CASE NOTES

Bankruptcy—Affiliated Corporations—Merger of Assets—Weight Given to Creditor's Reliance on Single Corporation.—*Chemical Bank New York Trust Co. v. Kheel.*[1]—Manuel Kulukundis, a shipping magnate, owned or controlled eight corporations, all of which became debtors in a reorganization proceeding under Chapter X of the Bankruptcy Act.[2] When an acceptable reorganization plan could not be formulated, the trustees of the eight corporations undertook to liquidate them pursuant to the Bankruptcy Act. The government, a major creditor, moved for consolidation of the eight corporations into one proceeding and for merger of all their assets and liabilities.[3] The basis of the government's motion was that there had been an extensive commingling of assets of the eight corporations, and that they were, in an economic sense, a single enterprise. Chemical Bank New York Trust Company, a trustee for certain bondholders of Seatrade Corporation,[4] one of the eight in the Kulukundis group, objected to the motion on the grounds that, in extending credit to Seatrade, it had relied solely upon the assets of, and bargained only with, Seatrade. Chemical asserted that because Seatrade's percentage of assets to liabilities was greater than the combined assets of the eight corporations to their combined liabilities, merger would unfairly diminish the recovery upon its claim. A special master recommended to the district court that the government's motion be granted; the court adopted the recommendation and ordered consolidation and merger.[5] Chemical appealed the granting of the order to the Second Circuit Court of Appeals. HELD: affirmed (Judge Friendly concurring in a separate opinion).

In dealing with the contention of Chemical that the court could not order consolidation and merger of the corporations if there were creditors who had relied on a single corporation, the court, citing *Soviero v. Franklin Nat'l Bank*[6] and *Stone v. Eacho*,[7] said: "We find no such limitation on the power of the reorganization court."[8] The court nevertheless cautioned that

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[1] 369 F.2d 845 (2d Cir. 1966).

[2] Bankruptcy Act §§ 102-276, added by 52 Stat. 883 (1938), as amended, 11 U.S.C. §§ 501-676 (1964).

[3] Chemical did not object to an order of consolidation, but did object to one for the merger of assets. The first order would result in a bankruptcy proceeding for the eight corporations with a single administration. The second order would go one step further; not only would it gather the eight corporations into one proceeding but it would also abolish their separate corporate entities, pool their assets and liabilities, and result in a distribution according to a single plan. Although the distinction is a significant one, the two terms were frequently used interchangeably by the court in *Kheel.*

[4] The bondholders held a mortgage on a vessel owned by Seatrade. The validity of the mortgage, however, was being contested. Consequently, Chemical had assumed the position of an unsecured creditor for purposes of this action, even though the possibility existed that the mortgage would be upheld.

[5] 255 F. Supp. 696 (S.D.N.Y. 1966).

[6] 328 F.2d 446 (2d Cir. 1964).

[7] 127 F.2d 284 (4th Cir.), rehearing denied, 128 F.2d 16 (4th Cir.), cert. denied, 317 U.S. 635 (1942).

[8] 369 F.2d at 847.

merger of the assets of different corporations "should be used sparingly"[9] due to the very danger of which Chemical complained. The court's decision to affirm gave great significance to the "additional factor not present in *Sovicro* or *Stone v. Eacho*, the expense and difficulty amounting to practical impossibility of reconstructing the financial records of the debtors to determine intercorporate claims, liabilities and ownership of assets."[10]

By affirming the order of consolidation and merger of the eight corporations, the court has in effect disregarded their separate corporate entities, abolished all intercorporate claims, and treated all creditors as if they were the creditors of one enterprise. Because the facts of the instant case were somewhat unique, the device of disregarding corporate entities in order to reach an equitable result involved issues which do not usually arise when that device is employed in bankruptcy or reorganization cases.[11] Most often the bankruptcy or reorganization court is confronted with a conflict between a solvent corporation and an interrelated insolvent corporation. In such a case, the issue is whether the solvent corporation may isolate its assets from the claims of creditors of the insolvent affiliated corporation, or, alternatively, whether a solvent corporation may establish a claim against an affiliated corporation which has become the subject of a bankruptcy or reorganization proceeding.[12] In either of these two situations, the competing interests are between the shareholders of one corporation and the creditors of another. The argument in behalf of "piercing the corporate veil" is invariably based upon an allegation that the economic relationship of the interrelated corporations has been such as to work a fraud, or to otherwise harm, the creditors of the insolvent corporation.[13] If such is the case, a bankruptcy or reorganization court will usually disregard corporate entities in order to protect creditors who have bargained with the insolvent corporation and who, therefore, had a right to expect that the corporation was not being used in such a way as to

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9 Ibid.

