
IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

In re:

NORTHWEST PUBLISHING, INC.,

Debtor.

DUANE H. GILLMAN, Trustee of the estate
of Northwest Publishing, Inc.,

Plaintiff,

vs.

JAMES VAN TREESE, an individual, and
JASON VAN TREESE, an individual,

Defendants.

Bankruptcy Number 96B-22890

Chapter 7

Adversary Proceeding Number

97PB-2036

AMENDED FINDINGS OF FACT AND CONCLUSIONS OF LAW*

Leslie J. Randolph, Esq. and Duane H. Gillman, Esq., McDowell and Gillman, Salt Lake City, Utah,
appeared representing the Trustee.

* Findings of Fact and Conclusions of Law amended as to the spelling of Defendants' names only.

James Van Treese and Jason Van Treese appeared *pro se*.

The Chapter 7 Trustee brings this action against two of the debtor's officers and directors asserting against them the debtor's claims for corporate mismanagement. The Trustee seeks as relief against the debtor's president a determination that the debtor is his alter ego and for an accounting, and as against both of the defendants joint and several judgments of \$10,500,000 representing the amount of the claims filed in the case. During a four day trial, the Court heard the testimony of witnesses and the arguments of the parties, whereupon the matter was taken under advisement. The Court has now carefully considered the evidence, assessed the credibility of the witnesses, reviewed the Trustee's trial brief, and has made an independent analysis of applicable case law. Based thereon, the Court hereby enters Findings of Fact and Conclusions of Law as follows:

UNCONTROVERTED FACTS¹

1. Duane H. Gillman (Trustee) is the chapter 7 trustee of the estate of Northwest Publishing Incorporated (Northwest), having been appointed permanent chapter 7 trustee at the section 341 meeting of creditors on September 16, 1996.
2. Northwest was doing business in Utah as early as 1991 and was incorporated under the laws of the State of Utah on March 19, 1993.
3. Northwest was a closely held corporation.

¹ The Uncontroverted Facts are, in substance, those agreed to by the parties and set forth in the Pre-Trial Order executed by the Court on May 13, 1998.

4. Defendant James Van Treese (Van Treese), is an individual and was a resident of Salt Lake County, State of Utah, at all times relevant herein.
5. Van Treese was the president and treasurer of Northwest and a member of Northwest's board of directors.
6. Defendant Jason Van Treese (Jason), is the son of Van Treese and an individual and was a resident of Salt Lake County, State of Utah, at all times relevant herein.
7. Jason was the secretary of Northwest and was also a member of the board of directors of Northwest.
8. According to documents filed with the State of Utah Department of Commerce, Division of Corporations and Commercial Code, Jason and Van Treese were the only officers and directors of Northwest from 1994 through 1995.
9. Van Treese was a shareholder of Northwest.
10. Northwest filed a petition pursuant to chapter 11 of the Bankruptcy Code (Code) on May 1, 1996.
11. On June 1, 1996, Northwest was involuntarily dissolved due to failure to file an annual report.
12. On July 2, 1996, the Trustee was appointed the chapter 11 trustee of Northwest.
13. On August 2, 1996, an order was entered converting the case to a case under chapter 7 of the Code.

14. On August 8, 1996, the Trustee was appointed interim trustee of the chapter 7 case which appointment became permanent on September 16, 1996, at the Northwest section 341 meeting of creditors.
15. Based upon the proofs of claim filed in the Northwest bankruptcy case, claims exceed the amount of \$10,500,000. The claims bar date was February 3, 1997.

CONTESTED FINDINGS OF FACT

Northwest's Business

16. Northwest was a publishing business engaged primarily in publishing books for aspiring authors, and also contracted as a commercial printer.
17. Northwest allegedly was not a “vanity press,” that is, a publisher that prints books the costs of which are paid entirely by the book’s author.
18. Instead, as a purported subsidy publisher, Northwest entered into joint venture contracts with authors (Author Contracts). In most of the Author Contracts, the authors advanced a portion of the costs of manufacturing their books, usually one-fourth of the projected costs of publication, in exchange for Northwest's preparation, manufacture, and marketing of 10,000 copies of the authors' books. The authors were also to be paid royalties based on the sales of their books. Generally, the royalties paid to authors were 40% of the revenue generated by the sale of the first 2,500 copies, then 15% thereafter.
19. Northwest was obligated under the Author Contracts to publish the authors’ books within a fixed period of time. Initially that period was one year from signing. Later, as Northwest became unable to comply with that schedule, new Author Contracts provided for publication within eighteen months of signing.
20. The amount of money an author was required to advance for the production of a book was based only upon the number of pages in the manuscript. The amount usually ranged between \$5,000 and \$6,000 per book.

21. Northwest accepted all manuscripts submitted to it by prospective authors for publication, except for some poetry and children's books which had an insufficient number of pages to warrant publication.
22. There is no evidence that any manuscript was ever rejected due to poor quality or content. Manuscripts were rejected if a prospective author failed to agree to pay his or her share of the publication costs.
23. Northwest entered into approximately fifty new Author Contracts per month, for a total of between 1,600 and 2,000 Author Contracts.
24. Northwest's salesmen, including Jason, aggressively "sold" Author Contracts to prospective authors. Jason carried out Northwest's policy to air express the documents to prospective authors, so that payment from the authors would arrive at Northwest as soon as possible. The salesmen received commissions on new Author Contracts they obtained.
25. Each of Northwest's salesmen kept a record book which contained the names of authors and prospective authors. The record books were referred to as "dirt books."
26. Each salesman's dirt book was used to track the status of Author Contracts sold, joint venture payments made, to determine sales commissions, and to project Northwest's expected revenue. Dirt books were not used to track authors' royalties.
27. Van Treese, as a director, president, and chief financial officer, controlled Northwest, made all important business decisions and was present at Northwest virtually every day. Van Treese

controlled not only Northwest's operations and accounting, but made the ultimate decisions regarding the manner of Northwest's business practices.

28. Jason, as a director, secretary, and as an employee, had daily access to Northwest's facilities and operations. However, he did not exercise any authority over either the maintenance of the corporate books and records, or over Northwest's finances. Instead, he deferred entirely to his father, Van Treese. No evidence was presented that Jason attempted to alter in any manner Van Treese's control over the procedures Van Treese employed to manage Northwest.
29. Northwest's facility to produce the authors' books consisted of a large warehouse and office space. Northwest had acquisition, marketing, editing, production, shipping, and accounting departments.
30. At the peak of its operation Northwest had seventy-nine employees.
31. Northwest placed large orders for paper from its vendors which it utilized in its printing business.
32. Northwest required an income of approximately \$300,000 per month in 1995 and \$350,000 per month in 1996 in order to keep operating.
33. At the peak of its operation Northwest produced yearly ten thousand or more catalogs listing authors' books for sale which it used in the marketing of authors' books. It also participated in national booksellers conventions.
34. Thousands of copies of books were produced and shipped. However, because Northwest essentially published books for whomever would pay the required fee, the books were not of the

type or quality normally marketed to the general public. The primary purchaser of each title was the book's author.

