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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In re

XF ENTERPRISES, LLC,
Debtor.

Case No. LA 01-40982 TD

Chapter 7

MEMORANDUM OF DECISION

Trial: March 22-23, 2004

Time: 9:30 a.m.

Place: Courtroom 1345

On March 22-23, 2004, the court tried Debtor XF Enterprises, LLC's (XFE), objections to 32 creditors' (CREDITORS) claims. Notwithstanding XFE's objection to 32 CREDITORS' claims, only two questions were presented for decision by the Joint Pre-Trial Stipulation and Order entered herein on February 13, 2004 (Joint Pre-Trial Order), as follows:

(a) Whether XFE, dba [doing business as] "Machete," and dba "Digital Millennium Productions" (XFE), is the alter ego and affiliate of an entity called "Machete, Inc.," later known as "Machete Red, Inc.," and still later known as "Threat, Inc." (MACHETE);¹

(b) If so, what are the amounts owed to CREDITORS Eugene Gilbert (GILBERT) and Culley Bunker (BUNKER).

A Supplemental Pre-Trial and Trial Setting Order was entered on February 13, 2004. The following attorneys appeared: M. Hope Aguilar and James M. Keir for 29

¹ Similar to the Joint Pre-Trial Order, where I use the name "MACHETE" in capitals, it refers to the corporate entities indicated above; where I use the name "Machete," I am referring to the acknowledged dba of XFE.

1 creditors; Lana Borsook for creditors Broadway Industries, Inc, The Foundry, and
2 Gregory Scribner; and Keith Rutman for XFE. Evidentiary objections were filed and
3 rulings were announced. Only one witness, GILBERT, was cross-examined, and his
4 written declarations and supporting documentary exhibits were admitted in evidence.
5 Numerous written declarations of the remaining 32 CREDITORS and others were
6 admitted in evidence after waivers of the right to cross-examination, along with a number
7 of documentary exhibits and transcripts of other pre-trial testimony. The attorneys
8 briefed and argued the matter.

9 **BACKGROUND**

10 This is an unusual dispute. Before I address the details, a greatly simplified
11 background statement is appropriate. Donald Guess (GUESS), a retired dentist who
12 provides financial services to doctors, is the principal shareholder of two corporations, (a)
13 Xelan, Inc. (XELAN), through which he provides his financial services and is
14 compensated for them, and (b) XFE, which he established, funded, and managed,
15 apparently to provide for his children's education and other personal and family needs.
16 In 2000, GUESS decided to assist his son Griffin (GRIFFIN), then 20 years of age, to get
17 started in the video post-production business. To do this, GUESS provided GRIFFIN,
18 largely through XFE (but sometimes XELAN) with hundreds of thousands of dollars in
19 funds and personal guarantees to enable GRIFFIN to acquire the necessary equipment,
20 employees, leased facilities, and organizational structure for the enterprise. GUESS also
21 furnished the advice and the help of professionals employed by XFE and/or XELAN for
22 purposes of documenting and operating GRIFFIN's video post-production enterprise.
23 Funds were promised or provided by XFE to pay many expenses of GRIFFIN's
24 enterprise, payroll, operating, and otherwise. However, by mid-2001, Guess lost
25 confidence in GRIFFIN and the enterprise and decided to terminate his financial support
26 for the enterprise. CREDITORS, unpaid vendors and employees of the enterprise, filed
27 claims in the XFE bankruptcy, asserting that XFE should be held liable based on an alter
28 ego theory. XFE's chapter 7 trustee herein previously assigned to XFE the right to

1 challenge CREDITORS' proofs of claim, with my approval, and this trial ensued.

2 **AS SET FORTH IN THE JOINT PRE-TRIAL ORDER, THE**
3 **FOLLOWING FACTS WERE UNDISPUTED AND REQUIRED NO PROOF:**

4 1. XFE² is a Washington limited liability company, 99 percent owned by GUESS,
5 1 percent nominally owned by Graham Guess.

6 2. XFE was not qualified to do business in California when the events below
7 occurred.

8 3. XFE's primary sources of revenue were GUESS' royalties and sales
9 commissions from XELAN and Pyramidal Funding (a XELAN affiliate), earned by
10 GUESS. An additional source of revenue was proceeds from the video post-production
11 business of XFE and MACHETE that forms the basis of this dispute.

12 4. XELAN is a financial services company owned by GUESS.

13 5. Xelan Law Firm provided legal services to XFE, GUESS and MACHETE,
14 through one of its partners, SUVERKRUBBE.

15 6. 401 West A Street, San Diego, CA 92101 is the common address of XFE,
16 XELAN, GUESS (Suite 2210), Xelan Law Firm (Suite 2250),³ and First National Bank of
17 San Diego. Financial Services for MACHETE were handled in San Diego; but none of
18 the video post-production facilities of MACHETE were there.

19 7. On March 2, 2000, GRIFFIN filed a Fictitious Business Name Statement in Los
20 Angeles County for "Griffin Guess, dba Digital Millennium Productions."

21 8. On April 27, 2000, XFE, as "XF[E] dba Digital Millennium Productions," leased
22 space at 23430 Hawthorne Blvd., Suite 120, Torrance, CA 90505 (the Torrance Lease).
23 Utilizing the equipment bought and paid for by XFE, dba "Digital Millennium Productions,"
24 GRIFFIN moved in, hired employees and began his video post-production company.

