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Substantive Consolidation: The Back Door to Involuntary Bankruptcy

Jeanne MacKinnon

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A motion for substantive consolidation or a motion to amend the caption is usually raised by creditors in a bankruptcy case in order to consolidate the assets and liabilities of related debtor entities. Recently, creditors have raised these motions in an attempt to consolidate the assets of a non-debtor with those of a debtor. Two bankruptcy courts have permitted such consolidation, thus making the non-debtor an involuntary debtor via a summary proceeding, without providing statutory protections normally afforded involuntary debtors. Another bankruptcy court has refused to permit consolidation of non-debtor and debtor assets and liabilities. This Comment examines these conflicting decisions as well as substantive consolidation case law. The Comment questions the propriety of the use of these motions.

INTRODUCTION

The purpose of bankruptcy is two-fold: to give an insolvent debtor a fresh financial start by relieving him of burdensome indebtedness, and to equitably distribute the assets of the debtor among his creditors.\(^1\) Liquidation\(^2\) and reorganization\(^3\) are two of the processes used

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2. In liquidation, the trustee collects debtor non-exempt property, converts the property to cash, and distributes the cash to creditors. The debtor gives up all non-exempt property owned at the time the petition is filed. Liquidation proceedings are governed by chapter seven of the Bankruptcy Code [hereinafter cited as the Code]. See generally 11 U.S.C. §§ 704, 726 (1982 & Supp. II 1984). A list of exempt property is provided in 11 U.S.C. § 522 which allows the debtor to take advantage of state exemptions. The federal alternatives listed in the Code exempt property of the debtor which is necessary for ordinary life. The debtor may choose more liberal state exemptions (11 U.S.C. § 522(b)) or federal exemptions provided by law other than the Code or the exemptions listed in 11 U.S.C. § 522(d). The debtor must elect one set of exemptions or another and cannot take advantage of all or some of the exemptions. 11 U.S.C. § 522 (1982 & Supp. II 1984); 3 W. Collier, Collier on Bankruptcy ¶ 522.02 (15th ed. 1985).
to achieve these ends. Creditors or debtors may initiate the bankruptcy process. Debtors may voluntarily initiate the process by filing a petition for relief. Creditors may force the debtor into bankruptcy by filing an involuntary petition. The involuntary method requires creditors to satisfy standing requirements, and to prove at trial that the alleged debtor is generally not paying its debts as they become due.

Recently, creditors have attempted to circumvent the protections afforded involuntary debtors by the Bankruptcy Code (the Code) and Rules of Bankruptcy Procedure by using either a motion for "substantive consolidation" or a "motion to amend the caption" of a bankruptcy case. These motions allow creditors to treat the assets and liabilities of non-debtor entities as if they were the assets and liabilities of the original debtor. Consolidation is accomplished by


   An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—(1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims; (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $5,000 of such claims.

11 U.S.C. § 303(h) (1982 & Supp. II 1984). See also In re Dill, 731 F.2d 629, 632 (9th Cir. 1984) (§ 303(h) requires a more general showing of debtor financial condition and debt structure than merely establishing a few unpaid debts).


8. S. W. COLLIER, supra note 2, at ¶ 1100.06[1]. But cf. id. ¶ 1100.07 (regarding procedural consolidation). Fed. R. BANKR. P. 1015 advisory committee note regarding procedural consolidation or joint administration distinguishes the two types of consolidation in the following way:

   Procedural consolidation applies to cases when the same debtor is named in both a voluntary and involuntary petition, when a husband and wife have filed a joint petition pursuant to § 302 of the code, and when two or more involuntary petitions are filed against the same debtor . . . . This rule does not deal
an order of the court on the motion of any party in interest.\textsuperscript{9} Typically, substantive consolidation occurs in two ways: (i) by consolidating the assets of various entities through a plan of reorganization;\textsuperscript{10} or (ii) by determining that the debtor is the \textit{alter ego} of a separate entity or by determining that two entities purportedly separate are in fact not separate.\textsuperscript{11} This latter determination justifies changing the caption of a case which allows the use of assets of the separate entity for satisfaction of debtor debts.\textsuperscript{12} Through these motions creditors draw non-debtor entities into existing bankruptcy actions as involuntary debtors without satisfying the statutory and constitutional procedural requirements imposed on petitioners for involuntary relief.\textsuperscript{13}

This Comment examines the propriety of the use of these motions which make a non-debtor entity a debtor. It discusses the constitutional and statutory procedural protections which apply to non-debtors when such motions are utilized by creditors. This Comment analyzes the procedural adversary safeguards beyond those afforded by bankruptcy motion practice which must apply when drawing a non-debtor into a bankruptcy proceeding under chapter seven or chapter eleven of the Bankruptcy Code.\textsuperscript{14}

\begin{footnotesize}
\item[\textsuperscript{9}] With the consolidation of cases involving two or more separate debtors. Consolidation as distinguished from joint administration is neither authorized nor prohibited by this rule.
\item[\textsuperscript{10}] E.g., Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1966).
\item[\textsuperscript{12}] Six components give rise to a presumption that a corporation has no separate existence: (1) the corporation is under-capitalized; (2) the corporation is without separate books; (3) its finances are not kept separate from individual finances, with individual obligations paid by the corporation; (4) the corporation is used to promote fraud or illegality; (5) corporate formalities are not followed; or (6) the corporation is merely a sham. Lakota Girl Scout Council, Inc. v. Harvey Fund-Raising Management, Inc., 519 F.2d 634, 638 (8th Cir. 1975). Alter ego status is determined if an individual holds all or most of the capital of a corporation and the corporation acts as the mere instrumentality of the individual. In alter ego situations, the separate corporate entity will be disregarded and the individual held liable. \textit{In re} Lewellyn, 26 Bankr. 246, 252 (Bankr. S.D. Iowa 1982).
\item[\textsuperscript{13}] See, e.g., Meridian, 15 Bankr. at 89.
\item[\textsuperscript{14}] See, e.g., \textit{id.}; \textit{In re} Crabtree, 39 Bankr. 718 (Bankr. E.D. Tenn. 1984).
\end{footnotesize}
The fifth amendment of the United States Constitution provides: "there shall be no deprivation of life, liberty or property without due process of law." Procedural due process ensures the right to notice of suit and an opportunity to be heard at a meaningful time and in a meaningful manner. Constitutional due process protection applies to any significant property interest, including legal entitlements created by state or federal law.

Fundamentally, bankruptcy creates deprivation of property. Entry of an order for relief results in the taking of all debtor non-exempt property, wherever located. Commencement of a voluntary or involuntary bankruptcy case results in the creation of an estate composed of all legal or equitable property interests of the debtor as of the commencement of the case. After an order for relief is entered, proceeds from the estate are made available for distribution to creditors. Due process considerations are especially important because significant property interests are implicated in any bankruptcy case.

