CASE NOTES

Bankruptcy—Creditor Corporation and Its Wholly Owned Subsidiary As Separate Petitioning Creditors.—*In re Gibraltor Amusements, Ltd.*[1] —The Wurlitzer Company (Wurlitzer) filed an involuntary petition in bankruptcy against Gibraltor Amusements, Ltd. (Gibraltor).[2] The latter's answer denied that there were fewer than twelve creditors, whereupon Wurlizter was granted leave to amend its petition, and three other parties were allowed to file as intervening creditors.[3] One of these creditors was Wurlitzer Acceptance Corporation (WAC), Wurlitzer's wholly owned financing subsidiary. After finding all parties qualified as petitioning creditors, the referee adjudged Gibraltor a bankrupt. The District Court upheld the referee's findings in all respects but one—it disqualified one of the intervening creditors on the ground that its claim was "contingent as to liability."[4] Thus, the number of petitioning creditors was reduced to the statutory minimum of three.

On appeal, the only real question before the court was whether a creditor corporation and its wholly owned subsidiary could be counted as separate petitioning creditors under section 59(b) of the Bankruptcy Act. The Court of Appeals affirmed. HELD: Neither ordinary principles of corporate law, nor the language or policy of the Bankruptcy Act warrant the disregard of the subsidiary's corporate identity.

In arriving at its decision, the court emphasized the "complete absence of fraud and strict honoring of the corporate form as to assets and intercorporate transactions."[5] It found that the language of the act defining "creditor"[6] was "virtually all encompassing;" and that the detailed provisions of section 59(e)[7] indicated that the principal Congressional fear of abuse was that insolvent debtors might be able to frustrate one or two large creditors by connivance with friendly creditors. Turning to the policy of the act, the majority referred to the fact that the courts had been quite liberal in allowing assignees of claims to qualify as petitioners, and noted the absence of any indication that Wurlitzer had used its subsidiary's corporate form to subvert the provisions of the Bankruptcy Act.[8]

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1 291 F.2d 22 (2d Cir. 1961).

2 Section 59(b) of the Bankruptcy Act, 30 Stat. 561 (1898), as amended, 11 U.S.C. § 95(b) (1958), provides that where all the creditors of a person are less than twelve, one or more creditors may file a petition to have him adjudged a bankrupt; but where his creditors are twelve or more, § 59(b) expressly requires that three or more creditors join in the involuntary petition. (Hereinafter citation is to sections of the act only, e.g., Bankruptcy Act, §—.)

3 Where only one creditor has filed the petition and the defendant's answer alleges the existence of twelve or more creditors, the court may allow the petition to be amended and other parties to join therein so as to make up the requisite number of creditors. Bankruptcy Act, § 59(d).

4 The Bankruptcy Act, § 59(b) requires that petitioning creditors have "provable claims liquidated as to amount and not contingent as to liability. . . ."

5 291 F.2d at 24-25.

6 "'Creditor' shall include *anyone who owns a debt, demand or claim* provable in a bankruptcy. . . ." Bankruptcy Act, § 1(11). (Emphasis supplied by the court.)

In a vigorous dissent, Judge Friendly concentrated on the policy question. Chastizing the majority for its "bland statement" that the requirement of three petitioning creditors was a compromise between divergent provisions of earlier statutes, he rekindled the passion of the Congressional debates leading to the compromise provision. While conceding that WAC might be regarded as a separate legal entity in other situations,[9] Judge Friendly felt that the obvious purpose of section 59(b) was to require three creditor interests, separate in reality, not merely in legal form. He concluded that it was inconsistent with this purpose "to hold that a single creditor corporation may insure its ability to initiate an involuntary bankruptcy by the simple expedient of organizing two financing subsidiaries—and seeing to it that claims against each debtor are parceled out in advance of bankruptcy."[10]

Judge Friendly has expressed his belief that the recognition granted WAC by the majority violates the policy of the Bankruptcy Act. This he has done with a clarity unfortunately lacking in the majority opinion. A better reasoned and more forceful opinion would perhaps have allayed many of the fears expressed by the dissenting judge.

