BANKRUPTCY JURISDICTION OVER INDEPENDENT SUBSIDIARIES OF A REORGANIZING CORPORATION

In re Beck Industries, Inc., 479 F.2d 410 (2d Cir. 1973)

Beck Industries, Inc. formed a wholly owned subsidiary (Subsidiary) to acquire the assets of Webster Clothes, Inc. (Webster). The parties used a hybrid Type A tax-free statutory merger[1] whereby Beck held all Subsidiary stock, Webster stockholders received Beck stock from Subsidiary, and Subsidiary acquired all of Webster's assets. Further, an agreement among the three parties established the framework within which Subsidiary could operate independently of Beck[2] and provided for delayed payment of a portion of the consideration.[3] Beck and Sub-

1. INT. REV. CODE OF 1954, § 368 provides:

(a) Reorganization.

(1) In general.

For purposes of parts I and II and this part, the term "reorganization" means—

(A) a statutory merger or consolidation;

. . . .

(2) Special rules relating to paragraph (1).

. . . .

(D) Statutory merger using stock of controlling corporation.

The acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as "controlling corporation") which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction under paragraph (1)(A) if (i) such transaction would have qualified under paragraph (1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction.

"Tax-free" is not a completely descriptive term. It means present unrecognized gain for participating stockholders, which can be a substantial bargaining factor in securing stockholder acquiescence.

2. A Plan and Agreement (Plan), to which Beck, Subsidiary, and Webster were all parties, detailed the structure of the merger. *See In re* Beck Indus., Inc., 479 F.2d 410 (2d Cir.), *cert. denied*, 414 U.S. 858 (1973). *See also* notes 3-5 *infra* and accompanying text. The Plan, the Certificate of Incorporation, and the Articles and Agreement of Merger (a document between Subsidiary and Webster substantially similar to the Plan) established Subsidiary as an independent entity that was to have its own assets, offices, and retail outlets. *See* note 23 *infra.* Beck covenanted to take all steps necessary to maintain the existence and solvency of Subsidiary.

3. The Plan contained an adjustment of consideration provision based on stock market values. *See* note 5 *infra.* The provision enabled Subsidiary to pay Webster approximately $2.5 million of Beck stock on the date of the merger instead of the

sidiary each agreed to indemnify Webster's shareholders[4] against any loss in value of the consideration paid Webster due to a decrease in the value of Beck stock.[5] Before Subsidiary completed payment to Webster, Beck filed for Chapter X reorganization[6] and the value of Beck stock declined.[7] The Webster stockholders instituted a separate action against

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$3.75 million asked by Webster for its assets. The Plan called for Subsidiary to defer until December 31, 1971, payment of a sufficient number of additional shares of Beck stock to Webster stockholders to equal $3.75 million on that date.

4. The indemnification agreement provided in part:

> "Beck and Beck Subsidiary hereby agree to indemnify and hold harmless the stockholders against and in respect of any and all damage, deficiency, loss, claims, demands, actions, suits, proceedings, judgments and assessments . . . resulting from any misrepresentations, breach of warranty or nonfulfillment of any agreement, obligation or covenant to be performed by Beck or Beck Subsidiary."

479 F.2d at 413 (court's emphasis omitted).

5. The delayed payment provision became crucial in the ensuing reorganization of Beck. *See* notes 3 & 4 *supra*, 6 & 7 *infra*. The payment provisions read:

> In the event that the Market Value . . . of the shares of Industries' [Beck] Common Stock on December 31, 1971, is less than 150% of the Market Value on May 6, 1969, then [Subsidiary] shall deliver additional shares of Industries' Common Stock determined as follows: (i) the Market Value at December 31, 1971, shall be deducted from 150% of the Market Value on May 6, 1969 to determine the "Per Share Differential"; (ii) the Per Share Differential shall be multiplied by the number of shares of Industries' Common Stock delivered to the Stockholders on the Effective Date hereunder . . . to determine the "Aggregate Differential"; (iii) the Aggregate Differential shall be divided by the Market Value of Industries' Common Stock on December 31, 1971 and the quotient thereof shall be the number of shares of Industries' Common Stock which shall be delivered under this sub-paragraph. The shares to be delivered under this sub-paragraph, if any, shall be delivered on or before January 15, 1972, ten days after the Market Value of such shares is determined or (if applicable) three days after Industries' application to list such shares, on a when issued basis, has been approved by the American Stock Exchange, whichever occurs later.