**Procedural Requirements of Involuntary Petitions, Adversary Proceedings, and Contested Matters Differ**

A bankruptcy case commences with the filing of a voluntary or involuntary petition. Any bankruptcy case may include a number of adversary proceedings which are commenced by filing and serving

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15. U.S. Const. amend. V.
18. An order for relief operates as a determination of debtor status as a bankrupt, and the filing of a voluntary petition operates as an order for relief. 11 U.S.C. § 301 (1982). The court orders relief in an involuntary case if the involuntary petition is not contested. If the petition is contested, relief is ordered only after a trial in which requirements of 11 U.S.C. § 303(h) are met. 11 U.S.C. § 303(h) (1982 & Supp. II 1984). See generally 2 W. Collier, supra note 2, at ¶ 301.08.
19. 11 U.S.C. § 541(a)(1) (1982 & Supp. II 1984). Section 541(a)(1) provides that the commencement of a case under § 301, 302, or 303 of this title creates an estate. "Such estate is comprised of all of the following property wherever located: (1) [e]xcept as provided in subsections (b), (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case." Id. See also H.R. Rep. No. 595, 95th Cong., 2d Sess., 367-68, and S. Rep. No. 989, 95th Cong., 2d Sess. 82-83, reprinted in 1978 U.S. Code Cong. & Ad. News 5868, 6323 (describing the broad scope of § 541(a)(1) which includes all kinds of tangible and intangible property).
21. See generally In re Smith Corset Shops, Inc., 696 F.2d 971, 976 (1st Cir. 1982).
a summons and complaint, or a number of contested matters, which are commenced by motion. Adversary proceedings, similar in nature to litigation in federal courts, are governed by rules of procedure similar to the Federal Rules of Civil Procedure. Contested matters, on the other hand, are commenced by motion of one or more parties in interest and are governed by "motion practice" rather than adversary rules of procedure. A motion for substantive consolidation is considered a contested matter.

Contested involuntary petitions and adversary proceedings provide substantial opportunity for a party to receive notice, to respond, and to be heard in a meaningful, adequate, and timely manner. Involuntary cases are initiated by creditors and can only be commenced under chapter seven (liquidation) or chapter eleven (reorganization). Creditors must satisfy one of two standing requirements to file an involuntary petition. If the alleged debtor has more than twelve unsecured creditors, at least three creditors with aggregate claims of $5000 must file the petition. If the debtor has fewer than twelve unsecured creditors, a single creditor with a claim of at least $5000 may file the petition.

23. FED. R. BANKR. P. 7003.
24. Id. R. 9014.
25. Id. R. 7001 (advisory committee note) which provides: These Part VII rules are based on the premise that to the extent possible practice before bankruptcy courts and district courts should be the same. These rules either incorporate or are adaptations of most of the Federal Rules of Civil Procedure. . . . The content and numbering of these Part VII rules correlates to the content and numbering of the Federal Rules of Civil Procedure. Most of the Federal Rules of Civil Procedure have a comparable Part VII rule.
26. Id. R. 9014 (advisory committee note) which provides: Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter. For example, the filing of an objection to a proof of claim, to a claim of exemption, or to a disclosure statement creates a dispute which is a contested matter. Even when an objection is not formally required, there may be a dispute. If a party in interest opposes the amount of compensation sought by a professional there is a dispute which is a contested matter.
27. E.g., Meridian, 15 Bankr. at 89.
29. 11 U.S.C. § 303(a) (1982). Section 303(a) provides: "An involuntary case may be commenced only under chapter 7 or 11 of this title and only against a person . . . that may be a debtor under the chapter under which such case is commenced."
30. An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—(1) by three or more entities each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, . . . if such claims aggregate at least $5,000 more than the value of any lien on prop-
After the requisite number of qualified creditors file an involuntary petition, the alleged debtor has the right to file responsive pleadings or an answer, and may assert any affirmative defenses to the petition. A trial is required before an order for relief may be entered in a contested involuntary case. In most cases, debtors retain their property or continue to operate their businesses until after a trial is held on the involuntary petition. At trial, creditors must prove the debtor is generally not paying its debts as they become due. Failure to sustain the burden of proof on this issue results in dismissal of the involuntary petition. The alleged debtor is entitled to various remedies for damages sustained as a result of the petition. These include compensatory damages, and punitive damages if the petition was filed in bad faith.

Similarly, an adversary proceeding provides significant procedural safeguards for the defendant. It is commenced by filing a complaint. A summons and notice of trial, or pre-trial, is issued and served. The defendant then has thirty days from service of the summons to answer and file responsive pleadings. There is opportunity to conduct discovery before trial. Creditors or parties in interest who seek to obtain equitable or declaratory relief against a

property of the debtor securing such claims held by the holders of such claims; (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable . . . by one or more of such holders that hold in the aggregate at least $5,000 of such claims.
31. "The debtor, or a general partner in a partnership debtor that did not join in the petition, may file an answer to a petition under this section." 11 U.S.C. § 303(d) (1982). See also Fed. R. Bankr. P. 1011(b), (d) (regarding defenses, objections, and claims).
33. 11 U.S.C. § 303(f) (1982) provides: “except to the extent that the court orders otherwise, and until an order for relief in the case, any business of the debtor may continue to operate, and the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced.” See also 11 U.S.C. § 303(h) (1982 & Supp. II 1984) (regarding exceptions to this general rule).
34. See supra note 6.
36. 11 U.S.C. § 303(i) (1982). Section 303(i) provides:
If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—(1) against all the petitioners and in favor of the debtor for (A) costs; (B) a reasonable attorney’s fee; or (C) any damages proximately caused by the taking of possession of the debtor’s property by a trustee appointed under subsection (g) of this section or under section 1104 of this title; or (2) against any petitioner that filed the petition in bad faith for (A) any damages proximately caused by such filing; or (B) punitive damages.
38. Id. R. 7004.
39. Id. R. 7012.
40. Id. R. 7026-7037.
debtor, or obtain property of the estate, must do so within the confines of an adversary proceeding.41

Contested matters are summary in nature and are often heard on short notice42 without an evidentiary hearing.43 As a contested matter, a substantive consolidation motion, or a motion to amend the caption, enables creditors to bypass requirements of contested involuntary petitions and adversary proceedings, thus circumventing important due process safeguards and legal entitlements possessed by all alleged debtors.44

41. Id. R. 7001, 7004.
42. See id. R. 9006(d), (e) which provide:
(d) For motions—affidavits. A written motion, other than one which may be heard ex parte, and notice of any hearing shall be served not later than five days before the time specified for such hearing, unless a different period is fixed by these rules or by order of the court. Such an order may for cause shown be made on ex parte application. When a motion is supported by affidavit, the affidavit shall be served with the motion; and, except as otherwise provided in Rule 9023, opposing affidavits may be served not later than one day before the hearing, unless the court permits them to be served at some other time.
(e) Time of Service. Service of process and service of any paper other than process or of notice by mail is complete on mailing.