In spite of the vehemence which characterized the Congressional debates leading to passage of the Bankruptcy Act in 1898, it would seem that Judge Friendly has attached a disproportionate weight to policy considerations.[11] He expresses his regret concerning this particular case, but nonetheless the purpose of the act compels him to find an absolute prohibition against counting a parent and its subsidiary as separate petitioning creditors under section 59(b). In arriving at this conclusion, the dissenting judge would seem to indicate his lack of confidence in those fundamental safeguards which stem from the fact that bankruptcy proceedings are in the nature of proceedings in equity;[12] he would seem to look upon the test of "good faith," though adequate for other purposes, as not offering a sufficient degree of protection so far as section 59(b) is concerned.

Apparently, it has never been questioned that an assignee or transferee of a claim may be counted as a separate petitioning creditor under section 59(b), where the assignment or transfer was for bona fide consideration and

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7 As enacted in 1898, § 59(e) provided that in computing the number of creditors for the purpose of determining how many should join in the petition, relatives and employees of the bankrupt should not be counted. The section was amended in 1938 to exclude, in addition, stockholders and directors of a bankrupt corporation, and several other classes of creditors.

8 291 F.2d at 26.

9 Ibid.

10 291 F.2d at 29 & n. 6.

11 At this point, it might be well to note the admonition of Judge Holt who stated: "I am not able to see upon what ground courts have the right to impose additional conditions, not stated in the bankrupt act, upon the right of any creditor having a provable claim to join in an involuntary petition." In re Hanyan, 180 Fed. 498 (S.D.N.Y. 1910), aff'd without opinion, 181 Fed. 1021 (2d Cir. 1910).

12 Pepper v. Litton, 308 U.S. 295 (1939); Clark v. Johnson, 245 Fed. 442 (8th Cir. 1917); Ogden v. Gilt Edge Consol. Mines Co., 225 Fed. 723 (8th Cir. 1915).

not for the sole purpose of making up the requisite number of creditors.[13] The decided cases do not refer to any absolute prohibition, the inquiry being whether or not there was any attempt to defeat the carefully prepared scheme of the Bankruptcy Act. Although expressing his doubt concerning the wisdom of *In re Bevins*,[14] Judge Friendly does not seem to be questioning the results of these cases generally. Yet one might ask why the same policy considerations, which still retain sufficient vigor to impose an absolute prohibition upon recognition of parent and subsidiary under section 59(b), have never demanded this result as far as assignees and transferees are concerned.[15] The only difference between these two situations is the "control" exercised by the parent over the subsidiary, and yet a claim could be "parceled out" just as easily to a friendly but "separate" corporation, in advance of bankruptcy, as to a subsidiary corporation. Even if this were not so, it is submitted that the element of "control" alone should not bring about a different result in the present case, since Wurlitzer neither abused its dominant position, nor attempted to use its control to gain any unfair advantage in the bankruptcy proceedings.[16] The ability of the court to examine the entire transaction, to search for even the slightest intention to subvert the provisions of the Bankruptcy Act, certainly affords the parties, especially the debtor, adequate protection, and in so doing, fully satisfies the most stringent demands of the policy considerations underlying section 59(b).[17]

In a slightly different context, it has been held that a parent may place a subsidiary in an involuntary bankruptcy,[18] and that a parent may recover its full claim against a bankrupt subsidiary in reorganization proceedings.[19] The dissent refers specifically to *Comstock v. Group of Investors*,[20] and apparently finds no fault with the decision. It notes, however, that the policy there applicable did not require that parent and subsidiary be regarded as the same. Whatever may be the "policy" to which Judge Friendly refers,

[13] Emerine v. Tarault, 219 Fed. 68 (6th Cir. 1915); Stroheim v. Perry & Whitney Co., 175 Fed. 52 (1st Cir. 1910); In re Tribelhorn, 137 Fed. 3 (2d Cir. 1905); In re Glory Bottling Co., 278 Fed. 625 (E.D.N.Y. 1921), rev'd on other grounds, 283 Fed. 110 (2d Cir. 1922); Lowenstein v. Henry McShane Mfg. Co., 130 Fed. 1007 (D. Md. 1904). See also Leighton v. Kentucky, 129 Fed. 737 (1st Cir. 1904).