Brief for Appellant, App. at 18-19, *In re* Beck Indus., Inc., 479 F.2d 410 (2d Cir. 1973).

6. Bankruptcy Act, ch. X, 11 U.S.C. § 501 *et seq.* (1970). Chapter X proceedings apply to corporations unable to meet current liabilities. Court-appointed trustees attempt to formulate a plan to reorganize the corporation and prevent total insolvency. *See* Heebe, *Corporate Reorganization Under Chapter X of the Bankruptcy Act*, 16 LOYOLA L. REV. 27 (1970). In Beck's case the district court granted the petition for Chapter X reorganization in May 1971, some ten months prior to the date when Subsidiary had to meet the adjustment of consideration provisions. *See* notes 3-5 *supra*.

7. Beck stock declined to 25 cents per share. Therefore, to fulfill the deferred payment provisions, Subsidiary had to deliver to Webster over fourteen million additional shares of Beck stock. The Plan had provided that Beck would seek permission from the American Stock Exchange to issue additional shares, if needed to fulfill payment to Webster, but the Exchange ceased trading in Beck stock prior to the settlement date. With Beck undergoing reorganization, there was no method of securing these additional shares, thus making delivery impossible.

Subsidiary for rescission of the merger, return of Webster assets, and damages. The bankruptcy court enjoined the Webster action.[8] The Second Circuit Court of Appeals reversed and *held*: Assets of a wholly owned, independently operating subsidiary formed to acquire a third corporation through a hybrid Type A tax-free statutory merger do not constitute assets of the parent corporation for purposes of Chapter X reorganization proceedings and are not within the jurisdiction of the bankruptcy court.[9]

Chapter X of the Bankruptcy Act gives the bankruptcy court jurisdiction over all property of the debtor, wherever located,[10] as well as power to enjoin suits which affect the debtor's property.[11] Since the

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8. At the time of the approval of Beck's Chapter X petition, the district court issued an order that all persons were

> "enjoined and stayed from commencing or continuing an action at law or suit or proceeding in equity against said debtor or said trustees in any court . . . and from doing any act or thing whatsoever to interfere with the possession or management by said debtor or said Trustees of the property and assets of the within estate . . . or to interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over said debtor and said trustees and their respective properties."

479 F.2d at 413 n.6. In April 1972, the bankruptcy referee granted a motion of the Beck trustees to restrain further proceedings in the Webster action, finding that it fell within the district court order quoted above. The district court affirmed the referee's order which found that Subsidiary was a separate entity by virtue of the sheerest fiction and that it had served only as an instrumentality to facilitate the Beck merger arrangements. *In re* Beck Indus., Inc., 348 F. Supp. 367, 368 (S.D.N.Y. 1972). The bankruptcy court took jurisdiction over Subsidiary's assets. *See* notes 10-14 *infra*.

9. *In re* Beck Indus., Inc., 479 F.2d 410 (2d Cir.), *cert. denied*, 414 U.S. 858 (1973).

10. Bankruptcy Act § 111, 11 U.S.C. § 511 (1970) provides:

> Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

For a general discussion of Chapter X jurisdiction, see Heebe, *supra* note 6; O'Connell, *Jurisdiction, Supersession and Restraint in Bankruptcy*, 44 REF. J. 41 (1970); Seidman, *Chapter X or Chapter XI?*, 76 COM. L.J. 33 (1971).

11. Bankruptcy Act § 116, 11 U.S.C. § 516 (1970) provides:

> Upon the approval of a petition, the judge may . . .
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> . . . .
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> (4) . . . enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

See 6 COLLIER ON BANKRUPTCY ¶ 3.11 (14th ed. 1972) [hereinafter cited as COLLIER]; Heebe, *supra* note 6; O'Connell, *supra* note 10.

For a consideration of what constitutes property within the bankruptcy court jurisdiction, see Soviero v. Franklin Nat'l Bank, 328 F.2d 446, 448 (2d Cir. 1964); Greenbaum v. Lehrenkrauss Corp., 73 F.2d 285, 286 (2d Cir. 1934); Central Republic Bank

courts restrict jurisdiction to property over which a parent-debtor has actual or constructive possession or title,[12] they do not consider the assets of a solvent, independently functioning subsidiary as property of the parent.[13] Recently, however, a few courts have suggested the need to enlarge bankruptcy court jurisdiction to deal effectively with the economic realities of large conglomerate organizations.[14]

& Trust Co. v. Caldwell, 58 F.2d 721, 730-31 (8th Cir. 1932). The Bankruptcy Act § 70(a)(5), 11 U.S.C. § 110(a)(5) (1970), as applied to Chapter X proceedings in 11 U.S.C. §§ 502, 586 (1970), defines property as:

> property, including rights of action, which prior to the filing of the petition he [the debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him or otherwise seized, impounded or sequestered . . . .