10 Ibid. Compare Fish v. East, 114 F.2d 177 (10th Cir. 1940).

11 The best discussion on the subject of disregarding corporate entities for bankruptcy purposes is contained in Latty, Subsidiaries and Affiliated Corporations 142-54 (1936). See also 3 Collier, Bankruptcy § 63.06[5.3] (14th ed. 1966); 1 Remington, Bankruptcy § 263 (5th ed. 1950).

12 The second situation has given rise to the "Deep Rock Doctrine," which emanated from the leading case of Taylor v. Standard Gas & Elec. Co., 306 U.S. 307 (1939). One writer has defined the doctrine as follows:

> Where a showing can be made that a subsidiary corporation having public preferred stockholders was inadequately capitalized from the outset and was managed substantially in the interest of its parent, rather than in its own interests, the parent will not, in a bankruptcy or reorganization proceeding affecting the subsidiary, be permitted to assert a claim as a creditor, except in subordination to the claims of preferred stockholders.

Israels, The Implications and Limitations of the "Deep Rock" Doctrine, 42 Colum. L. Rev. 375, 379 (1942). There has been considerable comment, much of it critical, on the application of this doctrine. See, e.g., Bayne, The Deep Rock Doctrine Reconsidered I, II, 19 Fordham L. Rev. 43, 152 (1950).

13 It would be impossible to definitively state under what circumstances a court will disregard corporate entities. "The test is simply whether or not recognition of corporateness would produce unjust or undesirable consequences inconsistent with the purpose of the concept." Henn, Corporations § 143 (1961).

prejudice their interests. Their reliance, then, is the very foundation upon which a court will hold an affiliated corporation liable or will subordinate or disallow its claim against the insolvent corporation.

The facts and issues in *Kheel* are quite different from the usual case, since the corporations were all insolvent and the competing interests were different groups of creditors of the eight corporations.[14] The merger of assets and liabilities created a substantial danger of a diminution in the recovery of a creditor who had relied upon a single corporation and who did not anticipate sharing with creditors of interrelated corporations. Rather than being the foundation for a disregard of corporate entities, such reliance should be a reason for maintaining individual corporateness in the bankruptcy proceeding. On the other hand, because there was an extensive commingling of the assets of the corporations, the assets of some of them may have been significantly diluted to the benefit of their affiliated corporations. Consequently, merger may have been an acutely appropriate method by which to protect the rights of creditors of those corporations which were harmed by this dilution.[15] Moreover, it is arguable that, because the assets were so intermingled, and because the formalities of separate corporate existence were so abused by Kulukundis, recognition of individual corporateness would be wholly artificial and therefore unwarranted.

The above description of the issues in *Kheel* is only a simplified presentation of the conflicting equities which may arise when affiliated corporations are brought before a bankruptcy court. There are numerous factors in *Kheel* which complicate and obscure the issues; therefore, any generalizations would be misleading. Prior case law is of limited value in determining the most equitable result because of the uniqueness of the fact situations that *Kheel* and cases like it present. Nevertheless, there are decisions in this area which provide guidelines that can be useful if this caveat is kept in mind. The most notable case is *Commerce Trust Co. v. Woodbury*,[16] involving an insolvent lumber company. As part of a plan to financially rehabilitate the enterprise, a subsidiary sales corporation was formed. The subsidiary was managed by the parent lumber company, and the assets of the two were substantially commingled. Later, a proceeding to reorganize the parent was initiated. Because of this commingling, and also because the creditors of the parent had knowledge of the existence of the subsidiary and considered it part of the parent, the assets of the subsidiary were merged with those of the parent. In ordering merger, however, the court required that those creditors of the subsidiary who had relied solely upon the assets of the subsidiary be accorded absolute priority over any other general creditors. The court in effect

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[14] The distinction between the solvent-insolvent and the insolvent-insolvent situation has long been recognized by commentators and courts. See, e.g., Prudence Realization Corp. v. Geist, 316 U.S. 89, 97 (1942); Latty, op. cit. supra note 11, at 153-54.