35. In early 1996, Ingram Book Company, one of the primary retailers through which Northwest marketed the authors' books on consignment, indicated that only one out of every four of the recommendations made by Northwest regarding the number of copies of a book that would sell were accurate. Therefore, Ingram returned the bulk of initial orders of books to Northwest.
36. Hundreds of thousands of copies of newly published and returned authors' books were in Northwest's warehouse when it filed bankruptcy.
37. Many authors complained that their books were not being timely published, or that they were not receiving royalties to which they were entitled.
38. By the beginning of 1995 the number of complaints from authors was increasing. Northwest received between 75 and 100 calls per week from complaining authors. Books were not being published or if published, were not being delivered on time. Royalty checks were not sent to authors, or alternatively, the royalty checks sent to authors were returned having been drawn on insufficient funds.

Northwest's Cash Operation

39. Northwest operated its publishing business to generate cash.
40. Payments from authors, as well as any other receipts that were received by Northwest in check form, were quickly converted to cash.

41. As daily receipts were received by Northwest, all cash, correspondence, and mail was taken directly to Van Treese.
42. Van Treese then caused Jason, or one other trusted employee, to take the daily receipts to Cash Action, a check cashing service, which cashed the checks for a fee.
43. Between October 21, 1992 and July 3, 1996, Van Treese caused \$10,283,778 in checks to be converted into cash at Cash Action as follows:

Date	No. checks	Amount	Ave./ mo.	Fee
10/21/92 to 12/31/92	93	\$ 147,725	\$ 62,240 ²	\$ 6,075
1/5/93 to 12/31/93	911	\$1,863,687	\$155,307	\$ 56,342
1/3/94 to 12/31/94 ³	1,468	\$3,185,499	\$265,458	\$ 85,351
1/3/95 to 12/30/95	1,777	\$4,377,739 ⁴	\$364,811	\$124,148
1/3/96 to 7/3/96 ⁵	338	\$ 709,126	\$214,875 ⁶	\$ 20,287

44. Approximately ninety-nine percent of those checks cashed, or \$10,200,000, were provided by prospective authors as the amount advanced for the publication of their books. Between April 30, 1995 and July 3, 1996, \$3,597,515 in checks were cashed.

² Adjusted to consider only November and December, 1992.

³ Transactions occurred on only six days in April of 1994, rather than on each business day as in other months.

⁴ Between May 1, 1995 and December 30, 1995, \$2,888,389.17 in checks were cashed.

⁵ No transactions took place in March of 1996, only three in May on or after the May 1 date of filing, none in June, and one \$22,500 transaction occurred on July 3, 1996, the day after the Trustee was appointed.

⁶ In January \$441,056 and in February \$144,413 in checks were cashed.

45. Northwest paid Cash Action over \$292,000 in fees between October 21, 1992 and July 3, 1996.
46. Once the receipts were converted into cash, usually in \$100 bills, the cash was delivered to Van Treese in a large zippered bag.
47. Northwest paid many of its obligations, including major vendors and funds paid to its payroll service for employees' wages, in cash. Northwest did not borrow from commercial lenders to operate its business. In many instances, vendors would not extend credit to Northwest as a result of previously bounced checks.
48. No regular record of cash received or disbursed was kept by either Van Treese or Northwest.
49. Beginning in 1994 Northwest started keeping two-part cash receipt books. The receipt books did not represent a complete record of either cash receipts or expenditures. Some of the cash receipt books were lost or misplaced.
50. The cash receipt books that existed were never compiled into a ledger or used for any other accounting purpose.
51. The purpose of the unusual cash accounting method used by Van Treese for Northwest was to centralize total control of Northwest's receipts in Van Treese so that the cash could be used at his discretion without any accounting to governmental entities, creditors, or to Northwest.

Northwest's Accounting System

52. Other financial records of Northwest were also incomplete.
53. The financial records of Northwest contained some original documents, including payable invoices, but they were not marked as to whether they had been paid.

54. Merlene Messner (Messner), who in 1994 became Northwest's employee in charge of accounting, testified that there was no accounts payable file. Messner testified that she began trying to keep a log of bills that she paid or checks she had written in order to answer vendor or other inquires regarding payments and to determine which checks were bouncing, although this was not requested or required by Northwest. Messner's personal log was incomplete as it did not account for all checks being written. It did not contain a record of checks and cash received by and under Van Treese's control, or a complete record of payments Van Treese made in cash or by check.
55. A complete accounting of Northwest's accounts payable as of the date of filing is unavailable due to the incomplete condition of Northwest's records.
56. Northwest had trade accounts receivable from book sales, including books shipped on consignment to large distributors, and commercial printing services. The Trustee has been unable to collect \$392,338 in accounts receivable listed in Northwest's records because the account debtors have provided proof that the debts were already paid, the goods received unsatisfactory, or the account debtors cannot be located.
57. Regular inventory of the books was taken and a computer system was in place to track the books. However, since Northwest was a subsidy publisher, the sales value of most of the published books, other than to the authors, was less than books of the type or quality normally marketed to the public.

58. No accurate record of sales of authors' books was kept from which authors' royalties could be correctly computed. The accounting department at Northwest was unable to determine how much money to send authors in royalties.
59. Many checks to authors drawn on Northwest's royalty account bounced.
60. Van Treese represented to authors that he had retained a "Big Six" accounting firm to help upgrade Northwest's accounting system and to conduct an audit of the royalty reporting records. He had not.
61. Northwest kept personnel files on its employees. Wasatch Staffing often prepared Northwest's payroll unless there were insufficient funds to cover the payroll. In those cases, Northwest prepared the payroll internally and would hold checks for salaried personnel, while issuing payroll checks for hourly employees. Van Treese kept track of all commissions paid to sales employees, including Jason.
62. Employees of Northwest had paychecks regularly bounce. Employees would inform Van Treese who would have them hold the check and then resubmit the check when it would clear, or would exchange the payroll check for cash.
63. Messner testified that she did not issue payroll checks to Van Treese and that she was unaware of any money being paid to him, although evidence indicates he was to receive \$80,000 per year as compensation. She issued payroll checks to Jason as directed by Van Treese.
64. At times, Northwest's payroll would be paid from the account set aside for authors' royalties.

65. Northwest had five bank accounts. Over \$3.2 million was deposited in Northwest's bank accounts between 1992 and 1996. Van Treese decided from which accounts checks would be drawn.
66. Northwest's bank statements for sporadic months were received into evidence. They reflect a myriad of checks returned for insufficient funds. The bank statements also reflect an unexplained pattern of deposits consisting of even amounts in several thousands of dollars, rather than in odd amounts as would be customary if the deposits reflected actual collected accounts receivable.⁷ The bank statements also reflect numerous wire transfers as deposits, but the source of the deposits was not recorded.⁸ From the evidence produced, it is impossible to trace daily transactions at Cash Action to deposits in Northwest's various bank accounts.
67. From August 16, 1993 to January 1, 1994, Judith Burton was president of Northwest and tried, but failed, to implement a new accounting system. Burton installed a "Great Plains" program for shipping and receiving.
68. The Great Plains program and other bookkeeping methods were incompatible between departments. In 1995, Northwest purchased a "Peachtree" accounting program. Prior to obtaining Peachtree, Northwest had no way of tracking accounts receivable and payable. Peachtree was an unreliable program which "crashed" often. The Great Plains program may have been more

⁷ For example, in account number 190-00014-37 in December of 1995, of seven deposits that were not reversals of bounced checks, six deposits totaling \$86,500 were in even amounts. In February of 1995, of eight deposits, seven totaling \$34,000 were in rounded increments of one thousand. In October of 1994, of eighteen deposits, eleven totaling \$141,000 were in rounded increments of one thousand.

