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GRUPO MEXICANO AND THE DEATH OF SUBSTANTIVE CONSOLIDATION©

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Introduction

Substantive consolidation [1] is an equitable remedy developed during the 20th Century in bankruptcy cases to merge separate entities so that their assets and liabilities may be aggregated. [2] Application of the remedy of substantive consolidation in the context of corporations, limited partnerships, and limited liability companies may have the effect of overriding the bedrock principle of limited liability, in favor of creating a common pool of assets for the combined creditors of the affiliated entities. The federal courts that have developed the doctrine acknowledge the absence of express statutory authorization for the extraordinary remedy they have created. Instead, the authority to order substantive consolidation has been implied from general equitable powers vested in the federal courts. [3]

A recent decision of the United States Supreme Court indicates that such reasoning is flawed. In *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, [4] the United States Supreme Court held that a federal district court lacks jurisdiction to enjoin a defendant's transfer of assets prior to judgment, no matter how egregious the risk of irreparable harm. [5] In reaching this conclusion, the Supreme Court held that a federal court sitting as a "court of equity" is limited to such equitable remedies as existed in the English Court of Chancery in 1789, the year that Congress enacted the First Judiciary Act. [6]

Grupo Mexicano has restricted the federal courts' reliance upon general principles of equity to fashion remedies. While the historical record on the scope of equitable remedies exercised by the English Chancellor in 1789 is murky, a review of the record leaves a definite and firm conviction that the remedy of substantive consolidation was not available.

Furthermore, section 105 of the Bankruptcy Code [7] should not be interpreted to create equitable remedies that do not have a statutory basis, and that did not exist prior to 1789. While section 105 may supplement relief authorized by statute, it does not grant bankruptcy courts a freewheeling "equitable jurisdiction" as exercised by the English Court of Chancery. In light of the *Grupo Mexicano* decision, the 20th Century doctrine of substantive consolidation should be pronounced dead.

I.The Judge−Made Origins of Substantive Consolidation

A survey of the law of substantive consolidation demonstrates that our federal courts developed the applicable principles during the 20th Century. The origins of substantive consolidation are found in "piercing the corporate veil" cases. The earliest examples of substantive consolidation type relief involved a finding that the insolvent entity with which consolidation was sought was the "alter ego" or an "instrumentality" of the target affiliate. [8] Initially, our federal courts applied state corporate law concepts to a bankruptcy trustee's request for "turnover" relief against the "alter ego" affiliate, such that assets of the affiliate could be administered by the trustee.

There are many different terms ascribed to a state law cause of action seeking to hold a parent corporation, or stockholders, liable for the actions of a corporation. Courts have used a variety of phrases including "alter ego," "instrumentality," "agency," "alias" and "dummy." Justice Benjamin N. Cardozo aptly described this corner of the law

as "enveloped in the mists of metaphor." [9]

The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an "alias" or a "dummy". All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation. Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice. [10]

In analyzing whether a bankruptcy trustee's request to compel "turnover" of the assets of a parent corporation to its subsidiary (or vice−versa) is appropriate in a bankruptcy setting, our federal courts initially borrowed the "instrumentality" concept from state corporate law. [11] In *Taylor v. Standard Gas & Electric Co.*, [12] decided in 1939, the United States Supreme Court had cited the "instrumentality" theory in affirming the lower court's disallowance of a claim asserted by a corporate parent against its bankrupt subsidiary. [13] Two years later, the Tenth Circuit Court of Appeals extended the "instrumentality" theory to a bankruptcy trustee's request for "turnover" relief against the bankrupt's corporate subsidiary. In the seminal substantive consolidation case of *Fish v. East*, [14] the Tenth Circuit cited the following factors as relevant in determining that a corporate subsidiary was a mere "instrumentality" of the parent and, therefore, that the subsidiary's assets should be included in the bankruptcy case of the parent:

(a) The parent owns all or a majority of the capital stock of the subsidiary;

(b) There are common directors and officers;

(c) The parent corporation finances the subsidiary;

(d) The parent corporation is responsible for incorporation of the subsidiary;

(e) The subsidiary has grossly inadequate capital;

(f) The parent company pays the salaries or expenses or losses of the subsidiary;

(g) The subsidiary has no independent business from the parent;

(h) The subsidiary is commonly referred to as a subsidiary or as a department or a division of the parent;

(i) Directors and executive officers of the subsidiary do not act independently but take direction from the parent; and

(j) The formal legal requirements of the subsidiary as a separate and independent corporation are not observed. [15]

While the Tenth Circuit found sufficient facts in the *Fish* appeal to grant the parent corporation trustee's request for turnover, it did not decide whether the creditors of the subsidiary should be denied priority to the subsidiary's assets. [16] Two years later, in *Stone v. Eacho* (*In re Tip Top Tailors, Inc.*) [17] the Fourth Circuit Court of Appeals approved the consolidation of the subsidiary (described as a "corporate pocket") into the parent corporation. Moreover, the court held that the creditors of the parent and the subsidiary should share *pro rata* in the combined asset pool, because there was no evidence that the creditors of the subsidiary relied upon its sole credit. [18]

However, in the early years of the doctrine's development, other federal courts were reluctant to grant "turnover" relief in the context of a corporate parent and its subsidiary. For example, while the Fifth Circuit cited approvingly the "instrumentality" factors from the *Fish v. East* opinion, it declined to approve a bankruptcy referee's turnover order against a corporate subsidiary. [19] The Fifth Circuit observed the subsidiary's assets were held by a state court receiver, and thus the bankruptcy referee lacked jurisdiction to grant the consolidation.

To be sure, the early substantive consolidation cases do not indicate whether state law or federal law govern the standards to be applied. Under the *Erie* [20] doctrine, which was announced just two years before *Fish v. East*, federal courts must apply state corporate law principles in order to grant "piercing the corporate veil" and "alter ego" relief. So long as the federal courts follow state corporate law "alter ego" principles to a creditor's request to consolidate one corporation into another, the *Grupo Mexicano* limitation upon the exercise of federal equitable powers as discussed herein is not invoked. The federal courts may pierce the corporate veil to effect a consolidation if fraud or "alter ego" acts recognized under state corporate law are present. [21]

It should also be noted at this juncture that many state legislatures eventually acted to reduce the "mist" associated with the "piercing the corporate veil" and related common law doctrines. [22] However, a different kind of "mist" has fallen upon parties to bankruptcy cases involving multi−tiered corporate entities.

Beginning in the 1960's, federal courts departed from state corporate law "alter ego" principles, and invented a federal common law of substantive consolidation. The Second Circuit Court of Appeals summarized the difference between state "alter ego" law and federal "substantive consolidation" principles as follows: "The focus of piercing the corporate veil is the limited liability afforded to a corporation;" whereas, the focus of substantive consolidation is "the equitable treatment of all creditors." [23] The distinct federal law doctrine of substantive consolidation begins to emerge in 1964 in *Soviero v. Franklin Nat'l Bank of Long Island*, [24] in which the Second Circuit rejects a creditor's contention that corporate veils can be pierced only in cases of fraud [25] − which had been a fundamental requirement under most state law. The contours of this new consolidation doctrine were further developed in *Chemical Bank New York Trust Co. v. Kheel*, [26] *Flora Mir Candy Corp. v. R. S. Dickson & Co.* (*In re Flora Mir Candy Corp.*), [27] and *James Talcott, Inc. v. Wharton* (*In re Continental Vending Mach. Corp.*). [28] Finally, the term "substantive consolidation" itself appears in an opinion authored by Bankruptcy Judge Roy Babitt in 1977. In *In re Commercial Envelope Manufacturing Co.*, Judge Babitt wrote: "[s]ubstantial consolidation, as will be seen, is now part of the warp and woof of the fabric of the bankruptcy process involving related debtors, though to be used sparingly." [29]

Subsequent to the advent of the Bankruptcy Reform Act of 1978, a "modern" or "liberal" trend toward allowing substantive consolidation emerged. The Eleventh Circuit observed this "modern" trend had its "genesis in the increased judicial recognition of the widespread use of interrelated corporate structures by subsidiary corporations operating under a parent entity's corporate umbrella for tax and business purposes." [30] At present, two circuit−level tests guide the bankruptcy courts in the application of substantive consolidation, one from the United States Court of Appeals for the District of Columbia Circuit, [31] and the other from the Second Circuit. [32]

Under the District of Columbia Circuit test, the proponent of substantive consolidation must show: (1) a substantial identity between the entities to be consolidated; (2) that consolidation is necessary to avoid some harm or to realize some benefit; *and* (3) if a creditor objects and demonstrates that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation, then the court may order consolidation only if it determines that the demonstrated benefits of consolidation "heavily" outweigh the harm. [33]