Fed. R. Bankr. P. 9014 provides:
In a contested matter in a case under the Code not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. No response is required under this rule unless the court orders an answer to a motion. The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004, and, unless the court otherwise directs, the following rules shall apply: 7021, 7025, 7026, 7028-7037, 7041, 7042, 7052, 7054-7056, 7062, 7064, 7069, and 7071. The court may at any stage in a particular matter direct that one or more of the other rules in Part VII shall apply. A person who desires to perpetuate testimony may proceed in the same manner as provided in Rule 7027 for the taking of a deposition before an adversary proceeding. The clerk shall give notice to the parties of the entry of any order directing that additional rules of Part VII are applicable or that certain of the rules of Part VII are not applicable. The notice shall be given within such time as is necessary to afford the parties a reasonable opportunity to comply with the procedures made applicable by the order.
"After notice and a hearing," or similar phrase—(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but (B) authorizes an act without an actual hearing if such notice is given properly and if—(i) such a hearing is not requested timely by a party in interest; or (ii) there is insufficient time for a hearing to be commenced before such act must be done and the court authorizes such act . . ..

44. See, e.g., Meridian, 15 Bankr. at 94-95.
Substantive Consolidation is usually employed to consolidate the assets and liabilities of affiliated debtor corporations or partnerships. For example, it may be used to bring a parent corporation into a pending bankruptcy case involving a subsidiary, or to consolidate two pending cases involving corporate affiliates. Substantive consolidation is also used when a corporation functions as the mere instrumentality of individual shareholder debtors.\textsuperscript{46} In consolidation actions, bankruptcy courts can disregard separate corporate entities to reach additional assets for the satisfaction of debts. This practice is an example of “piercing the corporate veil.”\textsuperscript{46}

The substantive consolidation mechanism is troublesome and questionable when used to join a non-debtor as a debtor in a pending chapter seven or chapter eleven case.\textsuperscript{47} For example, the creditors in a pending case involving corporation $A$ may move to substantively consolidate the assets and liabilities of corporation $B$, a non-debtor. If this motion is granted, $B$ is effectively made a debtor without the opportunity to answer an involuntary petition, respond to a complaint filed as part of an adversary proceeding, take part in a trial, or, depending upon the motion practice in any particular court, present live testimony in its own defense. Creditors of $A$ would then have the assets of $B$ consolidated, without satisfying the standing requirements of 11 U.S.C. § 303(b), or proving that $B$ is not generally paying its debts as they come due.\textsuperscript{48} The procedural requirements of involuntary petitions and adversary proceedings are, therefore, bypassed through the use of substantive consolidation motions.\textsuperscript{49}

**Consolidation Under the Veil-Piercing Theory**

When faced with a motion for substantive consolidation, bankruptcy courts generally explore three areas: (i) whether the court has the power to consolidate; (ii) whether the rights of creditors will be protected or threatened if consolidation is granted; and (iii) whether the existence of the corporate entity may be disregarded.\textsuperscript{50} Jurisdiction is typically satisfied under 11 U.S.C. § 105(a), which gives the court equitable power to issue any order necessary or appropriate to

\textsuperscript{45} 5 W. Collier, supra note 2, at § 1100.06[1].

\textsuperscript{46} In re Continental Vending Machine Corp., 517 F.2d 997, 1000 (2d Cir. 1975); Kheel, 369 F.2d at 845.

\textsuperscript{47} In re Alpha & Omega Realty Inc., 36 Bankr. 416 (Bankr. D. Idaho 1984) (wherein the court refused to grant a motion for substantive consolidation of the estate of a general partnership, a non-debtor, with that of the debtor corporation).

\textsuperscript{48} See generally Crabtree, 39 Bankr. at 718; Meridian, 15 Bankr. at 89. Both courts stated satisfaction of these requisites was unnecessary.

\textsuperscript{49} See generally Crabtree, 39 Bankr. at 718; Meridian, 15 Bankr. at 89.

\textsuperscript{50} Lewellyn, 26 Bankr. at 250.
carry out the provisions of title eleven.\textsuperscript{51}

Consolidation affects substantive rights. Consequently, courts begin with the premise that the power to consolidate should be used sparingly.\textsuperscript{52} Consolidation may prejudice creditors who have dealt only with one debtor and have no knowledge of its interrelationship with others.\textsuperscript{53} Proponents of consolidation must therefore show that any economic prejudice to creditors is outweighed by the cost necessary to unscramble the interrelationships of inter-entity transactions.\textsuperscript{54} Put differently, proponents of consolidation must show that the economic prejudice of continued debtor separateness outweighs the economic prejudice of consolidation.\textsuperscript{55}

Finally, courts consider various circumstances in which the corporate entity may be disregarded and the assets and liabilities of separate entities pooled. Courts look at the following factors to decide whether to pierce the corporate veil: (i) the degree of difficulty in segregating and ascertaining individual assets and liabilities; (ii) the presence or absence of consolidated financial statements; (iii) the profitability of consolidation of a single physical location; (iv) the commingling of assets in business functions; (v) the unity of interest and ownership between various corporate entities; (vi) the existence of parent and intercorporate guarantees on loans; and (vii) the transfer of assets without formal observance of corporate formalities.\textsuperscript{56}

\begin{itemize}
  \item \textsuperscript{52} In re Flora Mir Candy Corp., 432 F.2d 1060, 1062 (2d Cir. 1970).
  \item \textsuperscript{53} Kheel, 369 F.2d at 847. Rights of two separate creditor groups are implicated. Creditors of the debtor entity ("A") may desire access to assets of the non-debtor entity ("B"). This would inevitably impair or dilute the ability of B's creditors to satisfy their debts. For example, in any bankruptcy case certain claims have priority over others. Persons essential to the administration of the estate such as attorneys, trustees, accountants, as well as lenders to the bankrupt have a preferred position and are paid before other creditors are paid. Because the debtor in the pending proceeding will have incurred administrative expenses which must be paid first, the creditors of the non-debtor will be forced to subordinate their claims to the expenses of the already established administration. They will also be forced to commingle their claims with creditors of the debtor. 11 U.S.C. §§ 503(b), 507(a)(1) (1982 & Supp. II 1984).
  \item \textsuperscript{54} Lewellyn, 26 Bankr. at 251.
  \item \textsuperscript{55} In re Snider Bros., Inc., 18 Bankr. 230, 234 (Bankr. D. Mass. 1982).
  \item It must be recognized and affirmatively stated that substantive consolidation . . . threatens to prejudice the rights of creditors . . . . This is so because separate debtors will almost always have different ratios of assets to liabilities. Thus, the creditors of a debtor whose asset-to-liability ratio is higher than that of its affiliated debtor must lose to the extent that the asset-to-liability ratio of the merged estates will be lower.
  \item Id.
  \item \textsuperscript{56} In re Vecco Construction Indus., 4 Bankr. 407, 410 (Bankr. E.D. Va. 1980). The same or similar analysis was used in In re Food Fair, 10 Bankr. 123, 126 (Bankr.}
\end{itemize}
Analysis of these factors frequently requires presentation of evidence regarding the actions of corporate officers and directors. Moreover, if the corporation acts as the alter ego or mere instrumentality of an individual (the individual holds all or most of the capital stock of the corporation and the corporation acts as the instrumentality of the individual), the corporate entity may be disregarded and the individual held personally liable for corporate obligations.