⁸ For example, account number 190-00019-99 in March of 1996, reflects \$73,000 in incoming wire transfers from a total of \$140,146.14 in deposits.

accurate and useful if additional segments of the program were obtained. They were not. No integrated accounting program was ever achieved.

69. Messner understood that Van Treese, as chief financial officer, was responsible for preparing financial statements for Northwest. Messner testified that she did not know where Van Treese obtained the numbers for Northwest's financial statements.
70. Contrary to the express representations in footnotes in the July 31, 1994 and the March 31, 1995, financial statements, the financial records of Northwest were not kept according to generally accepted accounting principles. The financial statements were prepared from unknown information sources. Northwest had no statement of cash flow, statement of retained earnings, income records, or balance sheets.
71. Contrary to normal accounting procedures, Northwest treated advances on costs provided by authors as book sale income.

Proposed Public Offering

72. Northwest became interested in making a public offering to raise capital. In order to take Northwest public, Northwest retained an attorney as a consultant. The attorney, Thomas Wood (Wood), later became a director of Northwest, and sometime in early 1995, its President.
73. Wood was never able to determine the initial capitalization of Northwest. Wood found no conventional cash control procedures. Northwest did not employ conventional banking methods. As a result, Wood determined that substantial reforms were necessary in order to enable Northwest to make a public offering.

74. Northwest had never filed federal or state tax returns. In an attempt to organize data from which returns could be prepared and to complete a public offering, in 1994 such original records as were available were sorted into boxes by year. It was hoped regular books and records could be reconstructed. Records for the years 1991 and 1992 were turned over to Northwest's accountant. A compilation of records for 1993 and 1994 was not completed.
75. The accounting firm of Mantyla, McReynolds and Associates indicated that, for \$25,000 to \$30,000, it would prepare statements of income, retained earnings and cash flow for 1994 and 1995. This would not include an audit or review of the accompanying financial statements nor could it be relied upon to reveal irregularities, errors, fraud, or illegal acts that may have existed.
76. The firm of Price Waterhouse was contacted regarding the performance of a certified audit of Northwest. Price Waterhouse opined that Northwest could not be audited.
77. No evidence was presented that tax returns were ever filed for Northwest during the pre-petition period, although returns may have been prepared.
78. Wood was unable to hire a chief financial officer of the caliber needed to address Northwest's extensive accounting problems.
79. Wood could not establish a conventional line of credit for Northwest largely due to the manner in which it handled its cash. Van Treese also opposed establishing a line of credit.
80. Wood believed Northwest needed to reduce the number of new Author Contracts upon which Northwest relied for revenue. Wood referred to the Author Contracts as "time bombs." New

Author Contracts provided immediate cash, but obligated Northwest to produce, market, and sell the authors' books. Northwest was not selling enough books to be profitable. As a result, incoming author money was used to keep the company functioning rather than as funding to meet Northwest's contractual obligations to authors for the publication of their books. The incoming author money was treated as fully earned when it arrived at Northwest.

81. As Wood reduced the number of new Author Contracts from approximately fifty per month to two or three per month, the resulting reduction in cash flow put Northwest into an economic tail spin.
82. The reduced revenue, however, occurred after January of 1996, because up until that time, Northwest was still receiving substantial revenue from Author Contracts.
83. To compensate for the reduction in cash flow, Wood determined that Northwest must increase its revenue from book sales and from capital contributions.
84. Wood's strategy, since a public offering was not ready because of the unauditible condition of Northwest's accounting, was to raise capital for Northwest through a private placement offering of newly issued stock. This private offering would replace income lost as a result of the reduction in incoming Author Contracts.
85. Van Treese raised upwards of \$1,500,000 from sixty-two investors during 1995 and early 1996. It is, however, unclear whether this money was ever paid to Northwest.
86. Some of the stock sold to finance Northwest was allegedly treasury stock. The balance allegedly belonged to JBV Investment (JBV) or Van Treese.

87. The status of JBV was never clearly established. JBV was an entity which Van Treese controlled and to which Jason was connected. Testimony indicated that JBV was an equipment leasing company which leased computers and other equipment to Northwest. At one point, computer equipment being purchased by Northwest was invoiced to “JBV dba Northwest Pub.” When the stock was sold to finance Northwest all the checks were made payable to JBV, not Northwest.
88. Another entity related to Northwest was Doc-Star Corporation (Doc-Star). Doc-Star was an entity created by Van Treese to develop software to be used in publishing and is identified on contracts as a Delaware corporation. Northwest's employees worked on Doc-Star projects. Apparently Van Treese entered into an agreement in August of 1995 with Northwest wherein he was to sign a promissory note for \$300,000 payable to Northwest in settlement for the amount of time and resources of Northwest that were used by Van Treese in the development of this publishing technology. Van Treese then assigned this technology and his obligation under the promissory note to Doc-Star in October of 1995. The assignment is signed by James R. Perkins as president of Doc-Star, but the note obligating Doc-Star to repay Northwest is signed by Van Treese as president of Doc-Star. Doc-Star was also seeking to raise capital to further develop and market its publishing technology.
89. There is insufficient evidence to determine if this transaction constituted an appropriation of a corporate opportunity of Northwest by Van Treese.
90. Wood never gained control of Northwest's cash from Van Treese, which was a key reason why Wood eventually resigned as Northwest's President.

Northwest's Economic Decline

91. Northwest fell further behind on publishing books, paying royalties, and responding to authors' complaints.
92. Some of the money from author checks was deposited to accounts owned by JBV. Some money from author checks was deposited to accounts owned by Van Treese's wife, Lynn Van Treese.
93. Van Treese used Northwest's funds to make personal loans to employees.
94. Jason and Van Treese gambled approximately once a week in Wendover, Nevada or other locations. Sometimes, cash generated from cashing author checks payable to Northwest and cashed at Cash Action, was taken by Van Treese. He and Jason used these funds to gamble.
95. The Utah Attorney General's office received hundreds of complaints from authors regarding Northwest. Many complaints related to Northwest's failure to publish books as agreed, pay royalties, and market books.
96. In April of 1996, a search warrant was obtained and executed by the Attorney General's office. Northwest's records and computers were seized by the Attorney General's office. The seized documents consisted of over 100 boxes of records.
97. The Attorney General's office discovered co-mingling of funds between the Van Treeses' personal accounts, JBV, Doc-Star, and Northwest.⁹

⁹ Van Treese and Jason were indicted by the State of Utah in relation to Northwest. As a result, Van Treese and Jason have refused to testify in this matter, asserting their Fifth Amendment right against self-incrimination. The last information provided this Court indicated Van Treese and Jason were to stand trial on the criminal matters towards the end of 1998. Wood was also indicted in relation to the private stock offering.