25 9. GUESS and HIXSON personally guaranteed the Torrance Lease.

26 10. On July 20, 2000, XFE filed a Fictitious Business Name Statement in San
27

28 ² The designation XFE has been substituted throughout to refer to the Debtor herein.

³ From October 2000 to December 31, 2000 Xelan Law Firm was located in Suite 2210 before moving to Suite 2250.

1 Diego County as "XF Enterprises, dba Digital Millennium Productions." It was signed by
2 HIXSON.

3 11. In about July 2000, GRIFFIN changed the name of the company from "Digital
4 Millennium Productions" to "Machete" with GUESS's knowledge and consent, and began
5 using the name "Machete" in its business. XFE paid for "Machete's" trade advertising.

6 12. On August 22, 2000, "Machete, a sole proprietorship of GRIFFIN GUESS,"
7 entered into a lease with 7th Street Associates for space at 1237 7th Street, Santa
8 Monica, CA (the 7th Street Lease).

9 13. XELAN guaranteed the 7th Street Lease, and GUESS signed for XELAN.
10 Pursuant to this guaranty, XELAN's bank, First National Bank of San Diego, issued a
11 \$250,000 Irrevocable Standby Letter of Credit in favor of the lessor on August 31, 2000.

12 14. In late August 2000, XFE's outside counsel prepared employment contracts
13 for XFE's employees.

14 15. On October 18, 2000, a new entity - - "MACHETE" was incorporated and its
15 Articles of Incorporation named GUESS as agent for service of process.

16 16. The Minutes of Organizational Meeting of MACHETE said GUESS became
17 sole Director of MACHETE.

18 17. MACHETE never issued any stock.

19 18. There was no meeting of shareholders or directors of MACHETE. There are
20 no minutes or other corporate records other than name change amendments.

21 19. Two weeks after MACHETE was incorporated, XFE filed a Fictitious
22 Business Name Statement in San Diego County as "XF Enterprises, dba Machete"
23 signed by HIXSON.

24 20. After MACHETE's October 2000 incorporation, XFE, and sometimes
25 XELAN, continued to directly pay the 7th Street and Torrance Leases, [and] some
26 MACHETE bills, including equipment and furniture purchase and rental agreements,
27 telephone and utility bills.

28 21. XELAN paid some Kinko's copying charges for MACHETE, and some credit

1 card charges by GRIFFIN, GUESS and HIXSON, for MACHETE on their corporate credit
2 cards.

3 22. In about January 2001, XFE (dba Machete) mailed IRS Forms W-2 to its
4 employees for 2000.

5 23. On January 11, 2002, GUESS, as CEO and Treasurer of MACHETE, signed
6 IRS Form SS-4 (Application for Employer Identification Number), and received No. 95-
7 4829029 for MACHETE.

8 24. On about February 7, 2001, MACHETE leased space at 725 Arizona
9 Avenue, Suite 206, Santa Monica, CA (the "Arizona Avenue Lease").

10 25. GUESS and GRIFFIN signed a guaranty of the Arizona Avenue Lease.

11 26. On February 7, 2001, SUVERKRUBBE filed an amendment to MACHETE's
12 Articles of Incorporation, renaming it "Machete Red, Inc."

13 27. XFE paid for and assumed liability for MACHETE's equipment and other
14 physical assets, but XFE asserts it did not assume liability for services rendered to
15 MACHETE.

16 28. On February 21 and 24, 2001, MACHETE/GRIFFIN bought \$13,627.80 of
17 furniture for MACHETE; on March 13, 19 and 28, 2001 they bought \$11,200 of furniture
18 for MACHETE. XFE paid the sellers directly for these MACHETE invoices.

19 29. HIXSON paid the Arizona Avenue Lease rent out of MACHETE's account at
20 First National Bank of San Diego from funds transferred to the account by XFE.

21 30. On March 12, 2001, "Machete, a division of XF Enterprises (Debtor),"
22 contracted for MACHETE to do a project for a major advertising agency. The
23 CREDITORS worked on this contract.

24 31. On April 3, 2001, the XELAN Law Firm drafted an employment contract for
25 CREDITOR BUNKER.

26 32. On May 14, 2001, SUVERKRUBBE filed an amendment to MACHETE's
27 Articles of Incorporation, renaming it "Threat, Inc." This occurred six weeks before
28 MACHETE closed.

1 33. On June 29, 2001, GRIFFIN told MACHETE's (then called Threat, Inc.'s)
2 employees to take two weeks leave starting the July 4th week.

3 34. On July 2, 2001, XFE's counsel David Jacquot ("JACQUOT") discussed
4 selling the entire business of MACHETE to Liberty Media, then owned by Larry Chernoff.

5 35. On July 3, 2001, JACQUOT sent Chernoff a fax offering to sell MACHETE
6 on behalf of XFE. CREDITORS' claims were listed as MACHETE debts, and all
7 MACHETE's assets [were listed] as XFE's.⁴

8 36. A list of "accounts payable-Threat/XF Enterprises" dated 7/3/01, was
9 attached to XFE's offer to sell MACHETE to Liberty Media. XFE listed the "Tinder
10 License"⁵ as an account payable owed by XFE to CREDITOR The Foundry, and the
11 Discreet "plug-in" owed to CREDITOR Ultimatte; and [XFE] listed the assets as its own in
12 the attached balance sheet. Consulting fees owed to Weird Science (an undisputed
13 CREDITOR) for use of the TASCAM88, however, were listed as an account payable
14 owed by MACHETE.