Under the Second Circuit test, the proponent must show one of two alternative grounds for substantive consolidation: (1) that the creditors dealt with the entities as a single unit and did not rely on their separate identity in extending credit *or* (2) that the affairs of the entities are so entangled that consolidation will benefit all creditors because untangling is either impossible or so costly as to consume the assets. [34] If a party in interest objects and demonstrates one of the two alternative grounds, then the court may order consolidation only if it determines "that consolidation yields benefits offsetting the harm it inflicts on objecting parties." [35]

Unfortunately, there is enough fuzziness and uncertainty in the language of all these tests to allow a court to pick and choose amongst the factors and synthesize its own view of the jurisprudential standards. This inconsistency among courts over the standards to be followed is not surprising since the Bankruptcy Code itself is entirely silent on the issue. As noted in *FDIC v. Colonial Realty Co.*: [36]

There is no express authority for any substantive consolidation in the Bankruptcy Code. As this Court has stated, "[s]ubstantive consolidation has no express statutory basis but is a product of judicial gloss." [37]

The Advisory Committee's Note to Bankruptcy Rule 1015 observes there is no express authority under the statute or the rules for substantive consolidation. [38]

Lacking a statutory basis, the authority to order a pooling of assets and liabilities of affiliated debtors in appropriate cases rests on the premise that our bankruptcy courts have the powers of a "court of equity." [39] In the seminal *Continental Vending* case, the Second Circuit concludes the "power to consolidate is one arising out of equity." [40] However, the continuing validity of this premise is called into question by both subsequent statutory developments and the holding of *Grupo Mexicano*. [41]

II.Is a Bankruptcy Court a "Court of Equity"?

In 1934 the United States Supreme Court declared: "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." [42] In exercising the jurisdiction conferred upon it, the bankruptcy court "applies the principles and rules of equity jurisprudence." [43] At first blush, it may seem settled that a bankruptcy court is a "court of equity." [44] However, a review of the evolving bankruptcy jurisdictional statutes indicates this is an oversimplification.

The first federal bankruptcy law, the 1800 Act, gave bankruptcy jurisdiction to the district courts. [45] The second law, the 1841 Act, also empowered the district courts to exercise this jurisdiction in the nature of summary proceedings in equity. [46] The district courts were thereby empowered to effectively act as equity courts for purposes of bankruptcy.

The district courts' equity power in bankruptcy matters was explicitly continued under the 1898 Act. [47] The critical language of the 1898 Act was the very first part −− the introductory part −− of section 2:

[T]he district courts of the United States . . . are hereby made courts of bankruptcy, and are hereby invested . . . with such jurisdiction at law *and in equity* as will enable them to exercise original jurisdiction in bankruptcy proceedings . . . [48]

This language meant that "[a] bankruptcy court is a court of equity, . . . guided by equitable doctrines and principles except in so far as they are inconsistent with the [bankruptcy statute]." [49] To be a court of equity means "at least . . . that in the exercise of the jurisdiction conferred upon it . . ., it [the bankruptcy court] applies the principles and rules of equity jurisprudence." [50]

In the Bankruptcy Reform Act of 1978, Congress enacted section 1481 of title 28, which provided in pertinent part that "[a] bankruptcy court shall have the powers of a court of equity." [51] However, the United States Supreme Court found unconstitutional Congress' attempt to broadly expand the jurisdiction of the bankruptcy courts in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.* [52] As a result of *Marathon*, Congress repealed section 1481 [53] and other jurisdictional provisions of the Bankruptcy Reform Act of 1978. [54]

In response to *Marathon*, in 1984 Congress enacted new jurisdictional statutes with regards to bankruptcy courts. United States Code, title 28 section 1334(a) provides that "the district courts shall have original and exclusive jurisdiction of all cases under title 11." [55] Section 1334(b) of title 28 grants district courts jurisdiction of "civil proceedings arising under title 11, or arising in or related to a case under title 11." [56] Section 157 then allows district courts to refer to bankruptcy judges any and all cases and proceedings arising under title 11. [57] Section 151 states that bankruptcy judges constitute a "unit" of the district court, and may as a judicial officer of the district court, exercise the authority conferred under that chapter. [58] None of the current provisions make any reference to equity jurisdiction. Unlike pre−1984 law, title 28 at present does not expressly provide bankruptcy courts with equity jurisdiction. Under the post−1984 statutory scheme, a search for the source of the general equitable powers exercised by federal courts leads back to the 18th Century. [59]

III.Federal Court Equity Jurisdiction and *Grupo Mexicano*

A study of the "equitable powers" of our federal courts begins with two 18th Century landmarks−−Article III of the Constitution and the Judiciary Act of 1789. The Constitution provides that federal courts may be given jurisdiction

over "Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority." [60] Pursuant to the Judiciary Act of 1789, Congress chose to exercise its power to create inferior federal courts. [61] As explained by the Supreme Court in *Sprague v. Ticonic Nat'l Bank*, [62] the Judiciary Act of 1789 granted courts a "body of remedies, procedures and practices which theretofore had been evolved in the English Court of Chancery, subject, of course, to modifications by Congress." [63] However, the *Sprague* case did not preclude the development of equitable remedies beyond those that existed in 1789, [64] as would later be decided in *Grupo Mexicano*.

Section 1331 of title 28 further implements Article III of the Constitution, by providing that the district courts "have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." [65] To be sure section 1331 does not mention actions in "equity." However, because of the merger of law and equity in federal courts, [66] the reference to "civil actions" in section 1331 appears to encompass traditional equity actions. Likewise, with the merger of law and equity, it appears the "civil proceedings arising under title 11, or arising in or related to" covered by section 1334 may also encompass traditional equity actions arising in, under, or related to a bankruptcy case. [67] However, under the current statutory scheme, the general equity jurisdiction to be exercised by the bankruptcy judges must flow from their status as "units" of the district courts since they no longer have a specific grant of equity jurisdiction. [68]

Having shown the bankruptcy judge's equity power should be no greater than that exercised by the district court, the district court's equity powers are examined in light of *Grupo Mexicano*. In *Grupo Mexicano*, the Supreme Court was presented with the issue of whether the district court had the authority to issue a preliminary injunction to prevent the dissipation of assets. In deciding the case, the Supreme Court would revisit the discretion of the federal courts to develop equitable remedies.

The facts of the case are not unlike those encountered in the workout of a troubled company. Grupo Mexicano de Desarrollo (GMD), a Mexican holding company that constructs and operates roadways, sold $250 million of 8.25% guaranteed notes (the "Notes") to institutional investors (the "Investors") in order to take care of more than $100 million of high interest debt.

In August, 1997, GMD failed to make the interest payment on the Notes. Because of this default, the plaintiff−Investors caused acceleration of the principal. Ten days later, the Mexican government came to the rescue by implementing the Toll Road Rescue Program. Mexico promised to issue government guaranteed Toll Road Notes to GMD and other toll road operators to reimburse them for unpaid construction receivables and expenses. In addition to the debt owed to the Investors, GMD owed more than $450 million to other creditors. Its five largest creditors were the Mexican government, numerous Mexican banks, additional Mexican financial institutions, trade creditors, and terminated employees (collectively "Mexican Creditors"). Because the Mexican government's program would not fully alleviate its financial difficulties, GMD began to restructure its debt, reduce costs, and seek additional equity contributions. GMD undertook to negotiate with both the Investors and the Mexican Creditors to settle its financial obligations. Later, a press release disclosed that GMD had assigned $117 million in Toll Road Notes to settle other obligations−−$100 million to the Mexican government to pay taxes and $17 million to pay severance packages to terminated workers in accordance with Mexican law. Although GMD did not have possession of the Toll Road Notes, it placed certain assets in "trust" for these creditors with the understanding that the encumbered assets would later be exchanged for Toll Road Notes.

On December 12, 1997, the Investors commenced an action in the United States District Court for the Southern District of New York alleging that GMD had defaulted on its obligation under the Notes. The Investors sought, *inter alia*, damages for GMD's breach of its contractual obligations under the Notes and a preliminary injunction restraining GMD from assigning the Toll Road Notes. By order to show cause, the Investors secured a temporary restraining order precluding the transfer or encumbrance of the Toll Road Notes. One day before the preliminary injunction hearing, GMD revealed that GMD had made additional, previously undisclosed assignments of $38 million in Toll Road Notes to the Mexican banks. GMD also planned to make still further assignments, leaving only $5.5 million in Toll Road Notes to satisfy the $75 million debt owed to the Investors.