For a discussion of the definition of property within the Bankruptcy Act, see 4A COLLIER ¶ 70.15(2); 6A *id.* ¶ 8.02 n.5.

12. The bankruptcy courts have jurisdiction over property actually within the possession of the debtor. Buildings, inventory, and real property of the debtor, as well as the stock of a subsidiary, fall within this classification. Assets of a subsidiary, however, are neither actually nor constructively within the possession of the debtor. *See* Klein v. Board of Tax Supervisors, 282 U.S. 19, 23-24 (1930); *In re* Adolf Gobel, Inc., 80 F.2d 849, 852 (2d Cir. 1936); Liman v. Midland Bank Ltd., 309 F. Supp. 163, 167 (S.D.N.Y. 1970); Owl Fumigating Corp. v. California Cyanide Co., 24 F.2d 718, 719 (D. Del. 1928). *Contra, In re* Eilers Music House, 270 F. 915 (9th Cir. 1921). Questions concerning actual or constructive possession may arise when the debtor has leased property from a third party. *See* Irving Trust Co. v. Fleming, 73 F.2d 423, 426 (4th Cir. 1934) (bankruptcy court had jurisdiction over leased property although legal title remained with landlord). For instances of constructive possession, see Taubel-Scott-Kitzmiller Co. v. Fox, 264 U.S. 426 (1924); *In re* Weston, 68 F.2d 913 (2d Cir. 1934); *In re* Panitz & Co., 270 F. Supp. 448, 453 (D. Md. 1967).

13. *See In re* South Jersey Land Corp., 361 F.2d 610, 613 (3d Cir. 1966); *In re* Adolf Gobel, Inc., 80 F.2d 849, 851 (2d Cir. 1936); Wilson v. Williams Hardware Co., 32 F.2d 103, 105 (4th Cir. 1929); *In re* Copper Canyon Mining Co., 156 F. Supp. 535, 537 (D. Del. 1957); 6 COLLIER ¶ 3.11; E. LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS 42-46 (1936) [hereinafter cited as LATTY]. Trustees acting through the court could not enjoin a suit against an independent solvent subsidiary, but could exercise the power of the parent as a stockholder and vote to sell all assets of that subsidiary. Courts may not extend jurisdiction to an independent subsidiary's assets or disputes simply because the outcome would substantially affect the debtor's assets. *See In re* Adolf Gobel, Inc., 80 F.2d 849, 851 (2d Cir. 1936). *See also* Callaway v. Benton, 336 U.S. 132, 142 (1949); Greenbaum v. Lehrenkrauss Corp., 73 F.2d 285, 286 (2d Cir. 1934).

14. *See In re* Central R.R., 469 F.2d 857, 869 (3d Cir. 1972) (dissent); *In re* Westec Corp., 460 F.2d 1139, 1142 (5th Cir. 1972); *In re* Imperial "400" Nat'l, Inc., 429 F.2d 671, 677 (3d Cir. 1970). In an earlier case concerning reorganization of a city transportation system, the court found it necessary to expand jurisdiction to cover independent interline companies. *In re* Pittsburgh Rys., 155 F.2d 477 (3d Cir.), *cert. denied*, 329 U.S. 731 (1946). More recently in a railroad reorganization pro-

Whether a Chapter X court may disregard the separate status of a subsidiary to take jurisdiction over its assets or disputes depends on the relationship between parent and subsidiary.[15] The court may disregard the separate entities of parent and subsidiary if they do not function independently of one another[16] or if treating them as distinct entities would promote fraud, evade a statute, injure an innocent party,[17] or lead to public inconvenience.[18] To determine the independence of a subsidiary, the court looks at the degree of control exerted by the parent over the subsidiary.[19] It may disregard form and scrutinize the sub-

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ceeding, the court felt the nature of the proceeding required that the bankruptcy court retain jurisdiction over matters not normally within its jurisdiction. *In re* Penn Cent. Transp. Co., 446 F.2d 1109, 1113 (3d Cir. 1971).

15. *See In re* South Jersey Land Corp., 361 F.2d 610, 613 (3d Cir. 1966); Hamilton Ridge Lumber Sales Corp. v. Wilson, 25 F.2d 592, 594 (4th Cir. 1928).

