate veil is not justified upon a simple showing that a single individual owns or controls the corporation and does related business in his or her personal capacity. Jarnagin v. Busby, Inc., supra.

Under the circumstances outlined by the District Court, and particularly with respect to the matter before the Bankruptcy Court in this case, the application of the doctrine of reverse piercing is consistent with standard piercing of the corporate veil under Colorado law: the shareholder (Debtor) and the corporation (Philsax) are alter egos; the shareholder has abused the corporate privilege to injure legitimate creditors; the use and control by the shareholder of the corporation to fraudulently transfer its assets directly results in injury to the shareholder's creditors. The shareholder's actions constitute more than merely operating the corporation on an informal basis.

Under the circumstances outlined in the certified question, the imposition of the reverse piercing doctrine does not adversely impact non-culpable shareholders. There are no innocent shareholders. Indeed, the other shareholders of Philsax (Appellees) were part and parcel of the Debtor's scheme to injure the Debtor's legitimate creditors, as well as other non-culpable shareholders (the Saxtons). Further, use of the reverse piercing doctrine does not prejudice third party creditors. There are innocent third party creditors.

In the underlying bankruptcy case, the evidence is clear that the creditors of the corporation (Philsax) are identical to the creditors of the shareholder (the Debtor). Permitting the use of the reverse piercing doctrine under these circumstances is consistent with the use of traditional alter ego reverse piercing in Colorado, particularly since it is being used in a cautious and limited manner.

A claim of reverse piercing would not create a new cause of action. A claim based on the alter ego piercing the corporate veil doctrine is not in itself a claim for substantive relief. Rather, its implementation is to disregard the corporation as a distinct party and as such, its use is procedural. A finding of fact of alter ego, standing alone, creates no cause of action. It furnishes a means for an aggrieved party to reach a secured corporation or individual upon a cause of action that otherwise exists only against the initial corporation or individual. Fletcher CYC Corp., Section 41.10 (Perm.Ed.) 1999. The use of alter ego and reverse piercing is not inconsistent with a creditor's ability to avoid transfers of a shareholder's property nor is it inconsistent with traditional piercing of the corporate veil where it is appropriate to pierce through the corporation to avoid a shareholder's assets which are fraudulently conveyed away. This is particularly true, under the circumstances identified by the District Court, and specifically with respect to the underlying bankruptcy case. Other remedies most likely are not appropriate. For example, a creditor's attachment of a shareholder's (Debtor's) equitable interest in a closely held corporation like Philsax is meaningless. As described by the District Court, and in particular, the circumstances of the bankruptcy case, the Debtor conveyed his equitable interest in Philsax

away to minimize his exposure as a shareholder and additionally transferred assets of Philsax to dilute the value of his remaining equitable interest in Philsax. Application of the doctrine of reverse piercing combined with avoidance of fraudulent conveyances supply a means to rectify the Debtor's actions and avoid injury to innocent creditors.

Even cases such as Floyd v. Internal Revenue Service of the United States, 151 F.3d 1295 (10th Cir. 1998), which is critical of the reverse piercing doctrine, recognize that the problems associated with reverse piercing may be viewed as less serious in cases where the corporation is controlled by a single shareholder, there being no third party shareholders to be unjustly prejudiced by its use, and likewise, in this case, there being no third party creditors. Indeed, in the Crespi article, the author would limit "outsider" reverse piercing to those circumstances of a "closely held firm in which a single insider or small group of insiders acting in concert hold all the economic claims." Id., page 69.

Two early federal court decisions decided, at least in part, under Colorado law utilized the doctrine of reverse piercing of the corporate veil, although not delineated as such. These cases are: Fitzgerald v. The Central Bank and Trust Company, 257 F.2d 18 (10th Cir. 1990); and Shamrock Oil and Gas Co., Appellant v. J.E. Ethridge, et al., Appellees, 159 F.Supp. 693 (D.C.D. Colo. 1958). These cases utilize the alter ego doctrine and "reverse pierce" the corporate veil to avoid what both courts perceived as instances of fraud, injustice or wrong.