Following a hearing, the district court granted the preliminary injunction (under Fed. R. Civ. P. 65) restraining GMD from dissipating, transferring, conveying, or otherwise encumbering the Investor's right to receive or benefit from the issuance of the Toll Road Notes. The District Court determined that the Investors satisfied their burden for the issuance of a preliminary injunction because: (1) they would almost certainly succeed on their breach of contract claims against GMD; and (2) without the injunction they faced an irreparable injury since GMD's financial condition and its dissipation of assets would frustrate any judgment recovered. On appeal, the Second Circuit affirmed. [69]

The Supreme Court reversed, holding that a federal district court lacked jurisdiction to enjoin GMD's transfer of assets prior to judgment. Justice Scalia, on behalf of the majority, does "not question the proposition that equity is flexible; but in the federal system, at least, that flexibility is confined within the broad boundaries of traditional equitable relief." [70] The Court held that:

the equitable powers conferred by the Judiciary Act of 1789 did not include the power to create remedies previously unknown to equity jurisprudence. Even when sitting as a court in equity, we have no authority to craft a "nuclear weapon" of the law like the one advocated here. [71]

The broad reach of the opinion is exemplified by the Court's inclusion of a quote of Joseph Story:

If, indeed, a Court of Equity in England did possess the unbounded jurisdiction, which has been thus generally ascribed to it, of correcting, controlling, moderating, and even superceding the law, and of enforcing all the rights, as well as the charities, arising from natural law and justice, and of freeing itself from all regard to former rules and precedents, it would be the most gigantic in its sway, and the most formidable instrument of arbitrary power, that could well be devised. It would literally place the whole rights and property of the community under the arbitrary will of the Judge, acting, if you please, *arbitrio boni judicis*, and it may be, *ex aequo et bono*, according to his own notions and conscience; but still acting with a despotic and sovereign authority. A Court of Chancery might then well deserve the spirited rebuke of Seldon; "For law we have a measure, and know what to trust to−−Equity is according to the conscience of him, that is Chancellor; and as that is larger, or narrower, so is Equity. T is all one, as if they should make the standard for the measure the Chancellor's foot. What an uncertain measure would this be? One Chancellor has a long foot; another a short foot; a third an indifferent foot. It is the same thing with the Chancellor's conscience." [72]

Justice Scalia's majority opinion concludes that the public debate over the formidable equity power over debtors "should be conducted and resolved where such issues belong in our democracy: in the Congress." [73]

Justice Ginsburg's dissenting opinion leaves no doubt that the majority intended to freeze the expansion of equitable remedies at their 1789 status:

In my view, the Court relies on an unjustifiably static conception of equity jurisdiction. From the beginning, we have defined the scope of federal equity in relation to the *principles* of equity existing at the separation of this country from England, (citations omitted); we have never limited federal equity jurisdiction to the specific practices and remedies of the pre−Revolutionary Chancellor. [74]

The dissenting justices also expressed a concern that this static approach would hinder the ability of federal courts to avoid the modern trend toward "judgment proofing" strategies:

Moreover, increasingly sophisticated foreign−haven judgment proofing strategies, coupled with technology that permits the nearly instantaneous transfer of assets abroad, suggests that defendants may succeed in avoiding meritorious claims in ways unimaginable before the merger of law and equity. [75]

However, this point of view was not persuasive to a majority of the Court. Accordingly, it appears the United States Supreme Court has delegated the development of equitable remedies to counteract so−called "judgment proofing" strategies to legislatures. [76]

IV. Was Substantive Consolidation an Equitable Remedy in 1789?

In light of *Grupo Mexicano,* in order for a federal district court (or a bankruptcy court acting as a judicial unit of the district court) to exercise the equitable remedy of substantive consolidation, it must determine whether such remedy existed in 1789. In evaluating the availability of federal equitable remedies after *Grupo Mexicano,* it is assumed that the Supreme Court would look to the substance of the pre−1789 remedies available from a court of equity, and not the historic name given the remedy. In other words, the absence of the phrase "substantive consolidation" from the 18th Century case law is not dispositive of the continuing validity of the doctrine. Rather, the historical inquiry would be to find 18th Century precedent for an equitable remedy resulting in the assets and liabilities of one bankrupt being combined with those of another bankrupt for purposes of distribution to their combined creditors. Such precedent does not appear to exist.

The English bankruptcy acts were the primary sources used for resolving bankruptcy matters, when the Constitution first authorized Congress to enact "Laws on the subject of Bankruptcies." [77] Commissioners appointed by the Lord Chancellor of England made the initial adjudications in a majority of the bankruptcy issues in England. These "bankruptcy commissioners" were not judges. When they adjudicated bankruptcy related matters, the adjudication was not considered a "Case" in law or "Case" in equity. "A bankruptcy matter did not become a 'Case' in law or equity until one of the parties in the initial bankruptcy proceeding sought review of the initial bankruptcy adjudication by a law or equity court." [78]

When the United States Constitution was adopted, England had a number of acts concerned with bankruptcy. These acts included the 1570 Statute of 13 Elizabeth, [79] the 1604 Statute of 1 James, [80] the 1623 Statute of 21 James, [81] the 1705 Statute of Anne, [82] and the 1732 Statute of 5 George II, [83] along with a myriad of extensions and amendments. [84]

Under these English bankruptcy acts, a bankruptcy case began when creditors filed a petition with the Lord Chancellor alleging that an individual who was a "merchant" had committed an "act of bankruptcy." As a matter of course, the Lord Chancellor issued against the alleged bankrupt a "Commission of Bankrupt." The commission named five commissioners from among a list of standing bankruptcy commissioners, who were lawyers, to conduct the proceedings. The five commissioners, or a quorum of three, determined almost all of the issues arising in the bankruptcy proceeding. [85]

The first Congress enacted the Judiciary Act of 1789. [86] It created two sets of inferior federal courts, a district court for each state, and three circuit courts. It allocated some of the "judicial Power" authorized by section 2 of Article III to the district and circuit courts. [87] In 1800 the Sixth Congress enacted the first federal bankruptcy law. [88] This law followed the English bankruptcy acts in substance and procedure. It provided for a petition by creditors against a merchant.

It is doubtful that the 18th Century Lord Chancellor exercised an equitable power to combine the assets and liabilities of one merchant with another for purposes of distributions to their combined creditors. Traditional Anglo−American corporation law rests on the principle that each corporation is a separate legal unit with its own rights and responsibilities separate and distinct from those of its shareholders. This was the law familiar to Lord Coke and later to Blackstone. [89] With the emergence of limited liability in the third decade of the nineteenth century in the United States and several decades later in England, [90] the concept that the corporation was a separate entity was strongly reinforced. The 1897 decision of the House of Lords in *Salomon v. Salomon & Co.* [91] has shaped the English law to this day. In the *Salomon* case, a leather and boot merchant transferred his business to a corporation he organized and in which he and members of his family were the sole shareholders. As consideration for the business, Salomon took 20,000 £1 shares and secured debentures aggregating £10,000. The corporation failed and the House of Lords upheld Salomon's right to enforce the secured debentures in priority to the unsecured creditors. The House of Lords emphasized the separate entity of the corporation, distinct from the shareholders.

Another reason it is doubtful a substantive consolidation remedy type existed in 1789, is the fact that corporate law had not yet permitted the use of multi−tiered corporate enterprises. The late Professor Robinson's study of the early formation of holding companies indicates that it was not until 1832 that the first corporation was given authority to hold stock in another corporation, and, until the last years of the nineteenth century, such stock holdings were extremely rare. [92] Until the practice of multi−tiered corporate enterprises became commonplace, there was little need for a doctrine of substantive consolidation.

Grupo Mexicano's requirement that federal courts look back to 18th Century English legal practice to determine whether the equitable remedy may be granted is not without precedent in the American legal tradition. It has long been established that the constitutional right to a trial by jury is determined by reference to 18th Century English practice.

Reliance upon historical sources to determine the availability of a right in the 18th Century presents litigants in the 21st Century with practical problems in discerning the past practice. The Supreme Court encountered this problem in deciding *Granfinanciera, S.A. v. Nordberg.* [93] In this case, the trustee sued Granfinanciera, S.A. and another entity to recover a fraudulent conveyance by the debtor. The defendant asserted a right to jury trial. The bankruptcy court denied the jury demand, holding that a fraudulent transfer suit was "equitable" in nature. The Supreme Court reversed and held that the defendant had a right to a jury trial. The Court , concluding that in England, before the adoption of the Seventh Amendment in 1791, actions to recover preferential or fraudulent conveyances were tried at law, the Court held that the defendant had a right to a jury trial. [94]

According to *Granfinanciera*, the method to be used to determine the right to jury trial is: "First, we compare the statutory action to 18th−century actions brought in the courts of England prior to the merger of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature." [95] The Court then noted that the historic actions of "trover" and "money had and received "were resorted to for recovery of preferential payments in 18th Century practice, and such suits were conducted before juries. While the *Granfinanciera* majority opinion notes that several authorities had reached a different conclusion, the Court held that a party may demand a jury in a fraudulent transfer suit, even though fraudulent transfer suits were occasionally triad in courts of equity.