16. *See generally* F. POWELL, PARENT AND SUBSIDIARY CORPORATIONS (1931) [hereinafter cited as POWELL]; Canfield, *The Scope and Limits of the Corporate Entity Theory*, 17 COLUM. L. REV. 128 (1917); Wormser, *Piercing the Veil of Corporate Entity*, 12 COLUM. L. REV. 496 (1912). For a discussion of subsidiary independence as a factor in contract and tort liability of the parent, see Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929); 48 B.U.L. REV. 123 (1968); Annot., 38 A.L.R.3d 1102 (1971).

17. Courts traditionally discuss fraud, evasion of a statute, and injury of an innocent party without distinguishing them as independent factors. Often the courts deal with subsidiaries which do not function independently of their parent, but, instead of focusing on the lack of independence, they choose to emphasize fraud as the factor which led to disregard of the separate entities of parent and subsidiary. *See* Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 322 (1939); Maule Indus., Inc. v. Gerstel, 232 F.2d 294 (5th Cir. 1956); *In re* Muncie Pulp Co., 139 F. 546 (2d Cir. 1905); *In re* Rieger, Kapner & Altmark, 157 F. 609 (S.D. Ohio 1907).

Courts have relied upon fraud and injury of an innocent party as reasons for disregarding the corporate entity, without dealing with questions of independence. *See* Stone v. Eacho, 127 F.2d 284 (4th Cir.), *cert. denied*, 317 U.S. 635 (1942); Commerce Trust Co. v. Woodbury, 77 F.2d 478, 487 (8th Cir. 1935); United States v. Milwaukee Refrig. Transit Co., 142 F. 247, 255 (E.D. Wis. 1905). *See also* 6 COLLIER ¶ 3.11; LATTY 75-76; 46 HARV. L. REV. 823, 823 & n.4 (1933).

18. In *In re* Pittsburgh Rys., 155 F.2d 477 (3d Cir.), *cert. denied*, 329 U.S. 731 (1946), the court took jurisdiction to reorganize a network of separate interline companies in a citywide interlocking transportation system, although each company was independent of the other. The court cited public convenience as the factor which necessitated this expansion of jurisdiction. *See* note 14 *supra*. While cases such as *Beck* increasingly contain rhetoric pointing toward public convenience and necessity, particularly in relation to large-scale conglomerates, courts have resisted extensions of bankruptcy jurisdiction to include independent subsidiaries where no factors such as fraud are present.

19. Here the courts deal with parent corporations which, by definition, own at least controlling stock in the subsidiary. In order to disregard the separate entities of parent and subsidiary, courts require that the parent exercise more control than a

stance of the relationship between parent and subsidiary when they intermingle their functions, assets, funds, or personnel.[20] In assess-

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stockholder would in the normal function of a corporation. If the corporation exercises its stockholder right to vote as established in the corporate by-laws and makes no further attempt to direct the management and policy of the corporation, courts will not find sufficient parent domination to disregard the separate entities of parent and subsidiary. Courts require domination by the parent, such as operation of the subsidiary and use of the subsidiary's assets. *See* 46 HARV. L. REV. 823 (1933); notes 13 *supra*, 20-24 *infra*.

20. Courts have ruled that ownership of all the stock or unity of officers or directors, or both, are insufficient reasons to disregard the separate entities of parent and subsidiary. *See* Majestic Co. v. Orpheum Circuit, Inc., 21 F.2d 720 (8th Cir. 1927); Owl Fumigating Corp. v. California Cyanide Co., Inc., 24 F.2d 718 (D. Del. 1928); Berkey v. Third Ave. Ry., 244 N.Y. 84, 85, 155 N.E. 58, 58 (1926).

In Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940), the court enumerated ten factors to consider in determining whether a subsidiary is independent or functions as an "instrumentality" of its parent:

(1) Parent owns all or majority of capital stock of subsidiary.
(2) Parent and subsidiary have common directors or officers.
(3) Parent finances subsidiary.
(4) Parent subscribes to all capital stock of subsidiary or otherwise causes its incorporation.
(5) Subsidiary has grossly inadequate capital.
(6) Parent pays salaries or expenses or losses of subsidiary.
(7) Subsidiary has substantially no business except that with parent or no assets except those conveyed to it by the parent.
(8) Parent refers to subsidiary as a department or division.
(9) Directors or officers of subsidiary do not act independently in interest of subsidiary but take orders from parent.
(10) Formal legal requirements of subsidiary as a separate and independent corporation are not observed.