The party seeking consolidation must establish the need for consolidation and must prove by a preponderance of evidence that corporate formalities should be disregarded. Parties opposed to consolidation may argue that the benefits of consolidation do not outweigh the potential harm of consolidation. For example, if a creditor proves that he looked only to the credit of one debtor, and he is certain to suffer harm because assets to satisfy his claim will be dissipated, substantive consolidation may appropriately be denied.

No specific arrangement of facts will mandate consolidation in any particular instance; each case is sui generis. However, certain factual circumstances are consistently evident in court decisions involving substantive consolidation. Most consolidation cases based on alter ego determinations involved consolidation of two affiliated entities which were already debtors. Only three recent cases involved consolidation of a debtor and non-debtor entity. These cases, however, reached different conclusions. Two courts permitted consolidation of non-debtor entities by motion while another court did not permit consolidation.

**Cases Permitting Consolidation of Debtor and Non-Debtor Entities**

In Re 1438 Meridian Place, N.W., Inc.

Creditors in *In Re 1438 Meridian Place, N.W., Inc.* filed a motion to amend the caption of the voluntary chapter eleven petition filed by the debtor, and to pierce the corporate veil. The creditors alleged two individual non-debtors were the alter egos of the debtor

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62. *E.g.*, *Flora Mir*, 432 F.2d at 1063 (in which this argument was successful).


64. *See infra* note 97.

and of several non-debtor corporations. The court granted the creditor, motion based upon documentary and testimonial evidence adduced at an extended hearing. The court order resulted in the consolidation of six corporate and two individual non-debtors with the debtor corporation.

The responding parties argued the court lacked personal jurisdiction over the non-debtors. They claimed the creditors should have initiated either an adversary proceeding or filed an involuntary petition against the non-debtors. The court dismissed this argument by relying on the broad jurisdictional powers granted to bankruptcy courts under 28 U.S.C. § 1471. Section 1471 gave the court jurisdiction over all debtor property wherever located. The court also relied on its broad powers as a court of equity. The court rejected the argument that an adversary proceeding was required, stating that under Bankruptcy Rule 701 the relief requested did not require an adversary proceeding.66

In addressing the debtor argument that an involuntary petition was required to join the non-debtors, the court stressed that the creditors bringing the motion were creditors only of 1438 Meridian Place, N.W., Inc. Consequently, they could not comply with the requirements of 11 U.S.C. § 303(b) regarding standing to qualify as creditors of the non-debtors. Because the creditors could not satisfy the standing requirements, an involuntary petition could not possibly be filed and, therefore, was not necessary to accomplish the aim of the moving parties.67

In Re Crabtree

Creditors of an alleged involuntary debtor moved to amend the caption of an involuntary petition to include a non-debtor corporation. The motion was made and granted after the order for relief on the involuntary petition had been entered by the court.68

The alleged debtor argued that amending the caption to consoli-

66. Id. at 91, 94. Meridian relied on Fed. R. Bankr. P. 701. This was superceded by Fed. R. Bankr. P. 7001. Rule 701 limited adversary proceedings to actions to:
(1) recover money or property, other than a proceeding under Rule 220 or Rule 604, (2) determine the validity, priority or extent of a lien or other interest in property, (3) sell property free of a lien or other interest for which the holder can be compelled to take a money satisfaction, (4) object to or revoke a discharge, (5) obtain an injunction, (6) obtain relief from a stay as provided in Rule 401 or 601, (7) determine the dischargeability of a debt . . . .
67. Meridian, 15 Bankr. at 95.
date the debtor and its alter ego required the creditors to first file an involuntary petition against the non-debtor corporation and then move to consolidate the two pending cases. The court found this an acceptable, but not exclusive method available to creditors to add alter ego to petitions. Relying on *Meridian*, the *Crabtree* court held the creditor motion to amend the caption was acceptable simply because the non-debtor corporation was the alter ego and instrumentality of the individual debtor. The court noted that since the individual was the alleged debtor and owned all the shares of the corporate stock, the corporation itself was property of the estate. Thus, the corporate assets were subject to the claims of the individual debtor in any event.69

The court also stated that any defenses by the non-debtor corporation could be raised at trial. Consolidation occurred, however, after the order for relief had been entered in the involuntary case.70 Consequently, the corporate non-debtor was declared bankrupt and its assets joined with those of the individual debtor. This consolidation occurred without the creditors of the individual debtor satisfying standing requirements usually necessary to bring an action against a corporate non-debtor, and without proving the non-debtor corporation was not paying its debts as they became due.71 There was no opportunity to assert defenses which would otherwise have been available to the non-debtor corporation at the involuntary trial since the involuntary order for relief had already been entered.

The court cited several cases which permitted amendments to an involuntary petition after action had been concluded on the original petition. Two of these cases involved involuntary petitions which were originally dismissed for failure to sufficiently allege claims for which relief could be granted. After dismissal, amendments to the petitions were allowed and the proceedings were reinstated.72 In these two cases, the reinstatement of the petitions allowed the alleged debtors sufficient opportunity to file an answer and take part in a trial. Amending a caption after entry of an order for relief, however, makes the non-debtor a debtor without providing any of these procedural safeguards.73

Another case discussed in *Crabtree* allowed realignment of parties and amendment of the pleadings after judgment. The court held that, under certain circumstances, rule fifteen of the Federal Rules of Civil Procedure could permit realignment of the parties after

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69. Id. at 721.
70. Id. at 723.
73. *Crabtree*, 39 Bankr. at 723.
judgment, but only if all parties had notice of the issues being tried and no prejudice would result. The Crabtree court recognized that each party in the case before it received adequate notice of what the motion entailed and had an adequate opportunity to present evidence on the issues raised by the motion.

The Case Prohibiting Consolidation of Debtor and Non-Debtor Entities: In Re Alpha & Omega Realty, Inc.

In Re Alpha & Omega Realty, Inc., contained facts similar to Crabtree and Meridian, but the court reached a different result. The debtor was not a debtor-in-possession. The bankruptcy trustee requested consolidation of the assets of a non-debtor partnership into the estate of the debtor, asserting that Meridian supported the consolidation motion. The court found Meridian unpersuasive. It questioned the Meridian court's reliance on 28 U.S.C. § 1481 as conferring jurisdiction. In view of the Supreme Court decision in Northern Pipeline Construction Co. v. Marathon Pipeline Co., the Alpha & Omega court found the jurisdiction of bankruptcy courts was not as broad as previously thought.