98. The Attorney General's office also subpoenaed records from casinos in Las Vegas and Wendover, Nevada. Those records reflect a portion of the "reported winnings"¹⁰ attributable to the Van Treeses as follows:
- a. Peppermill Casino: In 1994, Van Treese had reported winnings of over \$388,000 on slot machines and over \$187,000 on keno. In 1995, Van Treese had reported winnings of over \$93,000, Jason had reported winnings of over \$94,000, and Lynn Van Treese had reported winnings of over \$63,000. In 1996, Van Treese had reported winnings of over \$114,000.
 - b. State Line Casino: In 1995, Van Treese and Jason combined had reported winnings in excess of \$35,000.
 - c. Silver Smith Casino: Between May 1994 and January 1996, Van Treese and Jason had reported winnings in excess of \$122,000.
 - d. Stardust Casino: In 1994 and 1995, Van Treese had reported winnings in excess of \$90,000.
99. Van Treese and Jason stipulated that the total reported winnings of the combined Van Treeses between 1993 and 1996 exceed one million dollars. This figure may not include unreported winnings.

¹⁰ Reported winnings constitute all winnings in excess of \$1,199 per event. If the gambler wins in excess of \$1,199 the casino is required to report that winning to the IRS. If the gambler wins less than \$1,199 in one event the winning is unreported by the casino.

100. The Court has insufficient evidence to determine the amount of money used or lost by the Van Treeses while gambling that belonged to Northwest.

The Trustee's Financial Investigation

101. The records of Northwest were in disarray when they were turned over to the Trustee.

102. The Trustee's investigator (Investigator) is a certified fraud and insolvency expert. The Investigator reviewed the books and records of Northwest.

103. The Investigator rendered the opinion that Northwest was insolvent by a margin of approximately \$7 million on April 30, 1995, one year prior to filing, but in spite of its insolvency continued to incur debt.

104. The Investigator included in his insolvency calculation a liability of \$7,537,405 representing author contract deposits.

105. Northwest's financial records were not kept in accordance with generally accepted accounting principles.

106. Statements of cash flow and retained earnings were not kept. The bank records and account statements of Northwest were incomplete. It was not possible to prepare an accurate profit and loss statement. The partial financial records of Northwest were insufficient to create a general ledger.

107. The Investigator was unable to locate any records reflecting what was owed to authors.

108. The majority of the proofs of claim filed against Northwest in this case are filed by authors based upon Author Contracts and seek a return of their funds advanced and in some cases, additional sums for damages caused by contract default or for unpaid royalties.
109. The Investigator opined that Northwest's books were in such a state of disarray that the company could not be audited.
110. There is no evidence that tax returns were ever filed by Northwest except by the Trustee for post-petition activities.
111. A company of Northwest's size could not be properly operated with books and records which were this incomplete, disorganized, and inaccurate.
112. A reasonable person could not have kept books and records in this manner and expected to have been acting in Northwest's best interest.

Corporate Books and Records

113. Articles of Incorporation were filed with the State of Utah by attorneys for Northwest in March of 1993.
114. The Investigator could not locate a list of Northwest's shareholders, a stock register, or any written communications to shareholders. The Investigator found no records that Northwest was ever capitalized or had any kind of cash reserves.
115. Van Treese and Jason produced the following corporate records, which they apparently located after all Northwest's records had been seized by the State of Utah:
 - a. The Articles of Incorporation dated March 19, 1993;
 - b. By-Laws;

- c. Minutes of the Organizational Meeting of the Board of Directors, Waiver of Notice of the Organizational Meeting, and a Statement of Actions Without Meeting of Shareholders and Directors, all dated April 3, 1993;
- d. Statement of Actions Without Meeting of Shareholders and Directors dated June 1, 1993, and August 16, 1993;
- e. Minutes of the Annual Meeting of Shareholders dated December 31, 1993;
- f. Statement of Actions Without Meeting of Shareholders and Directors dated January 17, 1994 and March 10, 1994;
- g. Two actions by Unanimous Written Consent of the Board of Directors of Northwest dated August 15, 1995, and October 11, 1995 (regarding the new publishing technology which was assigned to Doc-Star);
- h. A Securities and Exchanges Commission Form D (no evidence was submitted regarding whether it was filed);
- i. A Stock Register.

116. Neither Van Treese nor JBV were listed as stockholders on the original statement showing stock ownership or on any stock transfer list, even though their stock was allegedly sold to raise capital.

The only shareholders listed on Northwest's stock register were as follows: James R. Perkins, 200,000 shares; Jason Van Treese, 800,000 shares; Lynne Van Treese, 500,000 shares; and Judith Clark Burton, 90,000 shares. Northwest's stock transfer ledger did not reflect any transfers.

117. Early records show there were some corporate formalities observed. Those formalities, however, decreased later in the company's existence. Eight of the documents mentioned above were prepared in 1993, two documents were prepared in 1994, and two documents showing actions without meetings were prepared in 1995 (both dealing with the assignment of the Doc-Star technology).

118. Of these documents, none reflected any annual corporate meetings being held after 1993. Northwest's By-Laws required annual shareholder meetings and annual meetings of the board of directors.
119. No corporate records reflected Wood's election as president of Northwest, his resignation, or Van Treese's re-election. No corporate records indicate when Jason was elected secretary of Northwest, and it is apparent Jason did not carry out the duties imposed upon him by Northwest's By-Laws.¹¹ No corporate records authorize the issuance of treasury stock or authority to raise capital through a private offering. No shareholder list or stock transfer list indicates the identity of the sixty-two additional shareholders added through the private offering.
120. No dividends were ever paid by Northwest.
121. The evidence indicates that Van Treese made all major business decisions for Northwest. Even though a few early corporate records indicate certain actions taken by Northwest's board of directors, Van Treese controlled Northwest even when Burton and Wood were president.

¹¹ The By-Laws of Northwest state the duties of its secretary:

SECRETARY- the secretary shall attend all meetings of the shareholders, the Board of Directors and the executive committee, if applicable, and shall record, or cause to be recorded, the minutes, or proceedings, of said meetings. The minutes shall be kept as part of the permanent records of the corporation. It shall be the duty of the secretary to give, or cause to be given, all notices of meetings of shareholders or directors as prescribed by these By-Laws. The secretary shall be the custodian of the corporate seal. The secretary shall perform such other duties as may be set forth by the Board of Directors.

By-Laws of Northwest Publishing Incorporated at p. 6.

