UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

C.G.C. STORES, INC., Case No. 87-516-D J

Debtor. Chapter 11

ORDER ON OBJECTION TO CLAIM

On April 12, 1988 the debtor's objection to Illico Independent Oil Company's proof of claim came on for hearing in Des Moines, Iowa. John M. Titler appeared on behalf of the debtor and Joe H. Harris and John J. Curry appeared on behalf of Illico. The question before the court is whether the debtor is liable for a debt to Illico incurred by Muscatine Oil Company--whether the debtor is merely the alter ego of the other company, justifying piercing the corporate veil. Both parties submitted briefs on May 9, 1988. After carefully considering the parties' arguments, a transcript of the hearing and the numerous documents received into evidence, the court makes the following findings of fact and conclusions of law.

FACTS

1. On June 1, 1987 Illico, previously doing business as Apollo Oil Company, Inc. (for convenience Illico will be referred to as Apollo) filed a proof of claim in the amount

of $199,551.02 plus accruing interest and other charges. Apollo is a wholesale distributor of gasoline. It maintains a terminal known as the Koch Terminal in Bettendorf, Iowa.

2. On June 19, 1978 Harvey L. Haynes and George A. Peters incorporated Muscatine Oil, Inc. (Muscatine). Mr. Eckhardt purchased Mr. Peters' shares on March 14, 1979. Mr. Eckhardt and Mr. Haynes each own a 50% share of the company. Mr. Eckhardt is vice-president and secretary of Muscatine. Mr. Haynes is president. Muscatine presently is undergoing an involuntary Chapter 7 liquidation.

3. In October of 1983 Chuck Eckhardt and Gary Karkosh formed C.G.C. Stores, Inc. (C.G.C.) for the purposes of operating operating a chain of convenience stores. C.G.C. was incorporated on April 23, 1984. Mr. Eckhardt and Mr. Karkosh each own 50% of the company's outstanding shares. Mr. Eckhardt serves as president of C.G.C.

4. Muscatine purchased gasoline from Apollo on a credit basis. Muscatine shipped the gasoline to C.G.C.'s convenience stores for retail sale. During the month of October 1985, Muscatine pulled a number of truckloads of gasoline from the Koch Terminal for delivery at C.G.C.'s stores. As a result of these October shipments, Muscatine surpassed its credit limit and an arrearage of nearly $200,000.00 developed. Apollo eventually obtained a judgment against Muscatine in the United States District Court for Central Illinois for $199,551.02 plus interest, costs

and attorney fees.

5. Beginning in 1980, Muscatine obtained financing from the First National Bank of Muscatine (First National). At times over the course of the lender/borrower relationship, Muscatine's indebtedness to First National exceeded $1,000,000.00.

6. At C.G.C., Mr. Eckhardt directed the gasoline sales. Mr. Karkosh was in charge of the day-to-day operations of the stores. Both were aware of the financial aspects of the company and consulted daily with respect to business decisions. At Muscatine, Mr. Eckhardt made most of the major business decisions as he was in charge of gasoline shipments.

7. C.G.C. and Muscatine kept separate books. Muscatine used in-house and outside accounting services. C.G.C. used primarily an in-house comptroller. Michael Eugene Harkness served as C.G.C.'s first comptroller. He began work in June of 1984 and left on good terms with the company in October of 1986. Mr. Harkness was replaced by Ken Hopper. He stayed with C.G.C. until January 1987 at which time Mr. Eckhardt terminated his employment. Mr. Hopper contends that Mr. Eckhardt fired him for refusing to falsify tax documents. Shortly after the termination, Wilton State Bank, a party to an action whereby C.G.C. was placed into receivership, hired Mr. Hopper to assist in operating C.G.C.'s stores.

8. Mr. Harkness' portrayal of how C.G.C. handles its

finances contrasts sharply with that of Mr. Hopper. According to Mr. Hopper, C.G.C.'s books were in a total state of disarray. He testified that inadequate records prevented him from ascertaining the financial condition of the company. He stated he was unable to determine amounts owed to Muscatine because no reasonable records were kept of charges and shipments. Mr. Hopper also testified that checks drawn on C.G.C.'s account were used to meet Muscatine's payroll and other expenses. Mr. Hopper's most serious assertion was that Mr. Eckhardt directed him "to bottom line" tax documents. As explained of the hearing, "to bottom line" a tax return means to state a tax liability based on a taxpayer's ability to pay and then work backward on the return developing figures that justify the stated liability.

9. According to Mr. Harkness, C.G.C.'s accounting mechanisms were quite orderly. He stated that C.G.C. would pay Muscatine on an invoice basis. To ensure C.G.C. was not overbilled, tank readings were taken every day. Each month Mr. Harkness would reconcile accounts with bank statements. Generally, Mr. Harkness was responsible for writing checks. At some point after Mr. Harkness left C.G.C., the bookkeeping practices deteriorated to the point an accurate financial picture of the company could not be obtained. The evidence shows that assets were inflated and liabilities understated. The evidence also shows that Muscatine had difficulty in providing financial information to its primary

creditor, First National. However, no evidence was presented that shows that Apollo relied on misleading financial statements from either C.G.C. or Muscatine in conducting its business with Muscatine.