In the absence of 18th Century English law precedent for an order of substantive consolidation, such equitable remedy is not available. As observed in Section I of this article, the federal law remedy of substantive consolidation can be traced back to a series of legal opinions rendered in the 1940's and 1960's. It is not plausible that a similar remedy existed in 18th Century practice before the Chancellor. Under the *Grupo Mexicano* case, the federal courts are not authorized to predict what the Chancellor might have done if presented with the corporate structures routinely used in the 20th Century. *Grupo Mexicano* requires an 18th Century precedent before a federal court may fashion equitable remedies not authorized by statute.

V. Does Section 105 Vest an Independent Equity Power in the Bankruptcy Court?

It is anticipated that parties requesting the application of substantive consolidation may respond that the source of the power to grant such relief is not only the general equity jurisdiction of the federal courts, but also section 105 of the Bankruptcy Code. In fact, it is in section 105(a) that many courts presently find their grant of general equitable powers. [96] Section 105(a) which was included within the Bankruptcy Reform Act of 1978, states that:

[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. [97]

While section 105 does not expressly refer to "equity" powers, the legislative history indicates that Congress understood that section 105 implemented the federal equity powers granted the district court and bankruptcy court:

Section 105 . . . grants the power to issue orders necessary or appropriate to carry out the provisions of title 11. The district court and the bankruptcy court as its adjunct have all the traditional injunctive powers of a court of equity. [98]

The predecessor to section 105, section 2a(15) of the prior Bankruptcy Act, provided that courts of bankruptcy could:

make such orders, issue such process, and enter such judgments in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act; Provided, however, that an injunction to restrain a court may be issued by the judge only. [99]

However, in general pre−1978 substantive consolidation case law does not cite Section 2a(15) as the source of equity power from which to grant the remedy of substantive consolidation. For example, the *Continental Vending* case, decided in 1975, relies upon section 2(a)(2) of the 1898 Act. Section 2(a)(2) of the 1898 Act expressly granted equity jurisdiction to courts of bankruptcy. This jurisdiction statute, along with the balance of the 1898 Act, has been repealed.

Post−1978 courts have often cited section 2(a)(15)'s successor−−section 105−−as the source of equity jurisdiction. [100] However, Collier on Bankruptcy observes that the initial source of the power to grant an order of substantive consolidation was the "general equitable powers" of the federal courts. Collier appears to consider the recent reliance by courts on section 105 as unnecessary but "harmless."

The source of that power [to order substantive consolidation], however, was never settled. Although some courts have looked to the general equitable powers of the bankruptcy court or the Bankruptcy Rules, recently courts have focused on section 105's language to justify the tests and standards which have been previously developed. This usage is probably harmless. The power to consolidate would seem to be inherent in the equitable task of the bankruptcy court. Citations to section 105 for such general equitable powers are thus helpful, but in no way did section 105 add anything to the law of substantive consolidation; at most, it confirmed what powers the court already had. [101]

Section 105(a) adds nothing to the "general equitable powers" upon which the doctrine of substantive consolidation is premised. Such "general equitable powers" are the same federal equitable powers limited by the U.S. Supreme Court in *Grupo Mexicano*. Thus, reliance upon section 105(a) as the source of the power to grant consolidation may no longer be "harmless" error. This is because the text of section 105(a) could be misinterpreted to permit a district court (or its bankruptcy court unit) to exercise equitable remedies which are beyond those permitted by *Grupo Mexicano*. The argument would be that section 105(a) constitutes an independent grant of equitable power that is not subject to the *Grupo Mexicano* limitation on the development of post−1789 equitable remedies.

It is plausible that section 105(a) constitutes a direct, fresh, grant of supplemental power to the bankruptcy courts, independent of the judicial power granted to the federal courts under title 28. Under this interpretation, section 105(a) does not re−state equitable powers of federal courts granted under the Judiciary Act of 1789 or otherwise. Perhaps it could be argued that through section 105(a), Congress separately delegated to bankruptcy courts an open−ended authority to formulate equitable remedies. Under this interpretation, bankruptcy courts are free to make remedies as deemed "necessary or appropriate" to carry out the goals of bankruptcy law.

One problem with this argument, is that the text of section 105(a) does not authorize the court to issue any order which is "necessary or appropriate" to carry out the goals of bankruptcy law, rather it requires the order to carry out the "provisions of this title." The statute appears to require the court look back to a specific provision of the Bankruptcy Court which is to be fulfilled by the section 105(a) order. Another problem with the "open ended" interpretation is that it is unconstitutional, delegating what is essentially a legislative function to the courts. The judicial branch should neither be assigned nor allowed tasks that are delegated to another branch of the federal government. [102]

Generally, our courts have rejected the "open−ended" interpretation of section 105, and thus require that the section 105 relief implement or fulfill a specific provision of the Bankruptcy Code. Our courts have held section 105 powers "must and can only be exercised within the confines of the Bankruptcy Code" [103] and "cannot be used in a manner inconsistent with the commands of the Bankruptcy Code." [104] That is, an equitable remedy derived from section 105 must be consistent with the Bankruptcy Code and cannot alter a provision of the Code. [105] A court may exercise its equitable power arising under section 105 only as a means to fulfill some specific Code provision. [106] As stated by the Seventh Circuit in the *Fesco Plastics* case, "when a specific Code section addresses an issue, a court may not employ its equitable powers to achieve a result not contemplated by the Code." [107] The Supreme Court recently stated: "Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditor's entitlements, but are limited to what the Bankruptcy Code itself provides." [108]

The sole reference to "consolidation" in the Bankruptcy Code (outside the context of a joint case filed by a husband and wife [109]), arises in the listing of provisions which may be included in a chapter 11 plan. The issue presented is

whether use of section 105(a) is needed to fulfill such section of chapter 11 of the Bankruptcy Code.

VI.Is an Independent Doctrine of Substantive Consolidation Needed to Implement Section 1123(a)(5)(C) of the Bankruptcy Code?

Bankruptcy Code section 1123(a)(5)(C) states that a chapter 11 plan shall provide adequate means for the plan's implementation, such as "merger or consolidation of the debtor with one or more persons." [110] However, this statute does not authorize a bankruptcy judge to order the remedy of substantive consolidation, absent the proponent of such plan first "scaling the hurdles" of chapter 11. [111] The Bankruptcy Code requires that before a court confirms a plan, including a plan that provides for consolidation, the court must find the impaired classes have accepted the plan by the requisite majorities. [112] The powers granted under section 105 are not necessary to implement a substantive consolidation if the parties to a chapter 11 plan have consented by the requisite majorities. It is section 1123(a)(5)(c)−−not general federal court equity powers−−that permits the consolidation.

The text of section 1123(a)(5)(C) provides no authority for the exercise of the remedy of substantive consolidation *independent* of the confirmation of the plan. A court may not impose the equitable remedy of substantive consolidation pursuant to a plan unless (i) classes of impaired creditors have accepted the plan's proposed consolidation, or (ii) the "best interest test" and "absolute priority rule" protection granted dissenting creditors have been met by the plan proponent. [113] Section 105 cannot be used to expand the use of section 1123(a)(5)(C) outside the context of a chapter 11 plan since "when a specific Code section addresses an issue, a court may not employ its equitable powers to achieve a result not contemplated by the Code." [114]

In sum, section 105(a) of the Bankruptcy Code does not grant bankruptcy courts an independent equitable power to order substantive consolidation. Section 105 "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law," [115] nor does it allow bankruptcy courts to act as "roving commission[s] to do equity." [116] The bankruptcy court, as a unit of the district court, lacks authority to fashion equitable remedies greater than those which may be exercised by a federal district court. The bankruptcy court, as a unit of the district court, is subject to the limitations imposed by *Grupo Mexicano*. [117]

Conclusion

Resort to equitable remedies may appear to be a reasonable approach to the difficult problem of collecting debts. Frequently, it may appear reasonable to enjoin an alleged debtor from conveying assets where the creditor faces the risk of irreparable injury. Likewise, it may seem reasonable under certain facts and circumstances to permit a creditor of one entity to have recourse to the assets of an affiliated entity under the doctrine of substantive consolidation. The law of many states recognizes similar remedies, such as pre−judgment injunctive and "alter−ego" relief. Prior to *Grupo Mexicano*, it was plausible that the federal equity power was available to create such remedies in the absence of state law. However, in light of *Grupo Mexicano*, the development of new federal equitable remedies has been curtailed. As a result of *Grupo Mexicano*, the merits of new remedies for creditors should be a matter of debate and decision in legislatures and Congress. [118]