[15] Writers have acknowledged the inherent conflict in such a situation, but there has been little attempt by them to clarify or resolve the dilemma. As Latty realistically observed: "Whatever is done . . . in such a case is open to some objection." Id. at 153.

[16] 77 F.2d 478 (8th Cir. 1935). See also Hollander v. Henry, 186 F.2d 582 (2d Cir. 1951); Henry v. Dolley, 99 F.2d 94 (10th Cir. 1938). See Comstock v. Group of Institutional Investors, 335 U.S. 211, 238-39 (1948) (Murphy, J., dissenting).

held that à disregard of corporate entities, although otherwise warranted, could not be invoked to defeat the interests of creditors who had a right to expect that the corporation of which they were obligees was indeed a separate entity.

In *Kheel*, like *Woodbury*, the court was faced with the dilemma of deciding between the interests of those creditors to whom merger, or a throwing into "hotchpot," would be unfair and those to whom merger would be appropriate. The court's resolution of this dilemma, however, is confusing, for it is not clear by what rationale the court overruled Chemical's objection. The opinion may be reasonably interpreted in three distinctly different ways. First, Judge Smith, speaking for the majority, could be saying that, on the authority of the *Soviero* and *Stone* cases, the presence or absence of creditors who relied upon individual corporations is inconsequential where the relationship of affiliated corporations justifies a merger of their assets and liabilities. This reading is mostly occasioned by the tenor of Judge Friendly's concurring opinion, in which he stressed the great importance of protecting the rights of a creditor who has relied upon the credit standing of a single corporation. He argued, in apparent opposition to Judge Smith, that "equality among creditors who have lawfully bargained for different treatment is not equity but its opposite,"[17] and that "every reasonable endeavor to reach the best possible approximation in order to do justice to a creditor who had relied on the credit of one [corporation] . . ." must be made.[18] He proceeded to distinguish the *Stone* and *Soviero* cases from *Kheel*, pointing out that in both cases the fact situations did not reveal any creditors who had relied solely upon one corporation, and that in *Stone* the court held that if there were such creditors, their interests would merit protection. Judge Friendly further supported his argument by paraphrasing the holding of the *Woodbury* case which is "in contrast" to the present case.[19] Certainly, the tone of his initial remarks, his subsequent analysis of the *Soviero* and *Stone* cases, and his reference to *Woodbury* suggest a sharp disagreement with Judge Smith as to the merits of Chemical's position as a relying creditor.

This apparent disagreement, and Judge Friendly's forceful advocation of the equities of a relying creditor, raise the implication that Judge Smith was dismissing the objections of Chemical as being of no consequence. On the other hand, this first interpretation would appear to be inconsistent with Judge Smith's admonition that "the power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others."[20] Furthermore, as Judge Friendly pointed out, such a holding cannot be supported by the two cases cited, *Soviero* and *Stone*, nor by other cases in this area, such as *Woodbury*.

In *Soviero*, also a Second Circuit case, the trustee in bankruptcy of an insolvent parent corporation sought to have the parent's fourteen subsidi-

[17] 369 F.2d at 848.
[18] Ibid. Compare Consolidated Rock Prods. Co. v. Dubois, 312 U.S. 510, 524 (1940).
[19] 369 F.2d at 848.
[20] Id. at 847.