15 37. On July 5, 2001, when some employees went to MACHETE on their "off
16 time," [the employees found that] the doors were locked, the locks were changed, and
17 MACHETE was obviously closed.

18 38. On July 10, 2001, GUESS signed California Secretary of State Form LLC-5
19 "Limited Liability Company Application For Registration" to authorize XFE to do business
20 in California as a foreign LLC."

21 39. On or after July 27, 2001, the California Secretary of State advised XFE:
22 "The Secretary of State regrets to inform you that the proposed Application for
23 Registration (LLC-5) for the foreign limited liability company named above is not
24 acceptable for filing...."

25 40. In July 2001 bankruptcy attorney Jeremy Faith was hired to file a MACHETE
26 bankruptcy petition (the "MACHETE Petition").

27 _____
28 ⁴ GRIFFIN later went to work for Liberty Media.

⁵ "Tinder" is a software plug-in to the Discreet computer editing system.

1 41. CREDITORS assert that the first time any of them heard of the existence of
2 a separate corporation was when they saw the MACHETE Petition. XFE failed to
3 produce any evidence that it notified CREDITORS of the change in ownership from XFE
4 to GRIFFIN.

5 42. Since July 2001 when MACHETE closed, XFE has not paid its undisputed
6 debts, nor has MACHETE paid its debts [to CREDITORS] (disputed or not).

7 43. MACHETE's video business was never [located] in San Diego. At all times,
8 MACHETE was first [located] in Torrance, CA, then Santa Monica, CA; but financial
9 management was always [located] in San Diego.

10 44. There is no UCC-1 Financing Statement signed by MACHETE, whether
11 under the names Digital Millennium Productions, Machete, Machete, Inc., Machete Red,
12 Inc., or Threat, Inc., in favor of XFE [on file] with the California Secretary of State.

13 45. XFE put money in MACHETE's bank accounts without getting promissory
14 notes.

15 46. XFE does not dispute the claims of CREDITORS Discreet, Mason
16 Engineering, MCSI, Weird Science and South Bay Broadcast.

17 47. XFE did not qualify to do business in California until September 2001.

18 **AS SPECIFIED IN THE JOINT PRE-TRIAL ORDER,**
19 **THE FOLLOWING ISSUES OF FACT WERE TRIED:**

20 48. Whether XFE, at the direction of GUESS and by using XFE's employees,
21 commingled funds and other assets, failed to segregate funds and liabilities between
22 MACHETE and XFE, or authorized diversion of corporate funds or assets to XFE.

23 49. Whether XFE treated MACHETE's assets as its own.

24 50. Whether MACHETE failed to issue shares.

25 51. Whether XFE, through GUESS, held itself out as the financial backer of
26 MACHETE responsible for MACHETE's debts.

27 52. Whether XFE and MACHETE failed to keep or maintain corporate books,
28 records and minutes and whether they created confusing records between the two

1 entities.

2 53. Whether equitable ownership, domination and control of MACHETE was the
3 same as that of XFE.

4 54. Whether XFE and MACHETE maintained the same office, business
5 address, phone numbers, employees and attorneys.

6 55. Whether XFE failed to adequately capitalize MACHETE, or whether
7 MACHETE was undercapitalized or had a total lack of assets.

8 56. Whether XFE used MACHETE as a shell, instrumentality or conduit for the
9 continuation of XFE's business.

10 57. Whether XFE, its management and staff concealed and misrepresented the
11 true identity of the responsible party who held ownership, management and financial
12 control of MACHETE, or concealed its own business activities.

13 58. Whether XFE failed to maintain an arm's length relationship with MACHETE.

14 59. Whether XFE used MACHETE to procure labor, services or goods.

15 60. Whether XFE diverted assets from MACHETE to the detriment of
16 CREDITORS; manipulated the assets and liabilities between the two entities; put assets
17 in one entity and liabilities in the other; and created an illusion of MACHETE's solvency
18 that confused the public in general, and CREDITORS in particular, as to who truly owned
19 and controlled MACHETE.

20 61. Whether XFE contracted with CREDITORS with the intent to avoid
21 performance by using MACHETE as a shield against liability and used MACHETE as a
22 subterfuge.

23 62. Whether XFE formed and used MACHETE in order to shift its liabilities to
24 MACHETE.

25 63. How much money does XFE owe to GILBERT and BUNKER?

26 **THE FOLLOWING ARE MY FINDINGS OF FACT:**

27 64. XFE is a limited liability company formed in Washington State on September
28 29, 1999. XFE became authorized to do business in California on September 26, 2001.

1 65. GRIFFIN is GUESS's son.

2 66. In March 2000, GRIFFIN began operating a video post-production studio
3 under the name of "Digital Millennium Productions," in Torrance, California, with funding
4 from GUESS through XFE and XELAN, an affiliated corporation primarily owned by
5 GUESS.

6 67. Some CREDITORS began dealing with "Digital Millennium Productions" in
7 April 2000. It was unclear to CREDITORS whether they were dealing with XFE, dba
8 Digital Millennium Productions, or with GRIFFIN, dba Digital Millennium Productions.
9 The CREDITORS employed at that time continued to do business with the enterprise,
10 without distinction between XFE or GRIFFIN, when the name changed to "Machete."