The remedy of substantive consolidation was fashioned by our federal circuit courts during the 20th Century. The courts that established the doctrine relied upon an implicit assumption that the federal equity power could evolve as needed to meet the challenges of modern business organizations. In *In re Vecco Construction Industries, Inc*., [119] a bankruptcy court observed that the utilization of substantive consolidation was a judicial response to the recently encountered phenomena of multi−tiered corporate groups:

Due to the organizational make−up evidenced by the now common−place multi−tiered corporations in existence today, substantive consolidation of a parent corporation and its subsidiaries has been increasingly utilized as a mechanism to deal with corporations coming within the purview of the Act. This relatively recent development has been given judicial effect without the benefit of statutory authority or approval by way of rule of procedure. Rather, courts which have allowed substantive consolidation have done so based upon equitable principles. [120]

The *Vecco Construction* court could not have known that 19 years later the U.S. Supreme Court would freeze the development of equitable principles to their status in 1789. The equity power foundation upon which substantive consolidation is premised has been shattered under the rationale of *Grupo Mexicano*. Perhaps early in the 21st Century the doctrine of substantive consolidation will be pronounced a dead letter. [121]

FOOTNOTES:

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[1] The doctrine of substantive consolidation has been the subject of many articles. See, e.g., Jeffrey E. Bjork, Note & Comment, Seeking Predictability in Bankruptcy: An Alternative to Judicial Recharacterization in Structured Financing, 14 Bankr. Dev. J. 119, 136−40 (1997) (discussing effects of substantive consolidation doctrine on structured financing); Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, Structured Financing Techniques, 50 Bus. Law. 527 (1995) (offering background and analytical framework for structured financing and listing issues for substantive consolidation analysis); Joy Flowers Conti, An Analytical Model for Substantive Consolidation of Bankruptcy Cases, 38 Bus. Law. 855 (1983) (proposing "analytical model for deciding whether substantive consolidation should be ordered for bankruptcy cases"); Patrick C. Sargent, Bankruptcy Remote Finance Subsidiary: The Substantive Consolidation Issue, 44 Bus. Law. 1223 (1989) (addressing hurdle of trying to avoid substantive consolidation when bankruptcy occurs); TriBar Opinion Committee, Opinions in the Bankruptcy Context: Rating Agency, Structured Financing, and Chapter 11 Transactions, 46 Bus. Law. 717, 725−27 (1991) (discussing use of legal opinions to explain effects of substantive consolidation on certain transactions). As an increasing number of structured finance transactions came to market in the 1990's, rating agencies routinely have required legal opinions on whether the doctrine would be applied to a particular transaction. Since substantive consolidation would defeat one of the fundamental goals of the structured financing—investors and rating agencies looking to a "special purpose vehicle's" isolated asset pool apart from claims related to the affiliate's bankruptcy—opinions as to substantive consolidation are requested by the rating agencies in such financing. See id. at 726. Back To Text

[2] See, e.g., Reider v. FDIC (In re Reider), 31 F.3d 1102, 1105−09 (11th Cir. 1994) (discussing historical background of substantive consolidation); Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.), 954 F.2d 1, 11 (1st Cir. 1992) (distinguishing substantive consolidation from joint administration and noting that "substantive consolidation merges the assets and liabilities of the debtor entities into a unitary debtor estate"); id. at 12 (stating that by placing burden to show consolidation will foster net benefit for all holders of unsecured claims on party requesting substantive consolidation, "the order for substantive consolidation . . . constitutes an implicit determination by the bankruptcy court that any inequity to particular claimants would be overborne by the benefits to claimants generally"); Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845, 847 (2d Cir. 1966) (reasoning that "equity is not helpless to reach a rough approximation of justice to some rather than deny any to all" and affirming order of consolidation since it would create common assets, which would eliminate duplicate claims by creditors, thereby allowing trustees to work more effectively). Back To Text

[3] See In re Reider, 31 F.3d at 1105 (noting that while Bankruptcy Act of 1898 did not expressly provide for substantive consolidation, "the authority to order substantive consolidation was implied from the bankruptcy court's general equitable powers"). Back To Text

[4] 527 U.S. 308 (1999). Back To Text

[5] See id. at 333. Back To Text

[6] See id. at 332−33; see also Act of Sept. 24, 1789, ch. 20, 1 Stat. 73. This Act will be referred to as the "Judiciary Act of 1789" in this article. Back To Text

[7] 11 U.S.C. § 105 (1994) (setting forth bankruptcy court's powers). Back To Text

[8] See In re Reider, 31 F.3d at 1105 ("Early decisions in the corporate context applied essentially an alter ego or pierce the corporate veil test in assessing the propriety of substantive consolidation."); In re Standard Brands Paint Co., 154 B.R. 563, 567 (Bankr. C.D. Cal. 1993) (commenting that first cases of substantive consolidation applied tests similar to "alter ego" tests). Back To Text

[9] Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926), reh'g denied, 155 N.E. 914 (1927). Back To Text

[10] Id. at 61. See also Henry W. Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Cal. L. Rev. 12, 18−20 (1926) (exploring relationship between parent corporation and subsidiary in terms of agency, alter ego, alias, and dummy for example). Back To Text

[11] State courts will disregard the fiction of separate legal entity where a corporation is a "mere instrumentality of another." See, e.g., Swiss Cleaners, Inc. v. Danaher, 27 A.2d 806, 809 (Conn. 1942) (noting that court will look beyond corporation and look instead at individuals comprising corporation when corporation is "a mere sham or device . . . or is a mere instrumentality or agent") (quoting Hoffman Wall Paper Co. v. Hartford, 114 Conn. 531, 534 (1932)); Woods v. Commercial Contractors, Inc., 384 So. 2d 1076, 1079 (Ala. 1980) (stating that court will not recognize existence of separate corporations which function as another's instrumentality). See generally 18 Am. Jur. 2d Corporations § 45 (1985) (discussing instrumentality theory). Back To Text

[12] 306 U.S. 307 (1939). Back To Text

[13] See id. at 322 ("[The instrumentality rule] is not, properly speaking, a rule, but a convenient way of designating the application . . . of the broader equitable principle that the doctrine of corporate entity . . . will not be regarded when so to do would work fraud or injustice."). The "instrumentality" term was apparently first used in a bankruptcy context, in a dispute concerning the allowance of an affiliate's claim against a bankrupt corporation in In re Watertown Paper Co., 169 F. 252 (2d Cir. 1909). Back To Text

[14] 114 F.2d 177 (10th Cir. 1940). Back To Text

[15] See id. at 191 (recognizing ten factors to consider since "[t]he determination as to whether a subsidiary is an instrumentality is primarily a question of fact and degree"). Back To Text

[16] See id. at 199 (stating that creditors of subsidiary "may be entitled to be paid. . . .[and that] [s]uch questions may be raised and protection sought"). The Tenth Circuit restated this point in FDIC v. Hogan (In re Gulfco Investment Corp.), 593 F.2d 921, 929 (10th Cir. 1979). Back To Text

[17] 127 F.2d 284 (4th Cir.), cert. denied, 317 U.S. 635 (1942). Back To Text

[18] See id. at 290. Back To Text

[19] Maule Indus., Inc. v. Gerstel, 232 F.2d 294 (5th Cir. 1956). The Fifth Circuit noted that "[c]ourts are reluctant to pierce the corporate veil and destroy the important fiction under which so much of the business of the country is conducted, and will do so only under such compelling circumstances as require such action to avoid protecting fraud, or defeating public or private rights." Id. at 297. Back To Text

[20] Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938). See also City of Milwaukee v. Illinois, 451 U.S. 304, 312 (1981) ("Federal courts, unlike state courts, are not general common−law courts and do not possess a general power to develop and apply their own rules of decision."). Back To Text

[21] See, e.g., United States v. Cordova Chem. Co., 59 F.3d 584 (6th Cir. 1995) (stating that conduct did not rise to level necessary to pierce corporate veil under Michigan law because there was no evidence of fraudulent intent); Carte Blanche (Singapore) Pte., Ltd. v. Diners Club Int'l, Inc., 2 F.3d 24, 26 (2d Cir. 1993) (noting that exceptions to corporate separateness are made "to prevent fraud or other wrong, or where a parent dominates and controls a subsidiary"); Estate of Daily v. Lilipuna Assocs. (In re Daily), 107 B.R. 996, 1006 (D. Haw 1989) (stating that

Hawaii's corporate law allows for piercing of corporate veil when fraud or injustice is present), rev'd on other grounds, 940 F.2d 1306 (9th Cir. 1991); Murphy v. Stop & Go Shops, Inc. (In re Stop & Go of America, Inc.), 49 B.R. 743, 747 (Bankr. D. Mass. 1985) ("In determining whether there are grounds sufficient to consolidate, reference to state law concerning the concept known as 'piercing the corporate veil' is appropriate."); In re Tureaud, 45 B.R. 658, 662−63 (Bankr. N.D. Okla. 1985), aff'd, 59 B.R. 973 (N.D. Okla. 1986) (applying factors established in Fish v. East to determine if corporate veil should have been pierced).