aries consolidated into one proceeding and their assets merged. The Franklin National Bank, which had granted a loan to the parent and had taken a chattel mortgage on certain personal property of the subsidiaries to secure the loan, objected to the motion for merger. The bank never contended that it had relied solely upon the parent, nor that there were creditors who did so rely.[21] Instead, the objection to merger, based on the case of *Maule Indus. v. Gerstel*,[22] was that the entities of the affiliated corporations could not be disregarded absent a showing that they were "organized to defraud or hinder creditors."[23] The court, holding *Maule* to be inapplicable, based its order of merger on the disregard of corporate formalities and the commingling of the assets of the fifteen corporations. It is true that the absence of any relying creditors was not, in the words of the *Kheel* court, "a necessary foundation"[24] for the result reached by the court in *Soviero* in granting the motion for merger. Yet the issue was never raised; the language of the court must be read in light of the facts and arguments in the case. It would be purely speculative to say that, had there been creditors who relied only upon a subsidiary or the parent, the court in *Soviero* would have affirmed the motion despite such reliance.

In *Stone*, a Fourth Circuit case, the fact situation was similar to that in *Soviero*. Unlike *Soviero*, however, the court addressed itself to the problem of possible unfair prejudice to creditors of the subsidiary in the event that the assets of the parent and subsidiary were merged: "There may be reason for recognizing the separate entity of the subsidiary . . . , [as] where the subsidiary has been allowed to transact business as an independent corporation and credit has been extended to it as such on the faith of its ownership of the assets in its possession."[25] In denying a rehearing, the court emphasized that if there were creditors of the subsidiary who did in fact rely upon it, their interests were to be protected in the bankruptcy proceeding.[26]

These two cases, then, cannot be utilized to uphold the proposition that the absence or presence of relying creditors has no bearing on the question whether a bankruptcy court will merge the assets and liabilities of interrelated corporations. If the first suggested interpretation is the intended holding of the case, then Judge Smith is either misapplying the cited cases to the facts in *Kheel*, or he is saying that there is no precedent on the issue, and is therefore concluding that such reliance is irrelevant to the outcome on the basis of his own reasoning. The latter possibility is unlikely, since Judge Smith did not use any language which would suggest that *Soviero* and *Stone* leave him free to decide the issue of reliance on his own.

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21 Indeed, in pointing out the degree to which the corporations were in reality one enterprise, the court found that the controlling shareholder had sent to all creditors of the affiliated corporations a financial statement which listed the assets of the corporations without specifying to which corporation they belonged. Soviero v. Franklin Nat'l Bank, 328 F.2d 446, 448 (2d Cir. 1964).

22 232 F.2d 294 (5th Cir. 1956).

23 328 F.2d at 448.

24 369 F.2d at 847.

25 Stone v. Eacho, 127 F.2d 284, 288 (4th Cir. 1942).

26 128 F.2d at 16.

A second interpretation of the majority opinion is that, because of the "practical impossibility of reconstructing the financial records of the debtors,"[27] a determination of the significance of Chemical's objection is unnecessary. Accordingly, the majority opinion is not establishing any kind of precedent as to the merits of the objection to merger by a creditor who relies upon a single corporation. If a subsequent court does decide that a relying creditor's claim must be satisfied out of the assets of the corporation with which it dealt, the court could do so without overruling or rejecting *Kheel.* That no ruling on the merits of Chemical's objection need be made quite logically follows the factual finding of a "practical impossibility" of separation of the eight corporations, since this finding would seem to preclude the necessity of passing on *any* objection no matter how valid.

Although such a holding might have been a reasonable one, it does not in fact appear to be the holding of the case. Judge Smith did discuss, though ambiguously, the merits of Chemical's objection to merger; he did say something about the rights of a relying creditor and did support his conclusion by reference to the *Soviero* and *Stone* cases, neither one of which raises the problem of administrative infeasibility of separation. His discussion of Chemical's objection to merger, and the absence of any language which clearly indicates that Judge Smith purposely established no precedent on the issue of reliance, dictates against such an interpretation.