11 68. Machete, Inc. (MACHETE) was incorporated in the state of California on
12 October 18, 2000 (corporate No. 2265739). Ownership of MACHETE was disputed by
13 the parties. The articles of incorporation of MACHETE designated GUESS as its only
14 agent for service of process.

15 69. In November 2000, XFE filed a fictitious business name statement in San
16 Diego County, to do business as "Machete."

17 70. Attorney Michael Suverkubbe (SUVERKRUBBE) was employed as outside
18 counsel by both XFE and MACHETE at the behest of GUESS, the principal shareholder
19 and de facto chief executive officer of XFE.

20 71. Wendy Hixson (HIXSON) acted as financial manager/controller for XFE,
21 MACHETE, and XELAN at the behest of GUESS as chief executive officer and principal
22 shareholder of XFE.

23 72. The MACHETE organizational minutes, dated January 11, 2001, stated that
24 GUESS was the sole director. On January 11, 2001, MACHETE filed an IRS Form SS-4
25 (Application for Employer Identification Number) which designated GUESS as CEO and
26 Treasurer of MACHETE. MACHETE was assigned Federal Tax Identification No.
27 95-4829029.

28 73. GUESS states that he was not aware he was designated agent for service of

1 process, CEO, or Treasurer of MACHETE; he claims these documents were not created
2 with his permission or under his direction. Based on all the circumstances, as
3 established by the evidence, I find that GUESS' denial is not credible but that the
4 evidence establishes that all MACHETE documentation challenged by GUESS was
5 prepared, executed (when signed by anyone), filed, and acted by others upon with
6 GUESS' approval and/or tacit consent.

7 74. MACHETE never held a shareholders' meeting, and has no corporate
8 minutes or other corporate records beyond its organizational minutes and amended
9 articles of incorporation.

10 75. No evidence establishing a transfer of ownership of MACHETE from GUESS
11 to GRIFFIN was introduced at trial. If a change in ownership occurred or was intended,
12 the CREDITORS were not informed of that fact or put on effective notice.

13 76. On February 7, 2001, SUVERKRUBBE filed with the California Secretary of
14 State a Certificate of Amendment to rename "Machete, Inc.," "Machete Red, Inc."
15 GRIFFIN signed the certificate as President and Secretary. There is no evidence to
16 establish that GRIFFIN had proper corporate authority to do so.

17 77. On May 14, 2001, SUVERKRUBBE filed with the California Secretary of
18 State a second Certificate of Amendment to change the name "Machete Red, Inc.," to
19 "Threat, Inc." GRIFFIN signed this certificate, though there was no evidence to establish
20 that GRIFFIN had proper corporate authority to do so.

21 78. GUESS personally guaranteed three lease agreements to accommodate
22 GRIFFIN's video post-production operations. XFE "dba Digital Millennium Productions"
23 was the designated lessee in the Torrance Lease, executed on April 27, 2000. GUESS
24 guaranteed this lease in his personal capacity. MACHETE was designated as the lessee
25 in the second and third leases. The second lease was signed on August 20, 2000 for a
26 location on 7th Street in Santa Monica. GUESS guaranteed this lease as a principal of
27 XELAN. The Arizona Avenue Lease in Santa Monica, was signed on February 7, 2001,
28 and was personally guaranteed by GUESS and by GRIFFIN.

1 79. GUESS directed that MACHETE's books and records be maintained by XFE
2 in San Diego, under his management and control.

3 80. The corporate certificates of amendment referred to above stated: "The
4 corporation has issued no shares." Neither amendment named a new director or stated
5 that GUESS had resigned.

6 81. The common business address of XFE, GUESS, and XELAN is 401 West A
7 Street, Suite 2210, San Diego, CA 92101.

8 82. Beginning not later than January 1, 2001, the bank accounts of both XFE,
9 dba Machete, and MACHETE were managed and administered by HIXSON from XFE's
10 office, under the direction and ultimate management and control of GUESS. GRIFFIN
11 had no control or signing authority with respect to either account. Bookkeeping and bill
12 paying for MACHETE were performed by HIXSON in San Diego. Video post-production
13 operations were conducted either in Torrance or Santa Monica.

14 83. CREDITORS continued to sell equipment and performed services for
15 "Machete." Sometimes CREDITORS were told to invoice "XFE dba Machete;"
16 sometimes they were told to invoice "Machete, Inc." Neither GUESS nor any
17 representative of XFE ever told CREDITORS that the two entities, MACHETE and XFE,
18 were separately owned. Many payments made by MACHETE clients were deposited
19 into San Diego maintained accounts in the names "Machete," "Machete, Inc.," or "XFE
20 dba Machete," but all such accounts were maintained and administered by HIXSON, who
21 reported to, and was primarily accountable to, GUESS.

22 84. XFE paid for equipment primarily, while MACHETE paid primarily operating
23 expenses. XFE paid rent, telephone, and utilities for MACHETE, both before and after
24 any alleged change of ownership. XFE paid some CREDITORS, undisputed creditors,
25 and capital expenditures directly from XFE's bank account. GUESS approved all capital
26 expenditures incurred by MACHETE.