10. Neither C.G.C. nor Muscatine adhered to bylaws with respect to holding annual meetings, issuing notices of meetings and maintaining written minutes of meetings.

DISCUSSION

Section 502 of the Bankruptcy Code governs the determination and allowance of claims or interests. Section 502(a) provides that a proof of claim is deemed allowed unless a party in interest objects. If an objection to a claim is made, the court must determine the amount of the claim as of the date the petition was filed and must disallow any portion of the claim that falls within the eight paragraphs of section 502(b).

C.G.C. objects to Apollo's claim on the ground that it is not indebted to Muscatine. The court assumes C.G.C. objects under section 502(b)(1) which disallows a claim if:

> (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

Thus, to the extent that applicable law, including state law, would afford the debtor a defense to a claim of a creditor absent bankruptcy, such defense is available to the trustee (or debtor in possession) in objecting to the claim.

3 Collier on Bankruptcy 502.02 at 502-25 (15th ed. 1986).

Pursuant to section 502(a) and Bankruptcy Rule 3001(f) the filing of a claim itself constitutes prima facie evidence of the validity and amount of the claim. The party objecting to a proof of claim carries the burden of going forward with evidence tending to defeat the claim. Such evidence must be of a probative force equal to that of the allegations in the creditor's proof of claim. 3 Colliers on Bankruptcy 50201 at 502-17 (15th ed. 1986). Once evidence as to the invalidity of the claim, the excessiveness of its amount or any affirmative defense going to the allowability of the claim has been presented, the burden rests upon the claimant to introduce evidence in rebuttal--it is the claimant's burden of ultimate persuasion. Id. at 502-18.

Apollo claims that Muscatine's debt to it is attributable to C.G.C. because Muscatine is merely the alter ego of C.G.C. Apollo asks the court to pierce the corporate veil and to hold C.G.C. liable for the debt. The court finds that the debtor satisfied its burden of going forward with evidence tending to defeat Apollo's claim by showing that C.G.C. and Muscatine are separate entities. Therefore, the court will focus on the evidence Apollo has presented in rebuttal.

In considering Apollo's theory, the court first notes that a corporation is a separate and distinct entity from the identity of its shareholders. Bankers Life & Casualty

Co. v. Kirtley, 338 F.2d 1006, 1013 (8th Cir. 1964); Northwestern Nat. Bank of Sioux City v. Metro Ctr., 303 N.W.2d 395, 398 (Iowa 1981). A corporate veil may be pierced only under exceptional circumstances. C. Mac Chambers Co. v. Iowa Tae Kwon Do Academy, 412 N.W. 593, 597 (Iowa 1987). Piercing the corporate veil is justified where the corporation serves no legitimate business purpose and is a mere shell or an alter ego of its controlling owner. Adam v. Mt. Pleasant Bank & Trust Co., 355 N.W.2d 868, 872 (Iowa 1984). Determining whether a corporate identity should be disregarded includes consideration of the following factors:

1. Is the corporation undercapitalized?

2. Does the corporation lack separate books?

3. Are corporate finances kept separate from individual finances, or are individual obligations paid by the corporation?

4. Are corporate formalities not followed?

5. Is the corporation used to promote fraud or illegality?

6. Is the corporation a mere sham?

Briggs Transportation Co. v. Starr Sales Co., 262 N.W.2d 805, 810 (Iowa 1978). Generally, a combination of these factors must exist before a court will pierce a corporate veil. Dewitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 687 (6th Cir. 1976). Corporations may be considered alter egos of one another in the same way that a corporation can be considered the alter ego of its shareholders. I. W. Fletcher Cyclopedia of the Law of Private

Corporations, ch. 2, section 41.10 (perm. ed.).

Application of these principles to the facts of this case leads the court to conclude that piercing the corporate veil is not warranted. First, Apollo adduced insufficient evidence to show that Muscatine was undercapitalized to the point the corporate shield should be disregarded. Although Muscatine eventually became insolvent and was forced into bankruptcy, insolvency alone does not prove a company is undercapitalized. Norris Chemical Company v. Ingram, 679 P.2d 567, 571 (Az. App. 1984). Muscatine's corporate existence spans ten years. The evidence suggests that for most of those years it conducted an oil transport business and met its obligations. The record shows that it was not until October of 1985--more than seven years after Muscatine was incorporated--that the company began experiencing serious financial problems. The adequacy of capital is to be measured at the time the corporation is formed. J-R Grain Co. v. FAC, Inc., 627 F.2d 129, 135 (8th Cir. 1980) (citing Hamilton, The Corporate Entity, 49 Tex. L. Rev. 979, 985-86 (1971)). Further, a corporation that is adequately capitalized when formed is not undercapitalized when it suffers later losses. Id. A clear standard for determining whether a corporation is undercapitalized is set out in I. W. Fletcher Cyclopedia of the Law of Private Corporations, ch. 2, section 44.1 (perm. ed.):

> It is coming to be recognized as the
> policy of the law that stockholders

> should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of this loss, this is ground for denying the separate entity privilege.