In most instances in which a court has determined that the parent and subsidiary are not independent entities, two or more of the following factors have been intermingled: funds, functions, personnel, or assets. For a discussion of the instrumentality rule encompassed by these ten factors, see POWELL 7-34. Powell also considers other theories enunciated by the courts, but the use of any of these theories to disregard the separate corporate entities implies that the parent and the subsidiary have operated as one. *See also* Steven v. Roscoe Turner Aeronautical Corp., 324 F.2d 157 (7th Cir. 1963); Maule Indus., Inc. v. Gerstel, 232 F.2d 294, 296 (5th Cir. 1956); Hamilton Ridge Lumber Sales Corp. v. Wilson, 25 F.2d 592 (4th Cir. 1928); *In re* Seatrade Corp., 255 F. Supp. 696 (S.D.N.Y.), *aff'd sub nom.* Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1966); Garrett v. Southern Ry., 173 F. Supp. 915 (E.D. Tenn. 1959); Woodbury v. Pickering Lumber Co., 10 F. Supp. 761 (W.D. Mo. 1933); Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926).

California courts use a formula involving unity of interest and ownership when the separate personalities of corporation and owner no longer exist and when to treat the acts (or obligations) of the parent (or subsidiary) alone would lead to an inequitable result because the functions of the two entities are so intertwined. Automotriz Del Golfo De California v. Resnick, 47 Cal. 2d 792, 796, 306 P.2d 1, 3 (1957).

ing the independent status of a subsidiary, the court examines the ongoing operation of the two businesses rather than the parent-subsidiary relationship at the time the subsidiary was created.[21]

In *Beck* the court focused on the function of Subsidiary and noted that, from the time of the merger, Subsidiary had operated independently of Beck with its own assets, creditors, management, and bank accounts. Subsidiary paid its own debts and held itself out to the public as a separate and distinct business entity.[22] The court concluded that Subsidiary adequately met the criteria of an independent entity,[23] and there-

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21. Justice Cardozo expressed the problems of a court in formulating criteria to determine independence of function.

> Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an "alias" or a "dummy." All this is well enough if the picturesqueness of the epithet does not lead us to forget that the essential term to be defined is the act of operation. Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice . . . .

Berkey v. Third Ave. Ry., 244 N.Y. 84, 94-95, 155 N.E. 58, 61 (1926). For a discussion of the philosophical and practical problems of disregarding the corporate entity, see LATTY 5-40.

In assessing matters such as adequate capitalization, courts consider whether a corporation has sufficient capital to finance operations and bear the normal risks of business. Thus, the court looks to the capitalization of the going concern rather than its initial capital to determine whether capitalization is adequate. If the capitalization is inadequate, the court will then determine whether to pierce the veil between parent and subsidiary's obligations. *See* Walkovszky v. Carlton, 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966); 48 B.U.L. REV. 123, 139 (1968).

22. 479 F.2d at 417.

23. The court noted a number of factors that served to make Subsidiary an independent business entity. *See* note 22 *supra* and accompanying text. The court found that Beck's ownership of all of Subsidiary's stock and the presence of common directors did not overcome the importance of the independent operation of Subsidiary's business. Under the criteria of Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940), set out in note 20 *supra*, the court's decision seems correct. There was no evidence of the type of parent control that these criteria and the discussions of commentators envision.

The court of appeals in *Beck* looked to the ongoing operation of the subsidiary, an approach similar to that set out in notes 20 & 21 *supra*. The district court, however, had focused on the position of Subsidiary on the date of incorporation and merger, rather than on the date of the reorganization. Since Webster sought to rescind the merger agreement, the court had felt that it ought to look at the facts existing at that time. On the basis of facts then existing, the district court had held that Subsidiary came within the bankruptcy court's jurisdiction. While the question of rescission of contracts often focuses on problems of mutual mistakes of fact at the time of formation, bankruptcy law tends to focus on the time of petition. The courts adjudicate the rights

fore the bankruptcy court could not assume jurisdiction over its assets and disputes.[24]

The *Beck* case involves the interaction of corporate law, bankruptcy jurisdiction, and corporate merger techniques. It is the first case to adjudicate the rights of parties to a hybrid Type A tax-free statutory merger[25] in which one of the parties subsequently undergoes

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of creditors and shareholders as they stand at the time of petition rather than on the date on which the debtor incurred a particular obligation.