27 85. GUESS, HIXSON, and SUVERKRUBBE made widespread, repeated, and
28 consistent representations to employee CREDITORS that, taken as a whole, lead

1 CREDITORS to believe that GUESS would honor the MACHETE debts.

2 86. XFE put the following funds into MACHETE's checking account after
3 January 1, 2001, to enable MACHETE to pay wages, disputed creditors, and operating
4 expenses: January \$40,000; February \$10,000; March \$60,500; April \$32,500; May
5 \$69,000; June \$40,000.

6 87. MACHETE did not issue promissory notes for money received from XFE.

7 88. GUESS exerted extensive personal management and control over
8 MACHETE. For example, on December 29, 2000, GUESS asked CREDITOR John
9 Roussey (ROUSSEY) to meet with GUESS and Leslie Buck (BUCK) in San Diego to
10 discuss GRIFFIN's enterprise. GUESS told ROUSSEY that GUESS was the "100
11 percent owner of MACHETE." At GUESS' request, ROUSSEY began working for the
12 enterprise on January 5, 2001, and, at GUESS' request met with GUESS, GRIFFIN, and
13 BUCK in San Diego on January 20, 2001. Throughout his employemnt, ROUSSEY was
14 directed by GUESS to report directly to GUESS. GUESS told ROUSSEY that GUESS
15 "completely backed GRIFFIN's endeavor." HIXSON directed ROUSSEY on January 16,
16 2001, that ROUSSEY was to update and forward the MACHETE check register to BUCK
17 "at least twice a week."

18 89. GILBERT was employed by XFE, dba Digital Millennium Productions (later
19 dba Machete), in February of 2000. GILBERT originally was promised a percentage of
20 the revenue of the video post-production business, but he never received any share of
21 revenues. Beginning in January of 2001, GILBERT reasonably expected to receive a
22 salary of \$5,000 a month, but he was not always paid in full. GILBERT was given
23 assurances of XELAN's "full support" by SUVERKRUBBE in May 2001, and he was
24 reassured by GUESS after the May 2001 meeting with SUVERKRUBBE. GILBERT
25 worked for MACHETE based also on GUESS' and GRIFFIN'S assurances that he would
26 be paid a percentage of the video post-production revenues.

27 90. BUNKER began working for XFE, dba Digital Millennium Productions, in the
28 spring of 2000. He was originally offered a salary determined by GUESS of \$1,250 a

1 week plus a percent share of GRIFFIN's 50 percent share of the revenues for the
2 contracts that BUNKER generated. Over time, BUNKER's compensation arrangement
3 changed, first to \$1,575 per week; then in December 2000, to one year agreement with
4 MACHETE at the rate of \$1,500 per week plus 3 percent of gross revenues; then, in
5 March 2001, to \$1,250 per week plus 3 percent of gross revenues. He was told by
6 GUESS that the "debt of the entity [meaning MACHETE] would be paid."
7 SUVERKRUBBE also assured BUNKER at the May 2001 meeting of MACHETE's
8 commitment and that the commitment had the full support of XELAN. BUNKER never
9 received any payment based on revenues, and BUNKER does not seek any
10 compensation based on the revenue sharing arrangement as part of his proof of claim.

11 91. In March 2001, BUNKER received a written employment contract proposal
12 that promised compensation at the rate of \$1,250 weekly, plus 3 percent of the net
13 revenue from contracts he generated. BUNKER signed the contract as proposed.
14 GRIFFIN took the signed proposal from BUNKER and did not give BUNKER a copy.
15 XFE did not produce BUNKER's contract, but an invoice from Xelan Law Firm, produced
16 by XFE, established that the law firm submitted a bill and was paid for preparing
17 BUNKER's employment contract.

18 92. BUNKER remained an employee and was paid under the employment
19 contract until GRIFFIN's enterprise ceased operating and furloughed employees about
20 July 5, 2001.

21 93. Although there was conflicting evidence, I conclude that CREDITORS have
22 proved by a preponderance of the evidence that (a) equitable ownership, dominion, and
23 financial control of MACHETE was at all times in XFE's hands and under the personal
24 management and control of GUESS, though some artistic, sales, or operational control
25 was in the hands of GRIFFIN; (b) that XFE failed to maintain an arms' length relationship
26 with MACHETE; (c) that XFE used MACHETE to obtain labor, services and goods; (d)
27 that XFE, through GUESS, created an illusion of MACHETE's solvency that led
28 CREDITORS to the reasonable expectation of payment from XFE; (e) that XFE used

1 MACHETE as a shield against liability and as a subterfuge in contracting with
2 CREDITORS; and (f) that XFE, through GUESS, held itself out as the financial backer of
3 MACHETE and is responsible for MACHETE's debts to CREDITORS.

4 DISCUSSION

5 **Introduction.** A proof of claim is allowed unless a party in interest objects under
6 11 U.S.C. § 502(a); it constitutes, "prima facie evidence of the validity and amount of the
7 claim" under Bankruptcy Rule 3001(f). See also Fed. R. Bankr. Proc. 3007. If a party
8 objects, then the court must hold a hearing to determine the amount of the claim. 11
9 U.S.C. § 502(b).

10 Here, XFE challenges two claims specifically, but more generally, XFE
11 challenges the claims of all CREDITORS on the grounds that claimants are not proper
12 creditors of XFE, but rather, that they are the creditors of a separate entity, MACHETE.