As an aside, while creditors may request "alter ego" relief based upon state law principles, the issue remains whether the bankruptcy trustee of the debtor corporation has the requisite standing to bring a state law "alter ego" action on behalf of creditors. At present, some of our federal circuit courts permit the bankruptcy trustee to assert "alter ego" claims, others do not. The Eighth Circuit has interpreted Arkansas law to deny the trustee standing. See Mixon v. Anderson (In re Ozark Restaurant Equip. Co.), 816 F.2d 1222, 1225 (8th Cir.) (stating that "the nature of the alter ego theory of piercing the corporate veil makes it one personal to the corporate creditors rather than the corporation itself"), cert. denied, 484 U.S. 848 (1987). In contrast, the Fifth Circuit has interpreted Texas law to permit the bankruptcy trustee to bring an alter−ego action. See S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc. (In re S.I. Acquisition, Inc.), 817 F.2d 1142, 1152−53 (5th Cir. 1987) (finding nothing in Texas law that prohibited corporation from asserting an alter ego claim); see also Schimmelpenninck v. Byrne (In re Schimmelpenninck), 183 F.3d 347, 359−60 (5th Cir. 1999), reh'g denied, 1999 U.S. App. LEXIS 22035, which provides the following test of a trustee's standing to sue:

To capsulize this legal framework for determining whether the trustee or an individual creditor is the appropriate actor, we categorize three kinds of action:

1) Actions by the estate that belong to the estate;

2) Actions by individual creditors asserting a generalized injury to the debtor's estate, which ultimately affects all creditors; and

3) Actions by individual creditors that affect only that creditor personally.

The trustee is the proper party to advance the first two of these kinds of claims, and the creditor is the proper party to advance the third.

The seeming inconsistency among the federal circuit courts on this issue is due to the variety of state laws which govern the outcome. The dispositive issue is whether a corporate debtor could bring an "alter ego" action on its own behalf under the applicable state law. State law is frequently unclear on this issue, since outside the bankruptcy context it is unlikely that a corporation would sue an affiliate under an "alter ego" theory. If the remedy is available, the bankruptcy trustee may bring such "alter ego" claim on behalf of the corporate debtor. If the remedy is not available to the corporation, the test becomes whether under state law the "alter ego" remedy is available to creditors generally, or is only available to individual creditors based upon specific acts of fraud or misconduct. The Bankruptcy Code grants the bankruptcy trustee the powers to assert certain claims that could be asserted by creditors, however as a general rule, a bankruptcy trustee lacks standing to sue for injuries sustained by a creditor. See Caplin v. Marine Midland Crace Trust Co., 406 U.S. 416 (1972); Richard L. Epling, Trustee's Standing to Sue in Alter Ego or Other Damage Remedy Actions, 6 Bankr. Dev. J. 191 (1989). Back To Text

[22] By way of example, in 1989 the Texas Legislature amended the Texas Business Corporation Act to eliminate constructive fraud and failure to observe corporate formalities as a basis to hold shareholders liable. See Tex. Bus. Corp. Act Ann. art. 2.21(A)(2)−(3) (West 1980 & Supp. 2000). As noted in Farr v. Sun World Sav. Ass'n, 810 S.W.2d 294, 296 (Tex. App. 1991, no writ), the Texas Legislature sought pursuant to the 1989 amendments to overturn the common law of alter−ego as established in Castleberry v. Branscum, 721 S.W.2d 270 (Tex. 1986). The Fifth Circuit recently recognized that the 1989 amendments require actual fraud, not constructive fraud, to permit a "piercing of the veil." See Randall & Blake, Inc. v. Evans (In re Canion), 196 F.3d 579, 587 (5th Cir. 1999) (stating shareholder cannot be held liable for corporate obligations unless actual fraud is shown). Whether the 1989 amendments impact the reasoning of the Fifth Circuit's prior holdings in S.I. Acquisition, Inc. and Schimmelpenninck remains to be seen.

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[23] FDIC v. Colonial Realty Co., 966 F.2d 57, 61 (2d Cir. 1992). See Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988) (stating that "[t]he sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors"). Back To Text

[24] 328 F.2d 446 (2d Cir. 1964). Back To Text

[25] See id. at 448 (stating that corporate veil may be pierced for reasons other than fraud). Back To Text

[26] 369 F.2d 845, 847 (2d Cir. 1966) (affirming issuance of substantive consolidation order where interrelationships of corporate group are hopelessly obscured and time and expense necessary even to attempt to unscramble them is so substantial as to threaten realization of any net assets for all creditors); id. at 847 (indicating that traditional fraud factors not dispositive). Back To Text

[27] 432 F.2d 1060, 1062−63 (2d Cir. 1970) (finding that because creditors relied upon separate credit, consolidation was denied). Back To Text

[28] 517 F.2d 997, 1000−02 (2d Cir. 1975) (approving hybrid form of consolidation), cert. denied, 424 U.S. 913 (1976). Back To Text

[29] 3 Bankr. Ct. Dec. (CRR) 647, 648, 14 Collier Bankr. Cas. (MB) 191, 192 (S.D.N.Y. 1977). Back To Text

[30] Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 248−49 (11th Cir. 1991) (quoting In re Murray Indus., Inc., 119 B.R. 820, 828−29 (Bankr. M.D. Fla. 1990)). See In re Vecco Construction Indus., Inc., 4 B.R. 407, 409 (Bankr. E.D. Va. 1980) (asserting that liberal trend of allowing substantive consolidation, "as evidenced by recent case law," is due to judicial recognition of widespread use of interrelated corporate structures by subsidiaries operating under parent corporation for tax and business purposes). Back To Text

[31] See Drabkin v. Midland−Ross Corp. (In re Auto−Train Corp.), 810 F.2d 270 (D.C. Cir. 1987). Back To Text

[32] See Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.), 860 F.2d 515 (2d Cir. 1988). Back To Text

[33] See In re Auto−Train Corp., 810 F.2d at 276 (presenting three prong test to determine when substantive consolidation can be ordered); see also Reider v. FDIC (In re Reider), 31 F.3d 1102, 1107−09 (11th Cir. 1994) (adopting D.C. Circuit standard as modified for the spousal contract); First Nat'l Bank of El Dorado v. Giller (In re Giller), 962 F.2d 796, 799 (8th Cir. 1992) (adopting similar test considering: (1) the necessity of consolidation due to the interrelationship among the debtors; (2) whether the benefits of consolidation outweigh the harm to creditors; and (3) prejudice resulting from not consolidating the debtors); Eastgroup Properties, 935 F.2d at 249 (adopting D.C. Circuit test); In re Standard Brands Paint Co., 154 B.R. 563, 571−73 (Bankr. C.D. Cal. 1993) (applying Auto−Train test to facts of case and finding test to be satisfied). Back To Text

[34] See In re Augie/Restivo Baking Co., 860 F.2d at 518 (issuing two factor test for substantive consolidation consideration); see also FDIC v. Colonial Realty Co., 966 F.2d 57, 61 (2d Cir. 1992) (reaffirming test espoused by Augie/Restivo); In re Standard Brands Paint Co., 154 B.R. at 571−72 (finding that facts of case satisfy Second Circuit test). Back To Text

[35] Colonial Realty Co., 966 F.2d at 61 (quoting In re Auto−Train Corp., 810 F.2d at 276). See In re Snider Bros., Inc., 18 B.R. 230, 238 (Bankr. D. Mass. 1982) (asserting that although need for consolidation is shown, "there is still the matter of the defense that the benefits of consolidation do not outweigh the harm to be caused to the objector"). Back To Text

[36] 966 F.2d 57 (2d Cir. 1992). Back To Text

[37] Id. at 59 (quoting In re Augie/Restivo Baking Co., 860 F.2d at 518). See In re Standard Brands Paint Co., 154 B.R. at 567 ("There is very little express[ed] in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure regarding the subject of substantive consolidation."); id. (observing that Bankruptcy Rule 1015 refers to joint administration of cases but does not refer to "the subject of substantive consolidation"). Back To Text

[38] Fed. R. Bankr. P. 1015 advisory committee's note (1983) (stating that Bankruptcy Rule 1015 "does not deal with the consolidation of cases involving two or more separate debtors" and that "[c]onsolidation [of the estates of separate debtors]. . . is neither authorized nor prohibited by this rule"). However, the Advisory Committee Note does state that [c]onsolidation of the estates of separate debtors may sometimes be appropriate, as when the affairs of an individual are so intermingled that the court cannot separate their assets and liabilities." Id. See In re Standard Brands Paint Co., 154 B.R. at 567 (noting that while nothing is expressed in either Bankruptcy Code or Bankruptcy Rule, Advisory Committee Note to Bankruptcy Rule 1015 appears to address substantive consolidation). Back To Text