75. Crabtree, 39 Bankr. at 722-23.
76. Alpha & Omega, 36 Bankr. at 416.
77. 5 W. Collier, supra note 2, at ¶ 1101.02. A “debtor in possession” refers to a debtor who remains in possession of his property during the pendency of a bankruptcy case. Unless the court appoints an interim trustee, the debtor remains in possession until an order for relief is entered.
78. Actually, 11 U.S.C. § 1471 was relied upon by the Meridian court. 15 Bankr. at 94.
79. 458 U.S. 50 (1982). The plurality in Marathon held that § 241(a) of the Bankruptcy Reform Act was unconstitutional because it violated constitutional separation of powers. Section 241(a) removed most of the essential attributes of judicial power from the Article III district court, and vested these attributes in a non-Article III adjunct (the bankruptcy court). Such a jurisdictional grant was not permissible under congressional power to create adjuncts to Article III courts.
Furthermore, the court questioned the Meridian court's conclusion that non-debtors could be declared involuntary debtors through the use of the veil-piercing theory. The court found this theory especially suspect when such action was raised by motion rather than through an adversary proceeding or involuntary petition with their attendant procedural protections. Finally, the court concluded that due process was not afforded to the non-debtor or to the creditors of the non-debtor under the type of analysis employed by the Meridian court.\textsuperscript{81}

The analysis in Alpha & Omega was similar to that employed under the former Bankruptcy Act\textsuperscript{82} in cases which held that assets of non-debtor alter ego entities could not be consolidated in a summary (motion) proceeding, but required instead, a plenary (trial) proceeding.\textsuperscript{83} Under the Bankruptcy Act, bankruptcy courts had summary jurisdiction to adjudicate controversies relating to property over which they had actual or constructive possession. The test of this jurisdiction was not title to the property by the bankrupt but possession by the bankrupt at the time the bankruptcy petition was filed.\textsuperscript{84} The court was without power to summarily adjudicate adversary claims to title to property that was not in actual or constructive possession of the court, unless the parties consented. Absent consent, a plenary suit conducted by the district court was required.\textsuperscript{85}

In Suhl v. Bumb,\textsuperscript{86} a case decided under the Bankruptcy Act, the trustee of a corporation claimed that assets in the possession of two individuals were in the constructive possession of the bankrupt corporation.\textsuperscript{87} The trustee argued the individuals were alter egos of the bankrupt corporation. The bankruptcy court agreed, finding the individual claims to the assets frivolous. Absent a bona fide claim by the individuals, the property was considered to be in the constructive possession of the court. The court, therefore, had summary jurisdiction to resolve the conflicting claims to the property. Further, because the individuals were alter egos of the corporation, their assets could be administered with those of the bankrupt corporation.\textsuperscript{88}

\textsuperscript{81} Alpha & Omega, 36 Bankr. at 417.
\textsuperscript{82} The Bankruptcy Reform Act was enacted in 1978 as Pub. L. No. 95-598, 92 Stat. 2549, and is now commonly referred to as the Bankruptcy Code. Prior legislation, originally enacted in 1898 and superseded by the Bankruptcy Code, continues to be referred to as the Bankruptcy Act. In 1984, the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, were enacted in the wake of Marathon. These amendments changed the Bankruptcy Code as well as the judicial system. See generally I W. Collier, supra note 2, at § 1.01 nn. 1,2.
\textsuperscript{83} See, e.g., Suhl v. Bumb, 348 F.2d 869 (9th Cir. 1965).
\textsuperscript{84} Magnolia Pet Co. v. Thompson, 309 U.S. 478, 481 (1940).
\textsuperscript{85} Magnolia Pet Co. v. Thompson, 106 F.2d 217, 222 (8th Cir. 1939), rev'd on other grounds, 309 U.S. 478 (1940).
\textsuperscript{86} 348 F.2d 869 (9th Cir.), cert. denied, 382 U.S. 938 (1965).
\textsuperscript{87} Id. at 870.
\textsuperscript{88} Id. at 871.
On appeal, the individual appellants argued the bankruptcy court had exceeded its power by exercising summary jurisdiction. The Ninth Circuit concluded that the alter ego and tortious conversion of funds allegations required a plenary proceeding. A summary proceeding would sacrifice the rights to refute such allegations at a full trial. The Ninth Circuit could not accept this abrogation of the individual's right to a plenary proceeding and reversed the decision of the bankruptcy court.

A similar decision was reached in Mashburn v. Williams. The bankruptcy trustee sought to include property claimed by individuals in the bankrupt estate, thereby forcing these individuals to file schedules in bankruptcy via a summary procedure. The trustee argued the bankrupt corporation was a sham, and the court should pierce the corporate veil, make the individual non-debtors parties to the action, and require them to file schedules in bankruptcy. Relying on Suhl, the Fifth Circuit held that the bankruptcy court could not use a summary procedure to pierce the corporate veil and require these individuals to file schedules in bankruptcy which would disclose their assets to creditors. Where the individuals asserted absolute title to the property sought by the trustee, and the bankrupt corporation was never in possession of the property, a plenary suit was required. Anything less would violate the individual's right to a plenary proceeding.

Reconciliation of the Conflicting Decisions

These decisions cannot be fully reconciled. In Crabtree, assets of a non-debtor corporation were included in the debtor estate as assets of the individual debtor. The debtor owned 100% of the shares of the corporation, controlled the corporation, and provided personal guarantees for corporate debts. The vehicle used to include the individual debtor corporate holdings in the estate was substantive consolidation. This was actually unnecessary given the broad construction

89. Id. at 874.
90. Id. at 872-74. But see Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941).
91. 384 F.2d 363 (5th Cir. 1967).
92. Id. at 364.
93. Crabtree, 39 Bankr. at 720. It is important to note that although corporate stock may be included in the assets of the estate of an individual, its value is limited to shareholder equity or assets remaining after payment of corporate debts. 11 Fletcher, Cyclopedia of the Law of Private Corporations § 5083 (1971).
94. Crabtree, 39 Bankr. at 721.

217
generally applied to section 541 of the Code\textsuperscript{95} regarding composition of the estate, as well as 28 U.S.C. § 1334(d),\textsuperscript{96} enabling the court to exercise jurisdiction over all debtor property wherever located.

\textit{Meridian} court analysis permitting consolidation parallels those cases involving consolidation of two \textit{pending} bankruptcies of related corporate debtors or involving consolidation under a plan of reorganization.\textsuperscript{97} However, \textit{Meridian} and \textit{Alpha & Omega} involve creditor attempts to draw \textit{non-debtors} into bankruptcy as involuntary debtors using substantive consolidation motions. The involuntary non-debtors had no opportunity to utilize procedural due process protections of an involuntary petition or an adversary proceeding. The \textit{Meridian} court allowed consolidation; the \textit{Alpha & Omega} court did not.