13 CREDITORS contend that they have filed proper claims against XFE because
14 they assert that MACHETE is the alter ego of XFE and that XFE should be held liable for
15 MACHETE's debts.

16 CREDITORS have the ultimate burden of proving their claims. In re Mulvania,
17 214 B.R. 1, 6 (9th Cir. BAP 1997). Here, they must show sufficient evidence to prove the
18 applicability of the alter ego theory to their claims against XFE.

19 **Alter ego liability.** As a general rule, shareholders and affiliated companies are
20 not personally liable for debts incurred by a separate corporate entity. However, when
21 the corporate structure is abused, a court may choose to disregard the separate
22 corporate entity in order to hold an affiliated corporation or individual liable. This
23 disregard of corporate separateness is called "alter ego liability."

24 Two elements must be present in order to establish liability based on an alter
25 ego theory under California law. Minifie v. Rowley, 187 Cal. 481 (1921). "First, that the
26 corporation is not only influenced and governed by that person, but that there is such a
27 unity of interest and ownership that the individuality, or separateness, of the said person
28 and corporation has ceased; second, that the facts are such that an adherence to the

1 fiction of the separate existence of the corporation would, under the particular
2 circumstances, sanction fraud or promote injustice." Id. at 487.

3 Alter ego is a fact specific and equitable doctrine; there is no "litmus test" to
4 determine whether to pierce a corporate veil. Mid-Century Ins. Co. v. Gardner, 11
5 Cal.Rptr.2d 918, 922 (Cal.App. 3 Dist. 1992). However, many California courts have
6 considered the careful, in depth alter ego analysis presented by the court in Associated
7 Vendors v. Oakland Meat Co., 210 Cal. App.2d 825 (1962), as a tool for weighing the
8 evidence and determining the equities.

9 In Oakland Meat, the trial court had found that the alleged alter ego there was,
10 as it said:

11 "a separate and distinct entity . . . that it was not organized by [the defendants]
12 or used by them to operate . . . other than under their own names; that there was
13 no confusion between the two corporations and their affairs were conducted
14 separately; that there was no commingling of . . . funds; and that [the alleged
15 alter ego] was adequately capitalized in relation to the reasonable requirements
16 of its business and corporate purposes."

17 Oakland Meat, 210 Cal. App. 2d at 836. The appellate court found no error in the trial
18 court's findings and affirmed the trial court's judgment denying alter ego liability. Id. at
19 841- 42.

20 Here, XFE asserts pretty much the same position, that MACHETE and
21 GRIFFIN's business were separately owned and managed, that they were not managed
22 by XFE or GUESS "other than under their own names" and that there was "no confusion"
23 between XFE and MACHETE or GRIFFIN's business. I am not persuaded by XFE's or
24 GUESS' evidence.

25 The court in Oakland Meat also outlined a number of other factors that California
26 courts had long considered when evaluating alter ego claims, beginning with the
27 following:

28 The basic rule stated by our Supreme Court as a guide in the application of this
doctrine is as follows: The two requirements are (1) that there be such unity of
interest and ownership that the separate personalities of the corporation and the
individual no longer exist, and (2) that, if the acts are treated as those of the
corporation alone, an inequitable result will follow. [citations omitted.] . . . The
general rule is thus stated as follows: " 'Before a corporation's acts and

1 obligations can be legally recognized as those of a particular person, and vice
2 versa, it must be made to appear that the corporation is not only influenced and
3 governed by that person, but that there is such a unity of interest and ownership
4 that the individuality, or separateness, of such person and corporation has
5 ceased, and that the facts are such that an adherence to the fiction of the
6 separate existence of the corporation would, under the particular circumstances,
7 sanction a fraud or promote an injustice.' " [citations omitted.]

8 The gist of the cases which have considered the doctrine is that *both* of these
9 requirements must be found to exist before corporate existence will be
10 disregarded; that such determination is primarily one for the trial court and is not
11 a question of law; . . . [W]hile the doctrine does not depend on the presence of
12 actual fraud, it is designed to prevent what would be fraud or injustice, if
13 accomplished. Accordingly, bad faith in one form or another is an underlying
14 consideration and will be found in some form or another in those cases wherein
15 the trial court was justified in disregarding the corporate entity. [citations
16 omitted.]

17 Id. at 837- 38.

18 In the case at bar, these and other factors discussed in Oakland Meat factors
19 weigh heavily in favor of the CREDITORS' claim that MACHETE was the alter ego of
20 XFE. The evidence in favor of CREDITORS as to these factors, as outlined below, is
21 sufficient to hold XFE liable for the debts of MACHETE under the alter ego theory.

22 **MACHETE and XFE disregarded important corporate formalities.** The
23 evidence is essentially uncontroverted that both XFE and MACHETE failed to follow
24 customary corporate formalities with respect to the video post-production enterprise.
25 MACHETE never issued stock, never held a shareholders' meeting, and maintained no
26 corporate minutes or any other corporate records beyond organizational minutes and
27 amended articles of incorporation.

28 Second, if a transfer in ownership of any enterprise, MACHETE or otherwise,
was intended or made from XFE or GUESS to GRIFFIN, it was not properly documented.
GUESS and XFE claim that the ownership of MACHETE changed hands from GUESS to
his son GRIFFIN. The organizational minutes and filings with the IRS show that GUESS
was designated sole director of MACHETE. Later MACHETE documents are signed by
GRIFFIN as president, principal, or sole proprietor, but there are no corporate
documents, shareholders' minutes, or any other corporate records that authorize or
validate any such change in officers, ownership, or management.