It is submitted that the more plausible reading of the majority opinion is a third possibility. According to this interpretation, the court has recognized the soundness of Chemical's objection to merger. Nevertheless, other factors in the case, notably the extreme expense and infeasibility of conducting separate audits of the eight corporations, required a merger of their assets and liabilities. The statement "we find no such limitation on the power of the reorganization court"[28] therefore anticipated the court's approach of weighing conflicting factors, only one of which was Chemical's possible status as a relying creditor. Reliance on a single corporation was a factor to be taken into consideration in ordering merger, but it was outbalanced by other factors. This reading of the majority opinion does not contradict the holdings of the *Stone* and *Woodbury* cases, both of which were concerned with the rights of relying creditors. Whereas those two cases held that the assets of affiliated corporations could not be merged so as to adversely affect the claims of creditors who relied upon one corporation, the *Kheel* court found that this principle must give way to practical considerations which were not present in *Stone* and *Woodbury.* Thus *Kheel* does not abrogate the principle of those cases, but merely qualifies it.

As already noted, it would appear that Judge Friendly believed that the majority opinion did not qualify the principle of the *Stone* and *Woodbury* cases, but did in fact abrogate it. Yet the two opinions are readily reconcilable. The difference of opinion between Judge Smith and Judge Friendly lies more logically in their views of whether the facts *in this case* allow a relying creditor to be protected. This conclusion is borne out by Judge

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[27] 369 F.2d at 847.
[28] Ibid.

Friendly's belief, contrary to that of Judge Smith, that the administrative infeasibility of separate accountings "was not that aggravated"[29] so as to deny separation. In diminishing the significance of administrative considerations, and thereby removing the obstacles to separate audits, Judge Friendly correspondingly placed far greater importance on the objection of Chemical than the majority was willing to do. In short, the apparent discord between the majority and minority is not so much one of legal or equitable principles but one of fact, *i.e.*, the degree of administrative infeasibility of separate audits.

It would seem that the referee would be best situated to determine the fact question of whether such an impracticality was present. In *Kheel*, the referee's express findings of fact quite persuasively indicate that the administrative impracticality of separating the eight corporations for liquidation purposes far outweighed any equities which Chemical may have possessed by reason of its status as a relying creditor. The records of the corporations showed a discrepancy of one and one-half million dollars between the credits and debits of the intercorporate debts, probably because many of the intercorporate transactions were never sufficiently recorded.[30] That the corporations often satisfied or guaranteed each other's obligations to third parties is also indicative of the fact that the funds of the corporations were handled by Kulukundis as if they were one common source of operating capital.[31] Moreover, many employees, whose knowledge of the corporations' dealings would be essential to a proper accounting, had long since left the employ of the corporations.[32] Finally, to attempt separate audits, it would take six accountants one year and cost approximately two hundred thousand dollars.[33]

Notwithstanding their difference of opinion, Judge Friendly reached the same result as the majority of the court, but by means of a different approach. Whereas the majority tacitly assumed that Chemical had in fact relied solely upon Seatrade, Judge Friendly attacked the very basis of Chemical's allegation. His concurrence was founded "on the ground of insufficient proof by Chemical that it or the bondholders for whom it is trustee relied on the credit of the mortgagor, Seatrade Corp."[34] That Chemical should have the burden of proof in this case seems most reasonable.[35] A general pattern of dealing was clearly established between the corporations and their creditors; the creditors of one corporation were frequently paid with the assets of others, and corporations would often pledge their assets to secure the obligations of other corporations in the group.[36] It is logical therefore that Chemical should

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29 Id. at 848.

30 Brief for Appellant, pp. 30a, 31a (appendix) (Findings of Fact of Referee Nos. 30, 33). The corporations' financial records were so incomplete that the referee concluded: "In sum, the books and records do not fairly present the conditions of the Debtor Companies." Id. No. 30, at 30a.

31 369 F.2d at 846.

32 Findings of Fact No. 32, supra note 30, at 31a.

33 Id. No. 31, at 31a.

34 369 F.2d at 848.

35 It was Chemical's contention that such a burden of proof falls on the moving party. Reply Brief for Appellant, p. 3.

36 369 F.2d at 846.

prove that it fell outside of this pattern.[37] To rule otherwise would require the party which proposed consolidation and merger (the government) to come forth with evidence that each and every one of the fifteen hundred unsecured creditors had not relied solely on a single corporation. Basic considerations of practicality necessitate that Chemical, the party which could best bear the burden of proof, prove its allegation of reliance in order to protect whatever equities it may have.