Mismanagement

122. The Court finds, based upon the totality of the evidence related to Van Treese's management of Northwest while it was insolvent, that Van Treese did not act in good faith or in Northwest's best interests, and did not act as a reasonably prudent officer or director.
123. The Court finds, based upon the totality of the evidence related to Jason's management of Northwest while it was insolvent, that Jason did not act in good faith or in Northwest's best interests, and did not act as a reasonably prudent officer or director.

Adversary Proceeding

124. The Trustee filed this adversary proceeding February 13, 1997.
125. The Trustee's complaint plead three claims for relief against Van Treese and Jason (Defendants). The first claim asserted that the Defendants, as officers and directors of Northwest, failed to direct the business and affairs of Northwest in good faith with the care an ordinarily prudent person in a like position would exercise under similar conditions, and that they failed to keep corporate and accounting records. Therefore, they should be found jointly and severally liable for Northwest's debts in the amount of \$10,500,000.
126. The Trustee's second claim for relief asserted that Northwest was the alter ego of Van Treese and therefore Van Treese should be found liable for Northwest's debts in the amount of \$10,500,000.
127. The Trustee's third claim for relief sought an accounting from Van Treese for the receipts and disbursement of \$10,283,778.91 received by Northwest and used by and at the direction of Van Treese.

128. The Defendants, who appeared *pro se*, claim that this case is based on false, inadequate and incomplete information, and that the claims are not based on fact.
129. An Order Governing Scheduling was entered in this adversary proceeding fixing November 30, 1997, as the discovery completion date.
130. The Defendants served a request for production of documents upon the Trustee in August of 1997.
131. In April of 1998, approximately eight months later, Defendants filed a Motion to Stay Adversary Proceeding, asserting they had been unable to obtain discovery of business records held by the State of Utah and the Trustee.
132. The Trustee responded that he had made all records in his possession available to the Defendants pursuant to the request for production of documents on October 2, 1997, and that Defendants failed to avail themselves of the production of documents.
133. The Motion to Stay Adversary Proceeding was denied.

From the above Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

Jurisdiction

The Trustee asserts in his Complaint that this is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A)(E) and (O), and that this Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b) and 157(a), 11 U.S.C. §§ 541 and 544, and U.C.A. §§ 16-10a-840 and 16-10a-1601. No claim for turnover has been plead by the Trustee: therefore 28 U.S.C. § 157(b)(2)(E)

cannot serve as the basis for core jurisdiction. In spite of the Trustee's assertions, and the Defendants' lack of objection, this Court must determine whether the proceeding is core or non-core. *Styler v. Jean Bob Incorporated (In re Concept Clubs, Inc.)*, 154 B.R. 581, 584 (D. Utah 1993).

The first and second claims for relief are brought based upon the Trustee's ability to assert claims that are property of the estate pursuant to 11 U.S.C. § 541, and the claims are based solely on the statutes of the State of Utah or upon common law claims. Both the first and the second claims for relief asserted by the Trustee allege damages generally to Northwest and all of its creditors, and not particularly to one creditor. Therefore, the claims for relief accrue generally to Northwest and not to any specific creditor. *Clark v. Levine (In re Levine)*, 100 B.R. 537 (Bankr. Colo. 1989) (debtor's trustee may be deemed to own alter-ego claims as property of the estate); *ANR Ltd. Inc. v. Chattin*, 89 B.R. 898, 904 (D. Utah, 1988) (claims for damages from corporate mismanagement are derivative in nature and are enforceable solely by the trustee).

The Trustee argues that a determination that the claims for relief are property of the estate ends the inquiry into whether this proceeding is a core proceeding. That analysis is incorrect. Core proceedings are those that arise under or arise in the case. 28 U.S.C. § 157(b)(1). A proceeding "arises under" the Code if it asserts a cause of action created by the Code. A proceeding "arising in" a bankruptcy case is one that could not exist outside of a bankruptcy case, but is not a proceeding created by the Code. *Personette v. Kennedy (In re Midgard Corp.)*, 204 B.R. 764, 771 (10th Cir. BAP 1997). Since both the first and second claims for relief are pre-petition claims based solely on state law claims, they do not arise under the Code and could exist outside a bankruptcy case. This analysis is consistent with the

majority of current case law holding that pre-petition state law claims owned by the estate are not core matters, regardless of an overly broad interpretation of § 157(b)(2)(A) or (O). *Shea & Gould v. Red Apple Companies, Inc. (In re Shea & Gould)*, 198 B.R. 861, 866 (Bankr. S.D.N.Y. 1996) (state law breach of contract action to recover a pre-petition account receivable from a party that has not filed a proof of claim held not a core proceeding under §§ 157(b)(2)(A) or (O)). Further, a turnover proceeding can only be considered a core proceeding under § 542(b) when its purpose is the collection, rather than creation, recognition or liquidation of a matured claim. *Id.* (citing *Acolyte Electric Corp. v. City of New York*, 69 B.R. 155, 172 (Bankr. E.D.N.Y. 1986), *aff'd*, No. 86-0329, 1987 WL 47763 (E.D.N.Y. March 27, 1987)); *Staats v. Adolfsen & Peterson, Inc. (In re Statewide Pools, Inc.)*, 126 B.R. 877, 881 (Bankr. S.D. Ohio 1991) (gathering cases and finding the majority of courts hold that collection of pre-petition accounts receivable are related proceedings, thus rejecting the analysis that the catchall language of 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate) and (O) (other proceedings affecting the liquidation of the assets of the estate) render the proceeding core).

Although not core proceedings, the Trustee's first and second claims for relief are related to this case because "[they] could have been commenced in federal or state court independently of the bankruptcy case, but the 'outcome of that proceeding could conceivably have an effect on the estate being administered in bankruptcy . . . Related proceedings 'include (1) causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541, and (2) suits between third parties which have an effect on the bankruptcy estate.'" *Midgard*, 204 B.R. at 771. Bankruptcy judges do not have the authority to render a final adjudication of a non-core proceeding without the consent of the parties. However, "28

U.S.C. § 157(c)(2) allows the parties to consent to having the bankruptcy court enter a final order in a non-core proceeding.” *American Community Services, Inc. v. Wright Marketing, Inc. (In re American Community Services, Inc.)*, 86 B.R. 681 (D. Utah 1988). In this proceedings, the Defendants specifically consented to this Court entering a final judgment in this proceeding at the final pre-trial conference, and that memorialization is included in the Pre-Trial Order. Therefore, this Court has the authority to enter a final judgment upon the Trustee’s claims.

Corporate Mismanagement

In his first claim for relief, the Trustee seeks damages for "breach of director/officer duties and corporate mismanagement" against both Defendants. Van Treese was president during most of Northwest's existence, served as chief financial officer throughout Northwest's existence, and has been a director since the initial Articles of Incorporation were filed. Jason served as secretary of Northwest and was placed on its board of directors in April of 1993.