This conflict becomes especially important when re-examining the veil-piercing analysis. The vast majority of prior cases dealt with consolidating assets of existing debtor entities. The greatest concern of courts deciding these veil-piercing cases was to avoid creditor prejudice in consolidation.\textsuperscript{98} Prejudice to the debtor entities was not a factor because the two entities were already in bankruptcy. Their property was already subject to court jurisdiction for disbursement to creditors. Their property had already been taken with procedural due process protection.\textsuperscript{99} However, when a non-debtor is drawn into an existing bankruptcy case and is made a debtor, the taking adversely affects both the non-debtor entity as well as the non-debtor's creditors and equity interest holders.\textsuperscript{100}

Courts readily acknowledge that consolidation is no mere instrument of procedural convenience. It vitally affects substantive

\textsuperscript{95} Section 541(a)(1) defines the “estate” as comprised of all the following property, wherever located:
all legal or equitable interests of the debtor in property as of the commencement of the case. Although these statutes could be read to limit the estate to those “interests of the debtor in property” at the time of the filing of the petition, we view them as a definition of what is included in the estate, rather than as a limitation.

\textit{Whiting Pools}, 462 U.S. at 203.


\textsuperscript{97} See generally \textit{Luth}, 28 Bankr. at 565 (involving the substantive consolidation of two \textit{pending} proceedings of two related debtors); \textit{Lewellyn}, 26 Bankr. at 250 (in which trustees of two \textit{pending} proceedings sought to consolidate); \textit{G&L Packing}, 20 Bankr. at 805 (in which an \textit{adversary} proceeding was filed as part of an \textit{involuntary} case against a corporate subsidiary); \textit{Snider}, 18 Bankr. at 230 (in which creditors requested consolidation of six voluntary corporate debtors); \textit{Food Fair}, 10 Bankr. at 127 (in which several voluntary debtors requested consolidation); \textit{Richon Int'l}, 12 Bankr. at 555 (in which three debtors requested consolidation). \textit{But cf. In re Tureaud}, 45 Bankr. 658 (Bankr. N.D. Okla. 1985) (involving consolidation of individual debtor and corporate affiliate non-debtors with the consent of non-debtors).

\textsuperscript{98} See generally \textit{Continental Vending}, 517 F.2d at 997; \textit{Flora Mir}, 432 F.2d at 1060; \textit{Kheel}, 369 F.2d at 845.

\textsuperscript{99} See supra note 97.

\textsuperscript{100} See supra notes 53-55.
The admonition found in most veil-piercing decisions relied on in both Crabtree and Meridian that "consolidation should be used sparingly because of the unfair treatment of creditors," applies with even greater force to non-debtor consolidation. The certainty of substantial injury and prejudice to the name and property of the non-debtor entity mandate that full due process protections be afforded to the non-debtor entity as well as to its creditors. Ignoring this prejudice and harm to the non-debtor by failing to distinguish cases which do not involve non-debtor entities is clearly shortsighted. The potential for harm to the non-debtor entity is as significant as the potential prejudice to the creditors of non-debtor entities.

**DUE PROCESS PROTECTIONS COMPARED**

There are two types of proceedings in bankruptcy litigation: adversary proceedings and contested matters. Contested matters are generally non-adversarial in nature. They are procedurally less formal than an adversary proceeding. When a substantive consolidation motion is raised in the course of a bankruptcy case, it is treated as a contested matter, governed by the Rules of Bankruptcy Procedure beginning at rule 9014. Certain adversary rules apply in contested matters, and a court may direct the application of the rules governing adversary proceedings during the course of a contested matter. However, important notice and hearing differences still exist among contested matters, adversary proceedings, and involuntary cases.

In contested matters, notice is accomplished by personal service or

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101. *Flora Mir*, 432 F.2d at 1060.
102. *See*, e.g., *Vecco*, 4 Bankr. at 410; *Flora Mir*, 432 F.2d at 1063; *Kheel*, 369 F.2d at 847.
104. *Cf. In re Covey*, 650 F.2d 877, 884 (7th Cir. 1981) (involving a voluntary debtor); *Salem*, 29 Bankr. at 431 (involving involuntary debtors and the resulting stigma of bankruptcy).
106. Part VII rules applicable to contested matters are as follows: *Fed. R. Bankr. P.* 7004 (Process, Service of Summons, Complaint), 7021 (Misjoinder and Non-joinder of parties), 7025 (Substitution of Parties), 7026-7037 (Rules governing discovery), 7041 (Dismissal), 7042 (Consolidation of adversary proceedings/separate trials), 7052 (Findings on the Record), 7054 (Judgment costs), 7055 (Default), 7056 (Summary judgment), 7062 (Stay of Proceedings to enforce a judgment), 7071 (process on behalf of and against persons not parties).
service by mail setting forth the time and place of the hearing.\textsuperscript{108} An adversary proceeding requires filing a formal complaint and service of a summons.\textsuperscript{109} Similarly, an involuntary petition requires filing a petition, satisfying standing requirements, and serving the petition and summons.\textsuperscript{110}

In contested matters, notice of the hearing must be served not later than five days before the hearing. Even less time is required if the hearing is to be ex parte.\textsuperscript{111} Both personal service and service by first class mail are permitted. Service by mail is considered complete when notice is mailed.\textsuperscript{112} Thus, it is possible that the opposing party may not receive actual notice until two days before the hearing, if at all. A response to the motion is not required unless the court orders one, although the opposing party may elect to file one.\textsuperscript{113}

In contrast, service of a summons and complaint in an adversary proceeding must be complete ten days after issuance of the summons. The defendant must answer the complaint or file responsive pleadings within thirty days of issuance of the summons.\textsuperscript{114} In involuntary cases, debtors have twenty days after issuance of the summons and involuntary petition, to answer or file responsive pleadings. As in adversary proceedings, service of the summons and involuntary petition must be complete ten days after issuance of the summons.\textsuperscript{115}

Several practical problems exist with the notice provisions which apply to contested matters. Since notice may be mailed five days before the hearing date, service by mail invites abuse by the moving party. Moreover, five days notice leaves little time to prepare a defense, obtain legal counsel, or make arrangements to personally appear. Finally, unless the court orders an answer, or the responding party has time to consult counsel and file responsive pleadings, the only defense of the adverse party against the consolidation motion must be formulated on short notice. This procedure virtually guarantees the non-debtor will be forced to seek discretionary relief from the court for a continuance to file responsive pleadings.