The problem of the burden of proof raises a more basic issue, namely the nature of reliance itself. It is interesting to note that while both opinions discuss the importance of the existence of a relying creditor, neither opinion actually defines what a relying creditor is. Reliance is generally accepted to refer to the situation of a creditor who has dealt only with a single corporation, and who has extended credit to it on the basis of its ostensible ownership of assets. Put another way, if a creditor bargains with a specific corporation, he may be said to rely only upon that corporation for repayment of his loan.

The majority opinion, however, refers to relying creditors as those "who have dealt solely with [a] . . . debtor without knowledge of its interrelationship with others."[38] Similarly, Judge Friendly speaks of a creditor "who had relied on the credit of one [corporation]—especially . . . a creditor who was ignorant of the loose manner in which corporate affairs were being conducted."[39] These two descriptions emphasize the element of knowledge, yet reliance and knowledge are by no means synonymous. A creditor might bargain with and rely upon a corporation when it extends credit to it and still have knowledge that the corporation is intimately related with affiliated corporations. This is not to suggest that the two elements are mutually exclusive. The degree to which a creditor is aware of a corporation's involvement with affiliated corporations has obvious evidentiary weight in determining whether or not that creditor may be said to have relied upon the credit standing of one corporation. Given the facts in *Kheel*, for example, it would seem inconceivable that a creditor could claim to have relied solely upon Seatrade while knowing of its intimate relationship with the other corporations in the Kulukundis group. Although the majority and minority were probably referring to the evidentiary relationship between knowledge and reliance, and not holding that there can be no reliance unless the fact-finder rules that the creditor was ignorant of intercorporate dealings, the court could have clarified the issues if it had more explicitly defined the standard to which a relying creditor must conform if it is to have any basis for complaint.

Still another approach to the facts in *Kheel*, also involving a burden of proof, might have been undertaken to show that merger of the assets of the eight corporations was the most equitable result. The underlying basis of Chemical's contention was that, as a relying creditor, it would be unfairly

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[37] In Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941), the Court noted that "the theme of the Bankruptcy Act is equality of distribution. To bring himself outside of that rule an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice." *Woodbury* was cited as an instance where creditors did show such evidence.

[38] 369 F.2d at 847.

[39] Id. at 848.

prejudiced by such an order; Chemical's brief asserted that if there were merger, all unsecured creditors would receive seventeen cents on the dollar, whereas if there were separate audits, Chemical would realize fifty-four cents on the dollar.[40] These figures were based on a preliminary statement of the financial conditions of the debtor corporations prepared for the trustees. Because of the inaccuracy of the corporations' books and records, however, these estimates are only rough approximations, a fact which Chemical readily admitted. The referee and the district court concluded that Chemical had failed to prove to what degree, if at all, it would be adversely affected by merger.[41] Apparently, the foundation for this conclusion by the lower court was that the books of the corporations were so imprecise that they could not be utilized to form the basis of Chemical's allegation. On appeal, Chemical argued that a precise calculation of the adverse effect of merger was impossible, that such a burden of proof was therefore unreasonable, and that its approximations did satisfy whatever burden it possessed.[42] A burden requiring precision would indeed seem to be an impossible one in light of the fact that, short of a complete accounting, there was no other material upon which Chemical could calculate an approximation of the harm to it by merger. Nevertheless, if the majority or the minority had chosen to consider the issue of prejudice, they might easily have found that, on the basis of the very source Chemical relied upon—the preliminary statement of financial conditions—it failed to prove any probable harm by merger.