A cause of action against an officer or director of a corporation for breach of fiduciary duties become property of the bankruptcy estate if such actions belong to the corporation and not shareholders under state law. *Moore v. Kumer (In re Adam Furniture Indust. Inc.)*, 191 B.R. 249, 254 (Bankr. Ga. 1996) (state law governs the causes of action that can be asserted by a trustee). Under Utah law, the corporation is the correct party to assert causes of action for corporate mismanagement. *Chattin*, 89 B.R. at 901. The Defendants allegedly breached statutory duties arising under Utah Code Annotated § 16-10a-840(1) which imposes a duty of good faith and reasonable care while acting in a manner reasonably believed to be in the best interests of the corporation. *Hansen Jones & Leta v. Segal*, 220 B.R. 434, 450

(D. Utah 1998) (directors owe a fiduciary duty to the corporation and its shareholders that requires them to exercise reasonable care in making informed business decisions, and prohibits any form of self-dealing, fraud or other illegality). Additionally, the Trustee asserts the Defendants breached the statutory duty imposed by Utah Code Annotated § 16-10a-1601, which imposes requirements for corporate record keeping.

Courts have long recognized that corporate officers and directors are immune from personal liability under the "business judgment rule" that raises a presumption that in making a business decision the director acted on an informed basis, in good faith and with the honest belief that the action taken was in the best interest of the company. *C&Y Corp. v. General Biometrics Inc.*, 896 P.2d 47,55 (Utah Ct. App. 1995) (citing *Resolution Trust Corp. v. Hess*, 820 F. Supp 1359, 1366-67 (D. Utah 1993) (business judgment rule creates a presumption that directors act in good faith and according to sound business principles)); *Brandt v. Hicks, Muse & Co. (In re Healthco Internat'l, Inc.)*, 208 B.R. 288, 307 (Bankr. Mass. 1997) (describing the rule in the context of the law of Delaware).

In Utah, prior to May 3, 1993, the presumption in the business judgment rule that a director or officer's action was informed, in good faith, and with honest belief, could be overcome and they could be held personally liable, if they acted with ordinary negligence in the management of corporate affairs. See, *Resolution Trust Corporation v. Hess*, 820 F. Supp 1359, 1364 (D. Utah 1993). On May 3, 1993, the Utah Legislature enacted changes to its corporate law which raised the threshold for liability from ordinary negligence to "gross negligence, willful misconduct, or intentional infliction of harm on the corporation or the shareholders." See *id.* at 1365; Utah Code Ann. § 16-10a-840(4). The Trustee alleges that the

breaches by the Defendants constitute "at least gross negligence" in the performance, or failure to perform their duties. The Utah Supreme Court has defined gross negligence as, "the failure to observe even slight care; it is carelessness or recklessness to a degree that shows utter indifference to the consequences that may result." *Atkin Wright & Miles v. Mountain States Telephone and Telegraph Co.*, 709 P.2d 330, 335 (Utah 1985) (citations omitted). *Atkin* also ruled that willful misconduct, a higher standard than gross negligence, requires that a "defendant must be aware that his conduct will probably result in injury." See *id.* at 335.

In this case there can be no doubt that the Defendants' conduct as directors and officers of Northwest was careless and reckless to a degree that constituted at least gross negligence under the *Atkin* test. During a period when Northwest was insolvent by a margin of seven million dollars, the following was also occurring: 1) numerous checks were bouncing; 2) author royalties were used for payroll; 3) publishing deadlines were regularly missed; 4) the bulk of books shipped on consignment were returned to Northwest as unmarketable as a result of the Defendants' practice of accepting all Author Contracts without regard for the quality of the manuscript; 5) approximately 75 to 100 complaints per week were received by phone from authors in addition to numerous written complaints; 6) authors were led to believe a "Big Six" accounting firm was auditing the royalty reporting records; 7) author payments tendered pursuant to Author Contracts were used for a myriad of expenses, including gambling, rather than to offset production costs of books as was represented in the Author Contracts. It would be incredible to characterize this "management" as merely negligent, observing even slight care, or falling within the safe harbor of the business judgment rule. Any claim that Defendants honestly believed they were acting in Northwest's best

interest and simply misjudged the situation is without merit. The Defendants continued to take in over \$3.5 million from prospective authors after Northwest became insolvent without the ability to perform on the Author Contracts. This did not benefit Northwest. It simply allowed the Defendants to have access to cash.

Van Treese instituted the scheme by which authors were offered Author Contracts with approximately one quarter of the money to be paid up front by the authors to offset production costs, with the balance of the expense to be born by Northwest. There was no evidence that Northwest made any effort to edit the books in a substantive manner as to content and the only books which were ever turned down for publication were rejected because they did not have enough pages to be considered profitable by Northwest. Books were not turned down due to poor quality. Not surprisingly, the books were not selling as well as Northwest had represented they would to Northwest's buyers. As a result, Northwest was continually falling further into debt. Van Treese created and continued Northwest's impossible economic situation of paying for three-fourths of the costs of publication for books that had little market beyond the authors. Every time Northwest signed an Author Contract the company was obligated to produce and market a book which had not been reviewed for quality and for which it had no assurance that sufficient copies would be sold to cover its production costs, let alone make Northwest profitable. The more Author Contracts the Defendants caused Northwest to sign, the more immediate cash it had, but the further into debt it sank in utter indifference to the consequences. Under all the circumstances, the Defendants were grossly negligent in their management of Northwest.

The Defendants were also at least grossly negligent with regard to their duties as directors to oversee Northwest's finances, and breached their duties under Utah Code Ann. § 16-10a-1601 to keep both corporate and financial records. Van Treese, as chief financial officer, orchestrated Northwest's finances and Jason did nothing to stop him. In its most simplistic terms, it constitutes gross negligence to run a multi-million dollar company without an accounting system, whether or not according to generally accepted accounting principles, from which the financial condition of the company can be ascertained. Despite the costs involved, Van Treese cashed over ten million dollars worth of checks through Cash Action without any recordation of the amounts received. The cash was then spent without any accounting system in place to document the expenditures. Northwest could not determine what revenue it received or what debts it owed. Northwest had no general ledger and could not determine what royalties it owed authors, or with any degree of certainty, what bills it had paid. Northwest never filed a tax return until the Trustee took over. Price Waterhouse refused to audit Northwest. Van Treese was informed that Northwest could not be taken public without abandoning the cash system. Finally, during this period, while insolvent and without any auditable financial records or accounting system, Van Treese solicited and received \$1,500,000 from new investors, although these funds cannot be traced to Northwest. Despite all of these facts, Van Treese refused to abandon the cash system. The Court notes however, that the cash system did allow Van Treese unfettered access to all of the cash coming into Northwest without any documentation as to how much of that cash was being appropriated for Van Treese's personal use, gambling, or other activities. This behavior was careless, reckless, and showed an utter indifference

towards the harm being caused to Northwest. The Defendants may have seen this arrangement as serving their best interests, but no reasonable person could have seen it as serving Northwest's best interests.