Hearing requirements are also troublesome. Substantive consolidation motion practice requires a hearing. Hearings do not always permit presentation of live testimony.\textsuperscript{116} The issues resolved at consolidation hearings are serious: whether under the factual

\begin{itemize}
\item \textsuperscript{108} Id. R. 9006.
\item \textsuperscript{109} Id. R. 7004.
\item \textsuperscript{112} Fed. R. Bankr. P. 9006(e).
\item \textsuperscript{113} Id. R. 9014.
\item \textsuperscript{114} Id. R. 7004(f), 7012(a).
\item \textsuperscript{115} Id. R. 1011(b), 7004(f).
\item \textsuperscript{116} 11 U.S.C. § 102(1)(B) (1982).
\end{itemize}
circumstances, as established by the evidence, the corporate veil should be pierced, the non-debtor declared a debtor, and the non-debtor assets consolidated with those of the debtor.\textsuperscript{117} Ordinarily, a person may become a debtor involuntarily only after a full-scale trial in the course of an involuntary case. It is doubtful whether a determination with such far-reaching effect can fairly be made in the course of a hearing on a contested matter.

Requirements of procedural due process must be satisfied whenever creditors seek to include the assets of a non-debtor in a pending bankruptcy case.\textsuperscript{118} Procedural due process requires notice reasonably calculated to inform interested parties of the pendency of the action and to give them an opportunity to present their objections. Such notice must reasonably convey required information \textit{and} allow a reasonable time for interested parties to appear and respond.\textsuperscript{119} Five days notice of a substantive consolidation hearing \textit{may} reasonably convey the required information. However, this does not provide a reasonable time to present objections, or to prepare a response, particularly in light of the significant effect substantive consolidation has on the property of the non-debtor and the creditors of the non-debtor.

Procedural due process also requires the opportunity to be heard at a meaningful time and in a meaningful manner.\textsuperscript{120} Although non-debtors have the opportunity to be heard prior to the deprivation of their property,\textsuperscript{121} the manner in which rights are adjudicated in a contested manner stands in stark contrast to procedural protections associated with the full-scale plenary trials. It is questionable whether non-debtors or their creditors are heard in a "meaningful manner" under the limited framework of contested matter procedures.

The Bankruptcy Code and the Federal Rules of Bankruptcy Procedure violate the due process clause when they are found to be so arbitrary and unreasonable as to be incompatible with notions of fundamental fairness.\textsuperscript{122} However, due process must be assessed

\begin{itemize}
\item \textsuperscript{117} Meridian, 15 Bankr. at 92.
\item \textsuperscript{118} See Seligsen & Mandell, \textit{supra} note 14, at 346 (which examined the importance of procedural due process for creditors of non-debtor entities).
\item \textsuperscript{119} Mullane, 339 U.S. at 314.
\item \textsuperscript{120} Fuentes, 407 U.S. at 80.
\item \textsuperscript{121} \textit{Id.} at 81; Sniadach, 395 U.S. at 340; Goldberg, 397 U.S. at 264. These cases examined the importance of being heard prior to a deprivation of property.
\item \textsuperscript{122} \textit{In re} Joyner, 7 Bankr. 596, 599 (Bankr. M.D. Ga. 1980); \textit{In re} Bruntz, 10 Bankr. 444, 447 (Bankr. N.D. Iowa 1981).
\end{itemize}
within the particular circumstances of each case.\textsuperscript{123} When a non-debtor is declared a debtor without the benefit of a full-scale trial, consolidation is arbitrary, unreasonable, and incompatible with fundamental fairness.

Congress intended bankruptcy courts to act as a shield for debtors, not as a sword for creditors.\textsuperscript{124} This intention reflects two concerns. One is the stigma attached to bankruptcy. Some predictable consequences of becoming a bankrupt debtor include the inability to obtain credit, unavailability of goods except on a cash basis, and damage to the business reputation of the debtor.\textsuperscript{125} If the debtor voluntarily chooses the bankruptcy option, these consequences are known, and the risks of harm to the debtor are determined to be less than the harm of not filing at all.\textsuperscript{126} Involuntary debtors and non-debtors joined by substantive consolidation have no such option. Congress recognized this potential for damage by providing remedies to the alleged involuntary debtor if damaged by an involuntary petition that is ultimately dismissed.\textsuperscript{127}

The second concern which merits due process protection is the complete taking of debtor property after an order for relief is granted.\textsuperscript{128} Statutory procedural protections were generally designed to guard against such property takings without due process. These protections are embodied in standing requirements, burdens of proof, notice and hearing requirements, and the mandate that a trial be held before a person can involuntarily be brought into bankruptcy.\textsuperscript{129} Such protections are legal entitlements which deserve constitutional protection. Denying access to these constitutional safeguards also violates procedural due process.\textsuperscript{130} Because of express congressional intent to protect debtors, the stigma of bankruptcy, and the significant property interests and legal entitlements at stake, the procedural safeguards provided by adversary proceedings and involuntary petitions must be mandated whenever creditors seek to "consolidate" a non-debtor into a pending bankruptcy case.

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\item \textsuperscript{123} \textit{In re} Continental Inv. Corp., 642 F.2d 1, 4 (1st Cir. 1981).
\item \textsuperscript{124} \textit{Salem}, 29 Bankr. at 429.
\item \textsuperscript{126} \textit{Cf. Covey}, 650 F.2d at 884; \textit{Salem}, 29 Bankr. at 431. These cases discuss the resulting stigma of bankruptcy.
\item \textsuperscript{127} 11 U.S.C. § 303(i) (1982).
\item \textsuperscript{130} \textit{See} cases cited \textit{supra} note 17.
\end{itemize}
SUGGESTED PROCEDURES AND CONCERNS

Adversary Proceeding Protections Must be Provided

When creditors seek to consolidate via motion, the assets and liabilities of a non-debtor with those of a debtor, the bankruptcy court should require one of two procedures. First, the court should treat the consolidation as an adversary proceeding brought by creditors against the non-debtor. Federal Rule of Bankruptcy Procedure 7001 limits adversary proceedings to certain litigated matters including proceedings in bankruptcy court “(7) to obtain an injunction or other equitable relief, or . . . (9) to obtain a declaratory judgment relating to any of the foregoing.” Substantive consolidation logically falls into either of these categories.

Alter ego status determinations and decisions to pierce the corporate veil are equitable declaratory determinations. Creditor motions for consolidation are requests that the court require a non-debtor to submit its assets to the jurisdiction of the bankruptcy court. In this respect, substantive consolidation is a form of equitable injunctive relief. Further, consolidation results in a declaration that a corporation has no separate existence, that non-debtors owe a duty of repayment to the creditors of the debtor entity, and that creditors have the right to include the assets of the non-debtor in the debtor estate.

Because substantive consolidation is an equitable remedy, courts must comply with procedures governing adversary proceedings. Failure to require an adversary proceeding deprives non-debtors of a complaint, summons, and notice of trial, procedures due process protection requires. Compliance with these rules provides a mecha-

131. Equitable relief is sought in a court with equity powers, and is composed of injunction or specific performance instead of money damages. An injunction requires the person to whom it is directed to do or refrain from doing a particular thing. See, e.g., Fed. R. Civ. P. 65. A declaratory judgment is a declaration of the rights and duties of parties to litigation. Fed. R. Civ. P. 57.