1 Third, agents of XFE throughout the history of the video post-production
2 enterprise used the names "Machete," "Machete, Inc.," "Machete, a division of XF
3 Enterprises," "XF Enterprises," and "Xélan, Inc." confusingly, indiscriminately, and without
4 explanation in contracting with suppliers, lessors, and ultimately, CREDITORS.

5 Fourth, the money that XFE either loaned or invested in MACHETE was never
6 documented as a loan, investment, or otherwise despite GUESS' or XFE's claim to the
7 contrary. Instead, XFE and XELAN placed money into MACHETE's account without
8 receiving promissory notes in exchange and regularly used the money to pay MACHETE
9 bills.

10 **GUESS and his agents represented to CREDITORS that he and his**
11 **companies were financially responsible for the debts of MACHETE.** The written
12 declarations of some 29 employee CREDITORS contain numerous examples of
13 representations made by HIXSON and SUVERKRUBBE that the debts of MACHETE
14 would be paid by XFE. Because HIXSON represented that she was the agent of XFE,
15 and SUVERKRUBBE represented that he was counsel for XFE, under the circumstances
16 of this case the employee CREDITORS were justified in their reliance on such
17 representations. Their reliance also was reasonable under all the circumstances of this
18 dispute. Additionally, GUESS directly asserted to several employee CREDITORS on
19 several occasions, including right up to the time the business shut down, that he would
20 pay the debts of MACHETE and that he was behind MACHETE "100%."

21 **GUESS and his agents misrepresented the identity of the responsible**
22 **ownership of MACHETE.** The combination of a disregard for corporate formalities, the
23 confusing chain of events and names, the use of the same name "Machete" by both XFE
24 and MACHETE, and the assurances provided by GUESS and his agents created a
25 situation where employees or third parties could reasonably believe that XFE, which was
26 99 percent owned, and apparently 100 percent managed, by GUESS, was responsible
27 for all debts incurred by MACHETE. The evidence demonstrates that HIXSON and
28 SUVERKRUBBE were directed in their actions by GUESS, and that many important

1 meetings regarding MACHETE occurred and were directed or managed by GUESS,
2 whether from his San Diego office or directly on site at the Torrance or Santa Monica
3 video post-production facilities.

4 HIXSON admitted that whether she disclosed changes in ownership of
5 "MACHETE" depended on whom she was speaking with. Additionally, employee
6 CREDITOR GILBERT stated that GUESS consistently told him that "XFE," "Xélan, Inc.,"
7 and "Machete" were all one entity, not that MACHETE was a separate entity controlled
8 by GRIFFIN.

9 **XFE and MACHETE used the same offices and the same employees for**
10 **financial management and legal counsel.** While it is true that the video post-
11 production operations always were conducted in Torrance or Santa Monica, XFE and
12 MACHETE employed HIXSON who worked in San Diego for all post-production video
13 financial management, except to the extent that GRIFFIN took advantage of GUESS, his
14 father, and XFE by secretly diverting video post-production receipts that came into his
15 possession to private, undisclosed accounts maintained under GRIFFIN's personal
16 control. Specifically, all of the financial management for XFE and MACHETE was
17 handled by HIXSON in the San Diego office of XFE. HIXSON appears to have been
18 employed not only by MACHETE but also by XFE and XELAN during the period of time
19 that she managed the MACHETE finances. Additionally, HIXSON never made clear to
20 the creditors who she was working for when she administered the expenses of
21 MACHETE, according to the consistent and persuasive testimony of the CREDITORS.

22 XFE and MACHETE employed the same counsel. SUVERKRUBBE at times
23 acted as counsel for MACHETE, and other times he acted as counsel for XFE. He often
24 failed to clarify who he was working for when he made representations to CREDITORS
25 or third parties.

26 Many of the employee CREDITORS who worked for MACHETE originally were
27 employees of XFE, dba Digital Millennium Productions, or dba Machete. GUESS claims
28 that XFE terminated these employees and that thereafter they became independent

1 contractors working for MACHETE. If so, XFE failed to adequately document and inform
2 these employees either (a) that they were no longer working for XFE or (b) that thereafter
3 they would be working for MACHETE, a separately incorporated, independent entity.

4 **GUESS and XFE failed to capitalize MACHETE adequately at the time of**
5 **incorporation.** The equitable owner or shareholders of a fledgling corporation must
6 contribute sufficient capital in relation to the business intended to be done; otherwise, the
7 corporation is inadequately capitalized. Automotriz del Golfo de California S.A. de C.V.
8 v. Resnick, 47 Cal.2d 792 (1957). Here, the evidence establishes that there was an
9 almost complete lack of capitalization of MACHETE. Adequate capital was not invested
10 into MACHETE by GUESS or by XFE. Rather, GUESS used XFE and GUESS' other
11 company, Xélan, to pay MACHETE's obligations on a protracted but ad hoc basis.
12 MACHETE never appears to have had enough money in its account to cover even a
13 single month of its obligations without direct funding assistance from GUESS, through
14 XFE, or sometimes XELAN. Numerous faxes to HIXSON show that MACHETE
15 requested wire transfers to cover payroll, office expenses, promotional items, and
16 freelance artists' salaries. Many of the faxes give the impression that the money was
17 needed urgently, and that bills were past due. MACHETE never functioned a single
18 month without payments funded by XFE, or sometimes XELAN.