See also In re Mobile Steel Co., 563 F.2d 692, 703 (5th Cir. 1977) ("Capitalization is inadequate if, in the opinion of a skilled financial analyst, it would definitely be insufficient to support a business of the size and nature of the bankrupt in light of the circumstances existing at the time the bankrupt was capitalized."). Here, Apollo presented no evidence whatsoever that Muscatine's level of capitalization at its inception was inadequate in light of its prospective liabilities.

Secondly, Apollo failed to establish that C.G.C. and Muscatine lacked separate books. The record clearly shows that C.G.C. and Muscatine kept separate books. In addition, the companies had separate accountants.

Thirdly, Apollo failed to carry its burden with regard to proving that C.G.C. and Muscatine intermingled funds. Apollo bases its allegation on Mr. Hopper's testimony that Mr. Eckhardt stated to him that certain payments made by C.G.C. to Muscatine were used to pay Muscatine's salary and operating expenses. As a general matter, the court finds Mr. Hopper's testimony tainted by the fact that Mr. Eckardt terminated Mr. Hopper's employment. Moreover, Apollo failed to adduce any satisfactory evidence to corroborate Mr. Hopper's testimony. Admittedly, the evidence shows that C.G.C. paid Muscatine on an occasional and irregular basis, that is, not pursuant to invoice terms. However, Apollo failed to establish that the payments were made for purposes other than fuel deliveries to C.G.C.

With respect to the fourth inquiry, Apollo did present evidence which clearly shows that C.G.C. and Muscatine failed to adhere to corporate formalities. However, informality in conducting corporate business, standing alone, does not justify piercing the corporate veil. See Hellenic Lines Limited v. Winkler, 249 F.Supp. 771, 773 (S.D. N.Y. 1966) (minimum attention paid to corporate formalities in small close corporation context not considered an important factor in deciding whether to pierce corporate veil); Note, Shareholder Liability - Lakota Girl Scout Council, Inc. v. Havey Fund Raising Management, Inc. - A Single Factor Test?, 3 J.Corp.Law 219, 229 (1977) (many corporate formalities inappropriate in close corporations). Both companies were run by their two stockholders who worked closely together and had general knowledge of the respective businesses. Corporate formalities in this context serve no useful purpose. Moreover, Apollo failed to show how it was harmed by the failure of C.G.C. and Muscatine to abide by their bylaws. Accordingly, the court refrains from piercing the corporate identity on this ground.

Fifthly, the court finds that C.G.C. and Muscatine were not used to promote fraud or illegality. Apollo contends that Mr. Eckhardt,.Muscatine and C.G.C. engaged in a number of wrongful or fraudulent acts. Apollo asserts an unknown agent of C.G.C. forged Mr. Hopper's signature on a tax document. Apollo maintains Mr. Eckhardt asked Mr. Hopper to "bottom line" tax returns. It next alleges that Mr. Eckhardt misled First National, a creditor of Muscatine, with respect to a letter of credit in favor of Mobil Oil. Apollo asserts that Muscatine and C.G.C. maintained inadequate financial records which were used to mislead creditors, especially First National. Apollo also asserts that C.G.C. failed to keep track of Mr. Eckhardt's withdrawals for lease payments on a Porche. Finally, Apollo argues that C.G.C.'s acquisition of Apollo's fuel was the result of an intentional scheme to obtain such fuel without paying for it.

With the exception of the last assertion, none of the allegations of fraudulent acts involve Apollo. The claimant has not established any link between it and the purported forgery and request to "bottom line" tax documents. Any fraud actions based on these allegations lie within the province of the IRS. Likewise, the allegations concerning misleading financial statements are better suited to an action brought by First National. Apollo fails to show how it was damaged by financial information given to the bank. Also, the court fails to see the relevance of the lease payments made by C.G.C. on the Porche to the issue at hand. Lastly, Apollo has failed to show that C.G.C.'s acquisition of Apollo oil resulted from a fraudulent scheme.

With respect to the final criterion, the court concludes that C.G.C. and Muscatine are not mere shams. Both were created with the intent of conducting legitimate businesses. Although many of the companies' business practices were imprudent (sloppy bookkeeping), none of those practices rose to the level of actionable conduct. Furthermore, the companies are not shams simply because Mr. Eckhardt serves as a shareholder and an officer of both companies. The mere identity of ownership is not alone sufficient to pierce the corporate veil. Team Cent., Inc. v. Teamco, Inc., 271 N.W.2d 914, 923 (Iowa 1978). In short, nothing in this case leads the court to conclude that piercing the corporate veil is warranted.

CONCLUSION AND ORDER

WHEREFORE, based upon the foregoing discussion, disregarding the corporate identities of C.G.C. and Apollo is not warranted.

THEREFORE, C.G.C.'s objection to Apollo's proof of claim is sustained.

Signed and dated this 30th day of August, 1988.

LEE M. JACKWIG

CHIEF, U.S. BANKRUPTCY JUDGE