The basis for this conclusion is that Chemical's calculations did not give effect to the many intercorporate claims. This exclusion is significant, for the preliminary statement reveals that Seatrade Corporation was a net intercorporate debtor by a considerable amount.[43] Hence, by ignoring Seatrade's debts to her affiliated corporations, Chemical has in effect disregarded the supposedly separate corporate entities in the Kulukundis empire for one purpose—invalidating intercorporate claims—and yet advocated retention of the separate entities for another purpose—liquidation of assets for the satisfaction of creditors. The incongruity is manifest, for if there is justification for the second course of action, allowance of the intercorporate debts necessarily follows. As a net debtor, Seatrade, and therefore its creditors, would receive a windfall if the intercorporate debts against it were not given validity, since it would be relieved of liabilities which it had fairly incurred. It is obviously inconsistent for Chemical to argue that satisfaction of its claim in bankruptcy should be made out of the assets of a corporation upon whose credit standing it relied, and at the same time to argue that a substantial portion of that corporation's liabilities should be ignored.

Allowance of the intercorporate claims would radically decrease Chemical's approximation of fifty-four cents, since Seatrade's assets would no longer support such a recovery.[44] A further dilution of Seatrade's assets would re-

[40] Brief for Appellant, pp. 21-22.

[41] Id. at 33a (appendix) (Conclusions of Law of Referee No. 4); 255 F. Supp. at 702.

[42] Brief for Appellant, pp. 19-22.

[43] Id. at 64a-66a (appendix) (Seatrade Corporation, Statement of Condition).

[44] According to the preliminary statement, Seatrade had assets of $1,276,000 available for distribution to unsecured creditors. Because the claims of these creditors amounted

sult from the tremendous administrative expense of conducting separate audits. This expense, which of course would not be present if the assets were merged, was estimated to be at least two hundred thousand dollars, a substantial part of which would be allocated to Seatrade.[45] Given the allowance of intercorporate debts, it is highly unlikely that Chemical could recover more than seventeen cents on the dollar if merger were not ordered. This figure of seventeen cents is what Chemical claims would result if merger were ordered. Hence, there has been a failure to prove prejudice, since it can make little difference to Chemical whether it receives seventeen cents by one method of liquidation or by another.

The *Kheel* case presents a complex and unique situation in which the equities of the parties are not readily apparent. Because the fact situation in *Kheel* is unique, the possible ramifications of the court's holding and reasoning are limited. The case nevertheless raises significant questions as to the equities of creditors of affiliated corporations in a bankruptcy proceeding. If there is error by the court, it is the lack of a definitive statement and resolution of the conflicting equities which arise from the facts of the case. This alleged shortcoming can only confuse future courts and practitioners and make obscure what is undoubtedly a most equitable result.

SAMUEL P. SEARS, JR.

Bankruptcy—Jurisdiction of Bankruptcy Court to Enjoin Arbitration Proceedings—"Unusual Circumstances" Doctrine.—*Fallick v. Kehr*.[1] —In October 1964, Harry Kehr instituted an action in the Supreme Court of New York against his partner, Lowell Fallick, alleging that Fallick had misappropriated partnership funds. Pursuant to a clause in the partnership agreement which provided for submission of all controversies between the partners to the American Arbitration Association, Fallick moved in the state court for an order compelling arbitration. As a result of that motion, Kehr abandoned his state court action and commenced arbitration proceedings. In January 1965, Fallick filed a voluntary petition in bankruptcy, and an order was entered under Section 11(a) of the Bankruptcy Act, staying all proceedings (including the arbitration) pending resolution of the bankruptcy action.[2]

to $2,352,000, they would each receive 54 cents on the dollar. On the other hand, the assets and liabilities of all eight corporations equaled $2,796,000 and $16,135,000 respectively, leaving 17 cents per dollar for each creditor. These figures did not include intercorporate debts. As for Seatrade, it had intercorporate payables of $5,214,743 and receivables of only $62,036. When these amounts are added to Seatrade's above figures, its assets would total $1,338,036 and its liabilities $7,566,747. Calculation of these new sums reveals a striking coincidence: Seatrade's unsecured creditors would receive 17 cents on the dollar. Id. at 64a-66a, 75a-77a (appendix) (General Work Papers of Peat, Marwick, Mitchell & Company, Accountants for Trustees).

45 Id. at 31a (appendix) (Findings of Fact No. 31).

1 2 Bankr. L. Rep. (4th ed.) ¶ 62027 (2d Cir. 1966).

2 Section 11(a) provides:

A suit which is founded upon a claim from which a discharge would be a