24. *See* notes 11-13 *supra*. For a contrary view under circumstances somewhat similar to those found in *Beck*, see *In re* Beck Indus., Inc., 338 F. Supp. 1369 (2d Cir. 1972) [*Beck II*], which involved another subsidiary of Beck. *Beck II* involved a shareholder protest of another merger similar to the one between Subsidiary and Webster. Apparently there was an executory contract for further payment for the acquired corporation's assets but no separate indemnification agreement as in the Webster plan. The suit was against both the subsidiary (Beck-Salz) and Beck, citing misrepresentation of Beck's financial status at the time of merger. There the bankruptcy court took jurisdiction, but the losing parties did not appeal the result. The court made no findings as to this latter subsidiary's independence, and this might have had a considerable bearing on the result.

25. For the statutory language see note 1 *supra*. The hybrid Type A tax-free statutory merger allows the use of a Type A merger technique where there are three parties to the merger—parent corporation, its subsidiary, and a corporation which the parent wishes to acquire through its subsidiary. *See* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 14.15 (3d ed. 1971) [hereinafter cited as BITTKER & EUSTICE]; Lowenstein, *New Form of "A" Reorganization Solves Many Corporate Acquisition Problems*, 44 L.A. BAR BULL. 111 (1969); Shors, *The Role of the Subsidiary in Corporate Reorganization*, 18 DRAKE L. REV. 175 (1969). Prior to 1968, a Type A merger was restricted to two parties, the acquiring and the acquired corporation. *See* BITTKER & EUSTICE ¶ 14.12. Beck could not have used Subsidiary to acquire Webster within the provisions of the Type A technique. *See* Groman v. Commissioner, 302 U.S. 82 (1937); Rev. Rul. 67-326, 1967-2 CUM. BULL. 143; BITTKER & EUSTICE ¶ 14.12(2); Vesely, *"A" Reorganizations—Statutory Mergers and Consolidations*, 19 CASE W. RES. L. REV. 975 (1968). Only three of the six forms of tax-free mergers may be used for an acquisition of an ongoing corporation. *See* INT. REV. CODE OF 1954, § 368(a)(1); BITTKER & EUSTICE ch. 14; *Symposium: Tax-Free Corporate Reorganizations*, 19 CASE W. RES. L. REV. 974 (1968). Of those three, a Type A merger permits the acquiring corporation to use almost any form of corporate security as consideration paid to the acquired corporation, while the other two techniques require use of voting stock only. BITTKER & EUSTICE ¶¶ 14.11(8), 14.12; Lowenstein, *supra* at 131; Vesely, *supra* at 976. Because it is a statutory merger, however, a Type A merger must meet state statutory requirements for tax-free mergers in addition to Internal Revenue Code provisions. *Id.* Since one such requirement is that both parties to the merger obtain the consent of a given percent of their stockholders, permitting a parent to use its wholly owned subsidiary to acquire a third corporation eliminates the problems and costs encountered in securing stockholder approval if the parent itself had to make the acquisition. *See* BITTKER & EUSTICE ¶ 14.05(1); Lowenstein, *supra* at 112. Thus, the 1968 amendment allowing a wholly

reorganization or bankruptcy. The court took no new position concerning the limits of a bankruptcy court's jurisdiction; subsidiaries created to achieve a hybrid Type A tax-free statutory merger will be treated no differently than any other subsidiary of a parent undergoing reorganization.

In determining the limits of bankruptcy court jurisdiction, the *Beck* court confined its consideration to factors relating to subsidiary independence and did not deal with the complexity of the corporation undergoing reorganization. The court's analysis of the independence factors accurately reflects current jurisdiction theory as well as the relationship of the two entities; Beck and Subsidiary carefully maintained the formalities of independent corporations.[26] But the court did not deal with the competing interests reflected in the areas of the law involved in the case: namely, problems of complex economic entities, the need to preserve corporate formalities, and the purpose of Chapter X of the Bankruptcy Act.

Corporations such as Beck regularly use merger and acquisition of subsidiaries to increase the scope and complexity of their corporate activity. The hybrid tax-free statutory merger involves three entities as well as intricate financial and tax manipulations.[27] As in the case of Beck Industries, a complicated pyramid of interlocking subsidiaries controlled by a single parent emerges. Recently one court has noted that increased complexity of economic enterprise may require alteration of traditional concepts of property, title, and separate entities in determining the extent of bankruptcy jurisdiction.[28] To assure smooth functioning of the economic marketplace, courts need to adhere to the formalities of corporate structure to protect the creditors, contracts, liabilities, assets, and ties of independent subsidiaries, regardless of the complexity of the enterprise of which they are a part. But disregarding the interrelationships in conglomerate enterprises, even where formalities of independence are maintained, may ignore reality and impose an impossible task on the process of corporate reoganization.[29]

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owned subsidiary to use its parent's stock to acquire a corporation enhanced the usefulness of the Type A merger by expanding it to include three-party agreements. For the text of this amendment see note 1 *supra*.