[14] 165 Fed. 434 (2d Cir. 1908). Judge Friendly's doubts would seem to be well founded. The *Bevins* court went so far as to hold that claims may be purchased in order to make up the requisite number of petitioning creditors to sustain an involuntary petition.

[15] Supra note 13.

[16] 291 F.2d at 24-25, 26.

[17] The majority of the cases cited at note 13 suprà refused to recognize the assignee or transferee as a separate petitioning creditor under § 59(b). It is also interesting to note General Order 5(2), 11 U.S.C. following § 53, in this regard. It requires complete disclosure concerning the assignment or transfer, thereby assisting the court in arriving at a decision whether to allow the assignee or transferee to petition as a separate creditor.

[18] In re H. Hicks & Son, 10 F. Supp. 684 (S.D.N.Y. 1935), aff'd, 82 F.2d 277 (2d Cir. 1936).

[19] Comstock v. Group of Investors, 335 U.S. 211 (1948).

[20] Ibid.

Comstock and other like decisions make it even more difficult to accept the absoluteness of his conclusion in the present case. It seems difficult to justify a statutory interpretation which would allow a parent to place its subsidiary in involuntary bankruptcy, and recover its full claim, where the parent had not abused its dominant position, and which, at the same time, would not allow a parent and its subsidiary to be counted as separate petitioning creditors, in spite of the fact that there had been a strict honoring of the corporate form. It is more important, however, to note the approach taken by the *Comstock* Court. That Court did not find itself compelled to lay down a strict prohibition. Its decision is illustrative of the many which recognize the true nature of bankruptcy proceedings, and establish a standard in keeping therewith. In *Comstock*, the Court refused to apply the rule established in *Taylor v. Standard Gas and Electric Co.*[21] because it found that the parent had acted in good faith and with due regard for its obligations to the subsidiary.

Both the majority and the dissent would arrive at a like finding with regard to Wurlitzer's conduct in the present case, and both would also agree that there was no attempted subversion of the Bankruptcy Act.[22] In view of such a finding, which we may assume would withstand even the closest scrutiny, recognition of parent and subsidiary as separate petitioning creditors under section 59(b) would not seem to violate the policy of the Bankruptcy Act. It is difficult to speculate concerning the reaction of Congress to judicial recognition of a corporate form relatively unknown at that time. Nevertheless, behind the clenched fists and the ringing oratory lay one evident purpose, protection of the insolvent debtor! Adherence to the principles outlined above has afforded the debtor more than adequate protection under other circumstances,[23] while preserving the true character of bankruptcy proceedings. There is no reason to believe that adherence to these same principles would afford the debtor any less protection under the circumstances of the present case.

RICHARD T. COLMAN

Bankruptcy—Mortgages—Priority of Federal Tax Liens.—*Wethered v. Alban Tractor Company.*[1]—In October of 1954, Gaither Inc., the appellant—trustee's bankrupt, purchased certain goods from the appellee, Alban Tractor Co., on a conditional sale contract. In December of 1954 Gaither gave the Plaza Corp. a mortgage on some of the goods covered by Alban's

[21] 306 U.S. 307 (1938). The Court reformulated a general equity principle for application to reorganization cases. Known as the "Deep Rock Doctrine," this rule provided that a claim against a debtor subsidiary would be disallowed or subordinated where the parent corporation had dominated and controlled the subsidiary, and had breached its fiduciary duty in the transactions creating the debt, by acting for its own benefit, to the detriment of the subsidiary.

[22] Supra note 16

[23] Supra note 17.

[1] Wethered v. Alban Tractor Company, 168 A.2d 358 (Md. 1961).