[39] See Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934) (stating that "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity"); Reider v. FDIC (In re Reider), 31 F.3d 1102, 1105 (11th Cir. 1994) (recognizing that early authority to order substantive consolidation came from "bankruptcy court's general equitable powers"); James Talcott, Inc. v. Wharton (In re Continental Vending Mach. Corp.), 517 F.2d 997, 1001 (2d Cir. 1975) (noting bankruptcy court's equity powers) , cert. denied, 424 U.S. 913 (1976). Back To Text

[40] In re Continental Vending Mach. Corp., 517 F.2d at 1000. Back To Text

[41] A survey of the law of substantive consolidation would be incomplete without reference to the only decision of the United States Supreme Court perhaps relevant to the issue. In Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941), a bankruptcy court had directed assets of an affiliated corporation be marshaled into an individual bankrupt's estate. The bankruptcy court granted such relief after finding the transfer of property by the individual to the corporation was not in good faith, was made for the purpose of placing it beyond the reach of the individual's creditors, and where the effect of the transfer was to hinder, delay or defraud the individual's creditors. See id. at 217−18 (holding despite Court of Appeals finding that, under California law, non−debtor corporation could not be deemed "alter ego" of individual bankrupt). A creditor of the corporation, who was not a party to the turnover proceeding, later filed a claim asserting priority to the corporate assets. The Supreme Court noted that the initial bankruptcy court order granting the turnover had not adjudicated the priority of creditors of the corporation vis−a−vis the creditors of the stockholder. While noting that creditors of the corporation would normally be entitled to satisfy their claims out of corporate assets prior to any participation by the creditors of the individual stockholder, the corporate creditor here was found to have had knowledge regarding the fraudulent transfer of assets from the stockholder to the corporation. Furthermore, the corporate creditor was neither a "lien creditor nor an innocent grantee for value." See id. at 220. Thus having concluded that the bankruptcy court had jurisdiction to direct the turnover, the Court held that the creditor could not collaterally attack the order, and held that the bankruptcy court correctly determined the creditor should have no priority to the corporate assets under the facts presented. See id. It should be noted that the Supreme Court in Sampsell did not reach the issue of whether the turnover order would have been proper, if the request had been timely challenged by the corporate creditor. Furthermore, a bankruptcy court, exercising an equitable power to determine the allowance and priority of claims, would not run afoul of the limitations established by Grupo Mexicano. It was clearly the pre−1789 practice for the Chancellor to allow or disallow claims. See, e.g., Ex parte Groome, 1 Atk. 115, 26 Eng. Rep 75 (Ch. 1744) (involving husband's promise to pay wife 600 pounds if she survived him; husband was declared bankrupt and died before dividend made; bankruptcy commissioners disallowed wife's claim; Lord Chancellor dismissed wife's petition that she be allowed as creditor before commissioners because debt was not due at time of act of bankruptcy). Back To Text

[42] Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934). Back To Text

[43] Pepper v. Litton, 308 U.S. 295, 304 (1939). See United States v. Energy Resources Co., 495 U.S. 545, 549 (1990) ("These statutory directives are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor−debtor relationships."). However, as noted by Judge Marcia S. Krieger, in "The Bankruptcy Court Is a Court of Equity": What Does That Mean?, 50 S.C. L. Rev. 275 (1999), the "court of equity" characterization of the bankruptcy court may be misleading. Back To Text

[44] Equity has been defined as "the correction of the law wherein it is defective by reason of its universality." 1 Story's Equity Jurisprudence 3 (W.H. Lyon, Jr., ed., 14th ed. 1918). Because "[e]very system of laws must necessarily be defective[,] cases must occur to which the antecedent rules cannot be applied without injustice, or to which they cannot be applied at all." Id. at 9. Back To Text

[45] See Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803). Back To Text

[46] See Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 (repealed 1843). Back To Text

[47] See Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978). Back To Text

[48] Id. (emphasis added). Back To Text

[49] SEC v. United States Realty & Improvement Co., 310 U.S. 434, 455 (1940) (citing Bankruptcy Act § 2). Back To Text

[50] Pepper v. Litton, 308 U.S. 295, 304 (1939). Back To Text

[51] Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, § 241(a), 92 Stat. 2668, 2671 (repealed 1984). Back To Text

[52] 458 U.S. 50, 87 (1982) (holding that § 1481 of Bankruptcy Reform Act of 1978 was unconstitutional because it impermissibly granted Article III judicial powers to non−Article III tribunal). See Celotex Corp. v. Edwards, 514 U.S. 300, 320 (1995) (Stevens, J., dissenting) (noting that § 1481 was found to be unconstitutional in Marathon primarily because it gave bankruptcy judges broad powers reserved for Article III judges without making them Article III judges, specifically by denying life tenure and salary protection); Commodity Futures Trading Commission v. Schor, 478 U.S. 833, 838−39 (1986) (maintaining that Marathon found § 1481 unconstitutional because it allowed non−Article III judges to adjudicate contract claim arising under state law). Back To Text

[53] Pub. L. No. 98−353 § 122, 98 Stat. 333, 346 (1984). Back To Text

[54] See Kelley v. Nodine (In re Salem Mortgage Co.), 783 F.2d 626, 628 nn.3−4 (6th Cir. 1986) (outlining various revisions to Bankruptcy Reform Act of 1978 made in 1984); Helm v. Helm (In re Helm), 48 B.R. 227, 228 & n.2 (Bankr. W.D. Ky. 1985) (discussing 1984 revisions to § 402 of Bankruptcy Reform Act); see also 1 Collier on Bankruptcy ¶ 3.01[2][b][i], at 3−7 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (discussing Marathon). Back To Text

[55] 28 U.S.C. § 1334(a) (1994). Back To Text

[56] 28 U.S.C. § 1334(b) (1994). Back To Text

[57] Section 157(a) provides:

Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

28 U.S.C. § 157(a) (1994). See Parklane Hosiery Co. v. Parklane/Atlanta Venture (In re Parklane/Atlanta Joint Venture), 927 F.2d 532, 534 n.1 (11th Cir. 1991) (asserting that 1984 revisions to 28 U.S.C. § 157 give district court discretionary authority to refer bankruptcy cases to bankruptcy courts and to withdraw that authority for cause shown); Land−O−Sun Dairies, Inc. v. Florida Supermarkets, Inc. (In re Finevest Foods, Inc.), 143 B.R. 964, 966 (Bankr. M.D. Fla. 1992) (noting that new version of § 157(a) empowers district court to refer bankruptcy matters to bankruptcy courts, but does not require them to do so). Back To Text

[58] Section 151 states:

In each judicial district, the bankruptcy judges in regular active service shall constitute a unit of the district court to be known as the bankruptcy court for that district. Each bankruptcy judge, as a judicial officer of the district court, may exercise the authority conferred under this chapter with respect to any action, suit, or proceeding and may preside alone and hold a regular or special session of the court, except as otherwise provided by law or by rule or order of the district court.

28 U.S.C. § 151 (1994). See In re Finevest Foods, Inc., 143 B.R. at 967 (noting that under revised § 151, power of bankruptcy court is specifically subject to rules or orders of district court). Back To Text

[59] See Miller v. Mayer (In re Miller), 81 B.R. 669, 676 (Bankr. M.D. Fla. 1988) (holding that bankruptcy court has "long recognized" inherent equitable power, at least to punish for contempt, and that this inherent power is not affected by Marathon or 1984 revisions); cf. Plastiras v. Idell (In re Sequoia Auto Brokers, Ltd.), 827 F.2d 1281, 1288 (9th Cir. 1987) (maintaining that 1984 revisions abrogated bankruptcy courts equitable contempt powers). One other statute deserves passing mention at this point. The All Writs Statute, 28 U.S.C. § 1651 (1994), provides that federal courts may issue "all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usage of principles of law." Id. § 1651(a). The All Writs Statute enables courts to address situations for which no specific process has been provided by statute. It is not an independent source of jurisdiction, but rather it grants the court's flexibility to issue orders that preserve and protect their jurisdiction. The All Writs Statute was expressly made applicable to bankruptcy courts, but that applicability was later withdrawn as unnecessary in 1984 due to the enactment of § 105(a) of the Bankruptcy Code, discussed infra Section V, which empowers bankruptcy courts using similar language. Back To Text

[60] U.S. Const. art. III, § 2, cl. 1. Back To Text

[61] See Charles Alan Wright, Law of Federal Courts § 1 (5th ed. 1994) (noting that under Judiciary Act of 1789 Congress exercised its power to create inferior courts by setting up district courts of original jurisdiction for each state and three appellate courts with both original and appellate jurisdiction); see also U.S. Const. art. III, § 1 (granting Congress discretionary authority to establish inferior courts); Glidden Co. v. Zdanok, 370 U.S. 530, 551, reh'g denied, 371 U.S. 854 (1962) (asserting that because Congress' power to establish inferior federal courts is discretionary, they also have power to revoke authority of such courts). Back To Text