26. *See* notes 20-22 *supra* and accompanying text.

27. *See* BITTKER & EUSTICE ¶ 14.01.

28. *In re* Imperial "400" Nat'l, Inc., 429 F.2d 671, 677 (3d Cir. 1970).

29. Chapter X jurisdiction is broader than that of regular bankruptcy proceedings. Certain requirements for plenary proceedings found in the regular bankruptcy chapters

The purpose of Chapter X is to facilitate the reorganization rather than liquidation of a corporation unable to meet its current financial obligations.[30] To formulate an adequate plan of reorganization, or even to determine if such a plan is feasible, the trustee needs considerable control over the "body" of the enterprise, not just the "head." Although a successful suit by the Webster shareholders could reduce Subsidiary, an integral part of the total conglomerate estate, to an empty shell, the independence of Subsidiary precluded the bankruptcy court from assuming jurisdiction. In attempting to formulate a comprehensive, coordinated, and realistic plan of reorganization, the lack of jurisdiction over such matters might well prove crucial.[31]

Extending jurisdiction to encompass such suits would certainly require adequate protection for the independent subsidiary and the parties who have dealt with it as an independent entity. Nevertheless, summary proceedings in the bankruptcy court employ many procedural safeguards, including notice, rules of evidence, and representation. The pleadings, although termed petitions, resemble those in any court proceeding; but jury trials are unavailable except in involuntary petitions adjudicating a party bankrupt, and the choice of forum does not rest with the adverse party.[32] The courts and the Congress need to weigh

are not applicable to Chapter X proceedings, and the Chapter X court has the power to enjoin suits against the debtor. Bankruptcy Act § 102, 11 U.S.C. § 502 (1970). The reluctance of courts to bring independent subsidiaries into the reorganization proceedings probably rests more on notions of corporate law than on specific language within the Bankruptcy Act. The language of Chapter X, particularly in the case of a wholly owned subsidiary, would require little, if any, stretching to include the subsidiary as property of the debtor and fully within the court's jurisdiction. *See* notes 10-13 *supra.*

30. Heebe, *supra* note 6.

31. Numerous suits in widespread forums are costly and time-consuming. Bankruptcy courts can rearrange their calendars so as to facilitate early hearings on important matters, thus enabling the trustee to know the value of a reorganizing corporation's assets much more quickly. It is difficult to determine whether a parent is able to reorganize when the value of its assets is unknown. The trustee cannot liquidate a subsidiary and realize its full value if the subsidiary is involved in long-term litigation which may leave it valueless. Nor can the trustee reorganize the various entities into a more compact corporate form if several subsidiaries are involved in extensive litigation which may result in bankruptcy. Finally, the cost of litigations in diverse state or federal courts can become prohibitive. The result can well be litigation rather than reorganization.

32. Central Republic Bank & Trust Co. v. Caldwell, 58 F.2d 721 (8th Cir. 1932), briefly notes the difference between summary and plenary proceedings in bankruptcy. The court in *In re* Schafer's Bakeries, 129 F. Supp. 82 (E.D. Mich. 1955), expresses

these competing factors to determine whether further expansion of bankruptcy jurisdiction is needed in reorganizations involving complex enterprises such as conglomerates.[33] One court has recently noted a tendency of judicial interpretation toward liberalization of bankruptcy jurisdiction in order to meet changing economic and business conditions.[34] The proposed Bankruptcy Act now before Congress deals with expanding summary jurisdiction powers of the bankruptcy court,[35] and

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the belief that a court can offer sufficient protection to the various parties in reorganization proceedings. For a contrary view see Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1966). Treister, *Bankruptcy Jurisdiction: Is It Too Summary?*, 39 S. CAL. L. REV. 78 (1966), discusses adversary proceedings in a bankruptcy court. He finds the use of the word summary unfortunate, since it evokes an image of summary judgments resolved on pleadings and affidavits. An adversary proceeding in bankruptcy involves examination of witnesses, representation of all parties, pleadings, and normal rules of evidence. The bankruptcy court is more flexible and able to control its calendar to facilitate quicker determination of the issues, but constitutional guarantees of due process and adequate notice apply. Treister's major criticism of summary jurisdiction is the many roles of the referee. The referee handles all administrative matters and also serves as judge in adversary matters. These various roles give him access to normally inadmissible evidence which might influence his judicial determinations. The proposed Bankruptcy Act currently before Congress obviates these problems. Administrators will assume nonjudicial functions and bankruptcy courts would have separate judges. *See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 93-137, 93d Cong., 1st Sess., pt. II, at 15-65 (1973) [hereinafter cited as REPORT].