Jason is also at least grossly negligent as a director of Northwest and as its secretary. Jason's behavior differed from that of Van Treese in that Jason's conduct was characterized by a failure to act. Jason simply did not function as a director. Jason attended meetings of directors and signed documents arising from those meetings, but acquiesced to Van Treese in violation his duties as a director of Northwest. Jason's failure to act under these circumstances was not in the best interests of Northwest, was not what a reasonably prudent person would have done and was grossly negligent. Additionally, the fact that Jason participated in the gambling which was financed by Author Contract money indicates recklessness as to Northwest's best interests. As stated in a case with similar circumstances regarding the officers and directors of the affected corporation:

Moreover, Vogt knew that Buchanan was a gambler, and in fact handed him cash for gambling. It constitutes gross neglect for her to leave Buchanan with control over millions of dollars of 'Investor' funds, without any supervision, outside audits, or adequate internal accounting procedures or bookkeeping.

Henderson v. Buchanan (In re Western World Funding, Inc.), 52 B.R. 743, 767 (Bankr. Nev. 1985) (citation omitted); *aff'd in part and rev'd in part on other grounds, Buchanan v. Henderson*, 131 B.R. 859 (D. Nev. 1990); *rev'd on other grounds*, 985 F.2d 1021 (9th Cir. 1993).

Jason was also at some point elected secretary of Northwest and accordingly had the duties of Northwest's secretary as set forth in Northwest's By-Laws. *See* Utah Code Ann. § 16-10a-831. The By-Laws of Northwest require the secretary to record the meetings, keep the minutes of the corporation, be custodian of the corporate seal, and give all notices of meetings as required by the By-Laws. Jason

attended at least some of the corporate meetings, but did not record any of the meetings as secretary. Further, either some of the corporate meetings required by the By-Laws were not held, or, complete minutes were not kept for the meetings which were held. Jason was employed at Northwest and performed various duties, including selling Author Contracts: however, he did not function as its secretary.

The Court notes that Jason's role in the failure of Northwest is not as active as his father's. However, Jason's duties as a director and secretary required that he act in Northwest's best interest and that he inform himself of the manner in which Northwest was being operated. He cannot escape liability by hiding behind a shield of ignorance. "[C]orporate directors and officers are presumed to know that which it is their duty to know and about which they have the means of knowing." *Preston-Thomas Const. Inc., v. Central Leasing Corp.*, 518 P.2d 1125, 1127 (Okla. 1973). Neither does the fact that Jason is Van Treese's son relieve or lessen his responsibilities as a director of Northwest. *See Hoye v. Meek*, 795 F.2d 893, 896-97(10th Cir. 1986) (discussing corporate liability in a father-son context in which the father/director largely entrusted the son with running the business, and noting that the standard of care is that of an objective ordinarily prudent man, not an ordinarily prudent semi-retired director); *see also Senn v. Northwest Underwriters, Inc.*, 875 P.2d 637 (Wash. Ct. App.1994) (affirming decision holding wife/director personally liable for defalcation of over \$12 million due to her inaction and failure to apprise herself of the company's operations). Jason had a duty to Northwest and was reckless in his performance of that duty. Jason worked at Northwest daily and had a duty to take steps in the company's best interest

but failed to do so. Jason's inaction and participation in this scheme was grossly negligent and justifies the imposition of personal liability upon him.

The Court notes that both of the Defendants are sophisticated in business matters, understood, and helped create the crisis Northwest was facing. It is therefore extremely difficult, given all the facts and circumstances, to conclude that Northwest's failure was simply a result of their gross negligence. It is not necessary under U.C.A. § 16-10a-804(1) for the Court to conclude that the Defendants' acts also constituted willful misconduct, but it is implausible to conclude that they were not aware that their conduct would result in injury to Northwest. In addition, the lack of books and records prevent a supportable determination that Northwest was probably, in reality, a rather sophisticated enterprise in which revenue was not generated through the success of the underlying business venture, but was taken from principal sums of newly attracted investors in a scheme designed to produce cash for the Defendants' personal use.

Northwest has been severely injured as a result of the Defendants' mismanagement and failure to keep adequate books and records. There are no financial books and records by which the Trustee can verify if the \$10,500,000 in filed proofs of claim are in fact owed by the estate. The Trustee could not collect posted accounts receivable. The Trustee has insufficient financial records to determine if preferences occurred prior to the chapter 11 filing, or if fraudulent transfers occurred. Since no tax returns were filed, the Trustee has no way to challenge any assessment made by any taxing authority. There is no basis to determine which, if any, of Northwest's assets may have been converted to the Defendants' personal use, or if any salary owed to one or both of them was properly paid. The Trustee has no way to account for the \$7,080,000 in funds representing the difference between \$10,283,778 in Northwest's

checks cashed at Cash Action, and the \$3.2 million deposited in Northwest's bank accounts. The \$1,500,000 raised by Van Treese in late 1995 and early 1996 is not accounted for, although it may be partially represented by wire transfers into Northwest's bank accounts.¹² The Defendants gross negligence during the period when Northwest was insolvent makes them jointly and severally liable for the only measure of damages their actions have allowed, the debts owed by Northwest represented by the proofs of claim filed in this case.

Alter Ego

Alter ego is an equitable doctrine through which the Trustee, in his second claim for relief, seeks to disregard the corporate entity of Northwest and hold Van Treese personally liable for the debts of Northwest. The Tenth Circuit has recognized that a Bankruptcy Court, as a court of equity, has an obligation to disregard the fiction of separate legal entities when justice requires. *In re Eufaula Enterprises, Inc.*, 565 F.2d 1157, 1162 (10th Cir. 1977); *Levine*, 100 B.R. at 540. The elements of the alter ego doctrine are governed by state law. *Adam Furniture*, 191 B.R. at 254; *Luper v. Banner Industries, Inc. (In re Lee Way Holding Co.)*, 105 B.R. 404, 410 (Bankr. S.D. Ohio 1989). In order to disregard the corporate entity under the alter ego doctrine, Utah case law holds that two circumstances must be shown:

- (1) Such a unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist, but the corporation is, instead, the alter ego of one or a few individuals; and (2) if observed,

¹² The wire transfers could as easily be transfers from casinos. Without accurate books and records, a determination of the source of the funds is impossible.

the corporate form would sanction a fraud, promote injustice, or result in an inequity.

Norman v. Murray First Thrift & Loan Co., 596 P.2d 1028, 1030 (Utah 1979).

In determining whether the above test is satisfied, the Utah Court of Appeals has developed a list of significant, although not conclusive, factors:

(1) undercapitalization of a one-man corporation; (2) failure to observe corporate formalities; (3) nonpayment of dividends; (4) siphoning of corporate funds by the dominant stockholder; (5) nonfunctioning of other officers or directors; (6) absence of corporate records; (7) the use of the corporation as a facade for operations of the dominant stockholder or stockholders; and (8) the use of the corporate entity in promoting injustice or fraud.