19 **XFE and MACHETE commingled funds.** XFE and its agents failed to maintain
20 adequate, systematic financial distinctions between XFE and MACHETE. Most of
21 MACHETE's bills were paid directly by XFE, with XFE's checks. There is evidence that
22 MACHETE made some deposits into XFE's account without documenting the reason for
23 the transfer. Additionally, certain computer items were bought under the name
24 "Machete, Inc.," but later offered for sale as items owned by XFE.

25 **MACHETE failed to issue stock.** The parties stipulated that stock was never
26 issued by MACHETE.

27 **Alter ego liability has been established.** The evidence submitted at trial and
28 the pre-trial stipulations of fact prove that XFE, acting through GUESS, HIXSON, and

1 SUVERKRUBBE, exercised domination and control over MACHETE such that the
2 separateness between MACHETE and XFE did not exist. Additionally, if the court were
3 to recognize the corporate separateness of MACHETE and XFE, then XFE's chief
4 representative GUESS, who made careless representations and reckless assurances,
5 would benefit, and innocent parties would be left to bear the burden of that carelessness
6 and recklessness.

7 In the language of Oakland Meat, here there was a "unity of interest and
8 ownership" between MACHETE and GRIFFIN's enterprise, on the one hand, and XFE or
9 GUESS, on the other hand; "the individuality, or separateness, of" MACHETE "has
10 ceased;" and "the facts are such that an adherence to the fiction of separate existence of
11 [MACHETE] would, under the particular circumstances, sanction a fraud or promote
12 injustice;" "bad faith in one form or another is an underlying consideration." Oakland
13 Meat, 210 Cal. App. 2d at 837-38. In pursuing his admirable fatherly concerns for his
14 son's future, GUESS utilized XFE as an investment mechanism which he fervently hoped
15 would become a springboard for GRIFFIN's independence and financial success, but
16 actual independence cannot be found in the evidence. Rather, GUESS, and thus XFE,
17 left CREDITORS high and dry when GRIFFIN's enterprise turned sour. To sanction
18 GUESS' conduct here and absolve XFE of liability to the CREDITORS would lead to an
19 inequitable and unjust result.

20 **Claims of GILBERT and BUNKER.** Having concluded that XFE may be held
21 liable for the debts of MACHETE on the basis that MACHETE was the alter ego of XFE,
22 the claims of GILBERT and BUNKER must be considered.

23 **Eugene Gilbert.** GILBERT did not present sufficient evidence to demonstrate
24 how he calculated that he is owed \$101,179.76. GILBERT must provide a clearer
25 statement to document the dates and amounts for which he was not paid. He also must
26 provide proof of MACHETE's revenue applicable to his employment agreements if he
27 wishes to be allowed recovery of a percentage share of revenues.

28 **Culley Bunker.** BUNKER is not entitled to the "balance due on the contract."

1 He is only entitled to payment for work he actually completed and was not paid for. If
2 BUNKER can prove that he worked for some time without pay, then his claim will be
3 allowed.

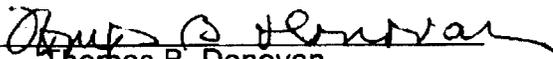
4 Finally, any conclusion of law herein may also be treated as a finding of fact, and
5 vice versa, as appropriate.

6 CONCLUSION

7 The issue of alter ego liability is resolved in favor of all CREDITORS. The claims
8 of CREDITORS GILBERT and BUNKER should be allowed, but this matter will be
9 continued to give the parties an opportunity to present further evidence as to the proper
10 allowable amount of each claim. As far as the remaining 30 CREDITORS are
11 concerned, the XFE objections are overruled insofar as XFE challenges the
12 CREDITORS' alter ego theory of liability. Each of the 32 CREDITORS' claims herein
13 should be allowed, but further pleadings, evidence, hearing, or written stipulations and
14 proposed orders are necessary to enable me to determine the allowed amount of
15 individual CREDITORS' claims.

16 The parties are directed to file such further pleadings, as necessary, or to
17 schedule a further status conference hearing herein as promptly as possible in order that
18 an appropriate scheduling or other order may be entered looking toward the final
19 resolution of the allowed amount of each of the CREDITORS' pending 32 proofs of
20 claim.

21 Dated: May 11, 2004

22
23 
24 Thomas B. Donovan
25 United States Bankruptcy Judge
26
27
28

1 NOTICE OF ENTRY OF JUDGMENT OR ORDER
2 AND CERTIFICATE OF MAILING

3 TO ALL PARTIES IN INTEREST LISTED BELOW:

4 1. You are hereby notified that a judgment or order entitled:

5 MEMORANDUM OF DECISION

6 was entered on MAY 12 2004

7 2. I hereby certify that I mailed a true copy of the order or judgment to the persons and
8 entities listed below on MAY 12 2004

9 Office of the U. S. Trustee
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12 Chapter 7 Trustee
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14 Danning, Gill, Diamond & Kollitz
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21
22 Dated: MAY 12 2004

23 

24 Clerk

25
26