33. As previously noted, the definition of property could accomodate the inclusion of independent subsidiaries and their assets within bankruptcy court jurisdiction. *See* notes 11 & 29 *supra*. What Congress or the courts must do is to relinquish adherence to concepts of corporate law which see the assets of independent subsidiaries as the property of the subsidiary rather than the parent. The assets of a corporation are not the property of its stockholders according to traditional corporate law. This concept is the basis of the corporate form. *See* notes 12 & 13 *supra*. Nonetheless, courts do, under some circumstances, ignore the separate entities of two interrelated corporations or look to the assets of a single shareholder to meet corporate obligations. *See* notes 15, 16, 19-21 *supra*. In the case of a wholly owned subsidiary, where the trustee can, as stockholder, decide to liquidate the subsidiary, merge it with another, or make other alterations in the subsidiary's form, it would require little disruption of traditional concepts of corporate entity theory to bring the subsidiary's assets within the bankruptcy court's jurisdiction. Either Congress or the courts must weigh the value of combining the administration of a total conglomerate enterprise within the jurisdiction of the bankruptcy court against the disruption, if any, of traditional corporate theory.

34. *In re* Imperial "400" Nat'l, Inc., 429 F.2d 671, 676-77 (3d Cir. 1970).

35. S. 2565, 93d Cong., 1st Sess. (1973); H.R. 10,792, 93d Cong., 1st Sess. (1973). Section 2-201 of the proposed Act extends bankruptcy court jurisdiction to "all controversies that arise out of a case commenced under this Act . . . ." It then enumerates certain types of such controversies but explicitly states that the list is not exclusive. *See* REPORT pt. II, at 30-31. The note to that section states that the provisions broaden jurisdiction presently granted to the bankruptcy court, *id.* at 32, and the provisions

the Supreme Court recently promulgated new bankruptcy rules.[36] But the proposed Act does not reflect any consideration of the particular problem outlined here.

The *Beck* court failed to recognize and discuss these competing interests. It did not note the emerging tendency to enlarge jurisdiction. Although the Beck trustees argued in their petition for certiorari that reorganization of multi-tiered conglomerates requires expansion of bankruptcy jurisdiction,[37] the Supreme Court declined to grant certiorari.[38] The arguments supporting expansion are persuasive, particularly if adequate protection can be offered to the involved parties; but if expansion is to come, it appears that it will have to be through legislative enactment.[39]

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themselves are clearly broad enough to encompass the *Beck* case if the court defines property to include assets of independent subsidiaries. The Act abandons concepts tied to nonbankruptcy definitions of property, such as "transferability." *Compare* Bankruptcy Act § 70(a)(5), 11 U.S.C. § 110(a)(5) (1970), *and* note 11 *supra, with* REPORT pt. II, at 147-52 (§ 4-601 of proposed Act and note thereto). Since the proposed Act and the notes dealing with the concept of property indicate a desire to develop a "bankruptcy" concept of property and broad jurisdictional powers, the extension of that jurisdiction to assets of independent subsidiaries would not seem inappropriate. Supportive of such a change is the increased procedural protection arising from the division of administrative and judicial tasks in the proposed Act. *See* note 32 *supra.*

36. R. BANKR. P., 411 U.S. 989 (1973). The following are of particular interest: Part I, Petition and Proceedings Relating Thereto and to Adjudication, *id.* at 1003-20; Part VII, Adversary Proceedings, *id.* at 1068-86; and Part IX, General Provisions, *id.* at 1091-103.

37. Petitioner's Brief for Certiorari at 14-18, Trustees of Beck Indus., Inc. v. Feldman, 414 U.S. 858 (1973).

38. Trustees of Beck Indus., Inc. v. Feldman, 414 U.S. 858 (1973).

39. Even in the proposed Act and its commentary there is no discussion of the need to expand jurisdiction in this manner. If the drafters did weigh the possibility and discard it, there is no indication in the *Report.*