Colman v. Colman, 743 P.2d 782, 786 (Utah Ct. App. 1987) (citations and footnote omitted); see also *Ditty v. Checkrite Ltd.*, 973 F. Supp 1320, 1336 (D. Utah 1997) (applying *Colman* factors to veil piercing analysis); *Chattin*, 89 B.R. at 902-03 (discussing veil piercing in a bankruptcy context under Utah law).¹³

Colman cited an Alabama case noting that applying these factors allows a court to look through form to substance and disregard the "corporate form when it was fiction in fact and deed and was merely serving the personal use and convenience of the owner." *Id.* (quoting *Lyons v. Lyons*, 340 So.2d 450,

¹³ The Tenth Circuit Court of Appeals has applied federal common law to the issue of piercing the corporate veil in the context of a Title VII sexual harassment case. See *N.L.R.B. v. Greater Kansas City Roofing*, 2 F.3d 1047, 1051-52 (10th Cir. 1993) (court noted that whether an individual is liable is a question of federal law when it arises in the context of a federal labor dispute). Additionally, the Supreme Court has recently stated that there is a dispute as to whether to apply federal common law to the issue of piercing the corporate veil in CERCLA actions. See *United States v. Bestfoods*, 118 S.Ct. 1876, 1885 n.9 (1998) (identifying, but not ruling upon, the issue of whether federal or state law applies to piercing the corporate veil in CERCLA cases). This Court notes that the test and factors used in piercing the corporate veil by the Tenth Circuit are almost identical to those applied by the Utah Courts. Any minor differences between the state and federal tests, if applicable, are irrelevant as both analyses produce the same result.

451 (Ala. Civ. App. 1976)). *Lyons* applied the alter ego doctrine to an individual who only owned one share of stock because he commingled corporate and personal funds, kept no regular corporate records, meetings or minutes, aside from a bank account, and filed no corporate tax returns. *Colman*, 743 P.2d at 787 (citations omitted).

In this case, the Court will look to the eight *Colman* factors to aid in the determination of whether the two prong test set forth in *Norman* is satisfied. The first and third factors are met, because the only evidence indicated that there was no initial capitalization of Northwest, and that Northwest never paid any dividends.

The second, fifth and sixth factors are met. Corporate formalities were not observed by the Defendants. Although Northwest initially had Articles of Incorporation, By-Laws and minutes of meetings, those formalities disappeared later in its operation. Minutes of meetings and records of corporate activities either were not kept, or the required meetings did not occur. There was no comprehensive list of shareholders and their addresses. The corporate formality of keeping a viable accounting system and financial records was breached as recited above. Northwest took in excess of ten million dollars in checks to Cash Action to have them converted to cash. The cash was then taken by Van Treese without any corporate records being kept of where the money was being spent. Normal business record keeping would have anticipated the use of a checking account whereby this multi-million dollar business could ascertain how much money was coming in and to whom it was being paid. There was no general ledger for Northwest. Northwest had no way of determining its accounts payable and receivable. Northwest never filed a tax return. Further, there was no evidence that the decisions being made had any meaningful

involvement by anyone other than Van Treese. Van Treese was the only functioning officer or director of Northwest. It was undisputed during the trial that Van Treese was in total control of Northwest, even during the time Burton or Wood were president. No other officer or director operated as an officer or director in any meaningful way.

The fourth factor is met because Van Treese siphoned funds from Northwest. All mail and cash was taken directly to Van Treese who utilized the funds without keeping any records of their use. There was uncontradicted testimony that on several occasions author checks were cashed, and the money was taken to Van Treese who took the cash to Wendover to be used for gambling. The total gambling winnings for the Van Treeses during the operation of Northwest exceeded one million dollars. There is no record of gambling losses.

The seventh factor to consider is whether Northwest was used as a facade for operations of the dominant stockholder or stockholders. In a footnote addressing this factor, *Colman* noted that

Failure to distinguish between corporate and personal property, the use of corporate funds to pay personal expenses without proper accounting, and failure to maintain complete corporate and financial records are looked upon with extreme disfavor.

Colman, 743 P.2d at 786 n.3 (citation omitted). Northwest appeared to be a functioning publishing company. However, as noted above, its record keeping was grossly inadequate. Its structure was such that with its indiscriminate entry into joint venture contracts and assumption of publishing duties, it could not make money. Additionally, Van Treese was using some money from Author Contracts to gamble.

The final factor is the use of Northwest in promoting injustice or fraud. *Colman* noted that: "It is not necessary that the plaintiff prove actual fraud, but must only show that failure to pierce the corporate

veil would result in an injustice." *Id.* at 786 (citation omitted). In this case a failure to pierce the corporate veil would certainly result in an injustice. Van Treese continued to receive the money from Author Contracts and use that money for a variety of purposes other than publishing and marketing the author's book as required in the Author Contracts. Van Treese also ran Northwest but did not implement an accounting system, rendering attempts to track the cash unsuccessful. Van Treese engaged in this behavior while rendering Northwest insolvent and thereafter continued entering into new Author Contracts and using author remittances. Allowing Van Treese to escape liability to Northwest's creditors, the majority of whom are authors, would be unjust.

In applying these factors to the test set forth in *Norman*, this Court finds that it would be equitable to apply the alter ego doctrine in this case. Both circumstances of the *Norman* test have been satisfied. Van Treese was in sole control of Northwest and utilized the assets of Northwest such that the two entities were no longer distinct. Recognizing the corporate form in this case would promote an injustice and produce an inequitable result. Northwest was, therefore, the alter ego of Van Treese and Van Treese is liable for its debts.

Accounting

The Trustee requested that Van Treese provide an accounting for the \$10,283,778 of Northwest's funds cashed through Cash Action. There was conflicting testimony or statements at trial as to whether such an accounting was possible. Although the Trustee's Investigator said such an accounting was impossible given the condition of Northwest's books and records, Van Treese indicated in closing argument that he believed it was possible. However, Van Treese has had since this adversary proceeding was filed

in early 1997 to review Northwest's books and records through discovery, has failed to review the documents, and has failed to present any evidence that would constitute an accounting. Further, the Court has no evidence which would indicate that Van Treese is capable of providing such an accounting. The Court hereby concludes that such an accounting would be impossible, and therefore the Trustee's third claim for relief is denied.

CONCLUSION

James Van Treese and Jason Van Treese were both grossly negligent in the performance of their duties as officers and directors of Northwest. James Van Treese and Jason Van Treese are each personally liable for the debts of Northwest. Northwest is the alter ego of James Van Treese and he is personally liable for the debts of his alter ego. Judgment will enter accordingly.

DATED this ____ day of January, 2000.

JUDITH A. BOULDEN
United States Bankruptcy Judge

___ooo0ooo___

I, the undersigned, hereby certify that I served a true and correct copy of the foregoing **AMENDED FINDINGS OF FACT AND CONCLUSIONS OF LAW** by mailing the same, postage prepaid, to the following, on the ___ day of January, 2000.

Duane H. Gillman
Leslie J. Randolph
McDowell & Gillman, P.C.
Twelfth Floor
50 West Broadway
Salt Lake City, Utah 84101

James Van Treese
3570 Wasatch Hills Lane
Salt Lake City, Utah 84121

Jason Van Treese
6048 S. Hathaway Street
Taylorsville, Utah 84118

United States Trustee's Office
100 Boston Building
9 Exchange Place
Salt Lake City, Utah 84111

Law Clerk