133. See, e.g., Kheel, 369 F.2d at 845; Suhl, 348 F.2d at 869.

134. See, e.g., Meridian, 15 Bankr. at 89.

135. Receipt of a summons and complaint is considered more serious than receipt of notice of a hearing. A summons clearly warns the party receiving it of the seriousness of the action brought against it. In re Commercial Western Finance Corp., 761 F.2d 1329, 1337 (9th Cir. 1985) (wherein the court stated that had the trustee followed adversary proceeding rules requiring a summons, complaint, and notice of trial, investors would have been clearly warned of the serious consequences of the power he was seeking to exercise).
nism by which non-debtor and non-debtor creditors are apprised of the serious consequences of the substantive consolidation action. Failure to file an adversary proceeding should result in dismissal of the action by the court. Failure to dismiss the action constitutes a reversible error of law.

The general provisions of 11 U.S.C. § 105(a), upon which the power to consolidate is based, do not supersede specific provisions such as Federal Rule of Bankruptcy Procedure 7001. According to several court decisions in the Ninth Circuit, where a rule exists which states the specific procedure for the exercise of the general equitable powers of a bankruptcy court, the specific rule applies. Where Federal Rule of Bankruptcy Procedure 7001(7) and (9) requires a complaint, summons, and trial, general provisions of 11 U.S.C. § 105(a) cannot be used to supersede this rule.

Given the doubt regarding which rules should apply to substantive consolidation matters, it is important to note that under Federal Rule of Bankruptcy Procedure 9014, the court may at any time apply Part VII of the Federal Rules of Bankruptcy Procedure governing adversary proceedings to a contested matter. Since the major problems with motion practice in the non-debtor situation exist at the notice and hearing stages, adversary rules requiring summons, complaint, and service of process must be applied early in the proceeding.

When all parties view an issue as adversarial in nature, Part VII rules governing adversary proceedings must apply. Since substantive consolidation matters are often adversarial in nature, they should, at a minimum, be treated as an adversary proceeding at the notice stage, giving fair notice to both the non-debtor entity and its creditors.

Another option for bankruptcy courts would require the moving party to first file an involuntary petition against the non-debtor, sat-

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136. Commercial Western, 761 F.2d at 1337.
137. See id.
138. E.g., id. at 1336-39; In re Golden Plan, 36 Bankr. 95, 96 (Bankr. 9th Cir. 1984).
139. See Commercial Western, 761 F.2d at 1336-39; see also Golden Plan, 36 Bankr. at 96. The bankruptcy court holding that 11 U.S.C. § 105(a) superceded Fed. R. Bankr. P. 765, governing adversary proceedings, was reversed by the Bankruptcy Appellate Panel for the Ninth Circuit. The Appellate Panel held that while § 105(a) granted bankruptcy courts the power to issue injunctions, rule 765 stated the procedure for the exercise of the power. Id.
141. Unless the court makes the rules governing adversary proceedings applicable at a very early stage of the proceedings, there will be no summons and notice of the trial issued and served upon the non-debtor. D.R. Cowan, BANKRUPTCY LAW AND PRACTICE § 3.19 (Supp. II 1984).
143. E.g., Meridian, 15 Bankr. at 89; Crabtree, 39 Bankr. at 718.
satisfy standing requirements, and prove that the non-debtor is generally not paying its debts as they become due. The creditors could then move for consolidation of the two pending actions after the order for relief is entered and after equity interest holders and creditors of both entities are provided adequate notice.

The Crabtree and Meridian courts found this procedure unnecessary. They stated that creditors did not have to satisfy standing requirements because, as creditors of the debtor only, they probably could not. Creditors did not have to prove non-payment of debts. This reasoning is both unpersuasive and constitutionally suspect. If the party bringing the motion has no standing under 11 U.S.C. § 303, the court should not have jurisdiction to consider the matter.

Eleven U.S.C. § 303 indicates that Congress intended to protect individuals and corporations from frivolous claims and the inevitable stigma of bankruptcy. Congress did so by providing standing requirements, imposing burdens of proof for creditors, and authorizing debtor remedies in the event of dismissal of the petition. When the Code clearly provides that these requirements must be satisfied when creditors seek to make an entity an involuntary debtor, decisions such as Meridian and Crabtree seem in clear disregard of legislative mandates and intent.

Moreover, procedural protection for involuntary debtors under 11 U.S.C. § 303 includes the right to notice by a petition and summons, and a hearing in the form of a trial. Such protections are legal entitlements which are constitutionally protected property interests. Because a substantive consolidation motion denies access to these legal entitlements, a deprivation of property without due process occurs.

Finally, while 11 U.S.C. § 105(a) is a broad grant of bankruptcy court discretion, the language of the statute is also that of limitation. The bankruptcy court may issue only those orders necessary to carry out the provisions of title eleven. Since the provisions of title eleven require a trial on the involuntary petition before a non-debtor can be made a debtor, use of broad discretionary 11 U.S.C. § 105(a) power to circumvent these provisions undermines section 105(a) it-
self and due process of law.

**CONCLUSION**

Bankruptcy results in a deprivation of property, requiring strict attention to due process requirements of adequate notice and hearing. Notice and hearing requirements of contested involuntary petitions and adversary proceedings provide adequate due process protection to parties involved in a bankruptcy proceeding. As a contested matter, a motion to amend the caption, or a motion for substantive consolidation, provides only minimal due process protection to a non-debtor.

Court analysis of substantive consolidation motions is decidedly one-sided. The greatest concern of courts is to avoid creditor prejudice. Such concern is appropriate when consolidation affects two debtors already parties to a bankruptcy case. However, this analysis is misguided when a non-debtor is drawn into a pending case. Potential prejudice to the non-debtor should be examined. Additional procedural safeguards such as those found in an adversary proceeding or contested involuntary petition should be mandated.

Substantive consolidation can be an efficient, convenient way to join pending cases involving related debtors. It can aid in effectuating creditor rights to repayment. However, when the doctrine is used to join a non-debtor to a pending case without the attendant procedural safeguards of an adversary proceeding or an involuntary petition, the use of consolidation is constitutionally suspect. Considerations of due process, legislative intent, and the practical effects of bankruptcy on the life of an individual or corporation, as well as the inherent prejudice to creditors of the non-debtor, indicate that additional safeguards are needed whenever creditors seek to join an entity not in bankruptcy to a pending bankruptcy case.

JEANNE MacKINNON

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149. See supra notes 18-21 and accompanying text.
150. See supra notes 28-41 and accompanying text.
151. See supra notes 111-17 and accompanying text.
152. See supra notes 98-104 and accompanying text.
153. See supra note 97.
154. See supra notes 131-46 and accompanying text.