In Fitzgerald v. The Central Bank and Trust Company, 257 F.2d 18 (10th Cir. 1958), the 10th Circuit affirmed the use of the alter ego doctrine and reverse piercing of the

corporate veil in circumstances where it found that there was a confused identity between the individual and the corporation, that the corporation maintained incomplete books, that there were financial problems with the individual, that the individual had engaged in wrongdoing involving a check-kiting scheme which resulted in the individual's checking account at Central Bank becoming seriously overdrawn as a result of the check-kiting scheme and that money of the individual was diverted to the corporate bank account, all to the detriment of Central Bank. Fitzgerald at 120.

In Shamrock Oil and Gas Co., Appellant v. J.E. Ethridge, et al., Appellee, 159 F.Supp. 693 (D.C.D. Colo. 1958), the District Court "reverse pierced" to prevent the occurrence of injustice in the context of a replevin action. Citing Colorado, Wyoming and Nebraska law, the District Court held that the non-debtor corporation, characterized by it as a "dummy corporation" and the alter ego of the individual judgment debtor, could not be used as a separate legal entity to defeat the rights of the judgment creditor. The court characterized the non-debtor corporation as a "dummy corporation" because it had no assets other than the asset subject to the replevin, carried on no business, was completely dominated and controlled by the individual debtor and enjoyed no real existence apart from the judgment debtor.

Both the above cited federal decisions recognize the appropriateness of utilizing reverse piercing in proper circumstances as an appropriate equitable remedy.

Not to allow the use of the alter ego/reverse piercing doctrine under the circumstances presented by the District Court results in sanctioning the injury and

wrongdoing done by the shareholder to legitimate creditors. Colorado courts have not permitted this in traditional veil piercing cases. La Fond v. Basham, supra. The doctrine of reverse piercing may have limited applicability, but as the case before this Court demonstrates, without such a remedy, those who use the fiction of the corporation to perpetuate fraud, defeat public convenience, or inflict injury, will be able to get away with it to the detriment of innocent victims.

As requested by the District Court, and given the circumstances described by it for invoking the doctrine, reverse piercing of the corporate veil would be appropriate under Colorado law, and as such, this Court should adopt the doctrine of reverse piercing of the corporate veil, under the limited circumstances as described by the District Court.

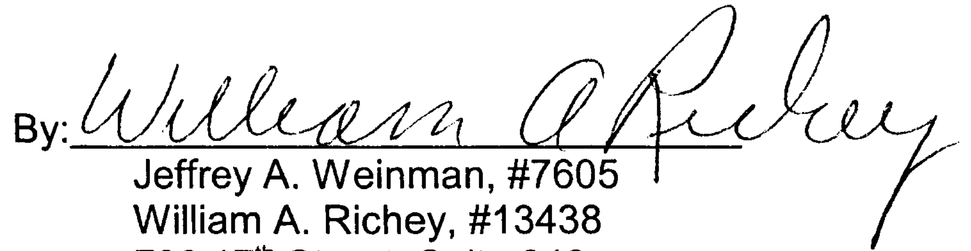
E. CONCLUSION

The Trustee requests that the Supreme Court answer the question certified to it by the United Stated District Court for the District of Colorado in the affirmative to permit "reverse piercing" of the corporate veil under the circumstances outlined by the U.S. District Court in the question it certified to the Colorado Supreme Court.

DATED: December 9, 2005

Respectfully Submitted,

WEINMAN & ASSOCIATES, P.C.

By: 

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CERTIFICATE OF MAILING

I hereby certify that I have mailed on this 9th day of December, 2005, a true and correct copy of the foregoing **OPENING BRIEF** by placing the same in the United States mail, postage prepaid, addressed to:

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