[62] 307 U.S. 161 (1939). Back To Text

[63] Id. at 164−65. See Michaelson v. United States, 266 U.S. 42, 65−67 (1924) (holding that Congress may alter inherent equitable contempt powers of inferior courts by statute); Purcell v. Summers, 145 F.2d 979, 990−91 (4th Cir. 1944) (maintaining that Sprague dictates that federal courts are endowed with same equitable powers as English courts, and that these powers cannot be limited by state legislation). Back To Text

[64] However, as in Grupo Mexicano, the Court has limited the development of equitable remedies in other cases. See, e.g., Butner v. United States, 440 U.S. 48, 56 (1979) (refusing to adopt uniform federal rule regarding property rights on basis of "undefined considerations of equity"). Back To Text

[65] 28 U.S.C. § 1331 (1994). Back To Text

[66] The merger occurred in 1938 with the implementation of the Federal Rules of Civil Procedure. See Fed. R. Civ. P. 1 ("These rules govern the procedure in the United States district courts in all suits of a civil nature whether cognizable as cases at law or in equity . . . ."); see also Wright, supra note 61, §§ 61, 67 (noting that separation of law and equity created constant difficulties for courts that eventually led to merger of both, creating system under which court may give litigant whatever relief it finds to be fair and just). Back To Text

[67] 28 U.S.C. § 1334 (1994). Back To Text

[68] See discussion infra Section V (discussing Bankruptcy Code § 105 in greater detail). Back To Text

[69] Alliance Bond Fund, Inc. v. Grupo Mexicano de DeSarrollo, S.A., 143 F.3d 688 (2d Cir. 1998), rev'd and remanded, 527 U.S. 308 (1999). Back To Text

[70] Grupo Mexicano de DeSarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 322 (1999). See generally Raymond M. Kethledge, U.S. Supreme Court Review: October 1998 Term, 78 Mich. B.J. 1314, 1314 (1999) (noting that equity jurisdiction of district courts is limited to equity jurisdiction exercised by English courts in 1789). Back To Text

[71] Grupo Mexicano, 527 U.S. at 332 . See also Gordon v. Washington, 295 U.S. 30, 36 (1935) (stating that suits in equity are bound by principles applied by English Court of Chancery before 1789). Back To Text

[72] 1 Commentaries on Equity Jurisprudence § 19, at 21. Back To Text

[73] Grupo Mexicano, 527 U.S. at 332. See, e.g., Snyder v. Harris, 394 U.S. 332, 342, reh'g denied, 394 U.S. 1025 (1969) (stating that expansion of jurisdiction of courts is vested in Congress not courts); Votolato v. Freeman, 8 B.R. 766, 770 (D.N.H. 1981) (noting court's jurisdiction can only be enlarged by Congress). Back To Text

[74] Grupo Mexicano, 527 U.S. at 336 (Ginsburg, J., dissenting). See Charles Jordan Tabb, The History of the Bankruptcy Laws in the United States, 3 Am. Bankr. Inst. L. Rev. 5, 6 (1995) (stating that first United States' bankruptcy law "virtually copied the existing English law"). Back To Text

[75] Grupo Mexicano, 527 U.S. at 338 (Ginsburg, J., dissenting) (citing Lynn M. LoPucki, The Death of Liability, 106 Yale L.J. 1, 32−38 (1996)). The dissent's reference to the LoPucki article is noteworthy, since LoPucki advances several radical reforms, including extending liability from property of the debtor to the debtor's shareholders, and affiliates, under an enterprise liability theory. See LoPucki, supra, at 54−55. Not only has Grupo Mexicano curtailed use of equity powers to attack "judgment proofing strategies," it also may have curtailed other creative uses of equity, such as third party injunctions, see, e.g., MacArthur Co. v. Johns−Manville Corp. (In re Johns−Manville Corp.), 837 F.2d 89, 90 (2d Cir.), cert. denied, 488 U.S. 868 (1988), and orders enjoining an equity committee from pursuing actions to compel shareholders meeting, see, e.g., Manville Corp. v. Equity Sec. Holders Comm., A.F. (In re Johns−Manville Corp.), 801 F.2d 60, 64 (2d Cir. 1986)). See Grupo Mexicano, 527 U.S. at 338. Back To Text

[76] It should be observed that Congress in certain instances, has delegated the development of certain remedies, such as equitable subordination, to the Courts. See 11 U.S.C. § 510(c) (granting courts power to use principles of equitable subordination). No such Congressional intent is indicated with respect to the doctrine of substantive consolidation. Back To Text

[77] U.S. Const. art. I, § 8, cl. 4. See generally Tabb, supra note 74, at 6 (noting "framers of the United States Constitution had the English bankruptcy system in mind when they included the power to enact 'uniform laws on the subject of bankruptcies'") Back To Text

[78] Thomas E. Plank, Why Bankruptcy Judges Need Not and Should Not Be Article III Judges, 72 Am. Bankr. L.J. 567, 573 (1998); see also Richard H. Fallon, Jr., Of Legislative Courts, Administrative Agencies, and Article III, 101 Harv. L. Rev. 915 (1988) (stating that review by Article III judges of adjudications by non−Article III adjudicators satisfies requirements of Article III). Back To Text

[79] 13 Eliz., ch. 7 (1570) (Eng.) (detailing first act to allow creditors to begin bankruptcy case against those, generally considered to be merchants, who committed acts of bankruptcy). Back To Text

[80] 1 Jam., ch. 15 (1604) (Eng.) (amending Statute of 13 Elizabeth). Back To Text

[81] 21 Jam., ch. 19 (1623) (Eng.) (amending Statute of 13 Elizabeth and Statute of 1 James). Back To Text

[82] 4 Anne, ch. 17 (1705) (Eng.) (introducing concept of discharge for debtors). Back To Text

[83] 5 Geo. 2, ch. 30 (1732) (Eng.) (revising 1705 Statute of Anne). Back To Text

[84] See Plank, supra note 78, at 576 n.54 (providing list of English bankruptcy related laws); Tabb, supra note 74, at 10 n.30 (listing English bankruptcy related laws up to ratification of United States Constitution). Back To Text

[85] Plank, supra note 78, at 576. Back To Text

[86] Act of Sept. 24, 1789, ch. 20, 1 Stat. 73. Back To Text

[87] See id. §§ 9, 11, 1 Stat. at 76−79. Back To Text

[88] Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803). Back To Text

[89] See 3 First Part of the Institute of the Laws of England or a Commentary on Littleton 6, 412 (1628); 2 id. at 250a; Case of Sutton's Hospital, 10 Coke 23a, 77 Eng. Rep. 960, 970−71 (1612) (recognizing that principles of corporations are distinct); 1 William Blackstone, Commentaries 469 (1st ed. 1765) (discussing aspects of sole corporations); 2 Stewart Kyd, A Treatise on the Law of Corporations 103 (1793) (focusing discussion on corporations). Back To Text

[90] See Limited Liability Act, 1855, 18 &19 Vict., ch. 133; The Companies Act, 1862, 25 & 26 Vict., ch. 89. Back To Text

[91] 75 L.T.R. 426 (1897). Back To Text

[92] Edward V. Robinson, The Holding Corporation −I, 18 Yale Rev. 390, 400−07 (1910). Further evidence that a doctrine of substantive consolidation did not exist prior to the 20th Century, is that in 1889, the Illinois Supreme Court declared that a corporation could not, as one of its incidental powers, hold stock in other corporations. People v. Chicago Gas Trust Co., 22 N.E. 798, 799−800 (Ill. 1889) (in the 19th Century, generally a corporation could not, as one of its incidental powers, hold stock in other corporation; thus it is unlikely that the substantive consolidation doctrine would evolve in such legal environment). By 1910, only thirteen states had passed statutes definitely authorizing corporations to hold stock in other companies. See Edward V. Robinson, The Holding Corporation −II, 19 Yale Rev. 13, 29 (1910). Thus, it is not until the 20th Century that the remedy of substantive consolidation began to emerge in the context of multi−tiered corporate organizations. Back To Text

[93] 492 U.S. 33 (1989). Back To Text

[94] See id. at 43. Back To Text

[95] Id. at 42 (quoting Tull v. United States, 481 U.S. 412, 417−18 (1987)). Back To Text

[96] See Louisiana Pub. Serv. Comm'n v. Cajun Elec. Power Coop. (In re Cajun Elec. Power Coop.), 185 F.3d 446, 452 n.9 (5th Cir. 1999) (stating that § 105(a) is "where bankruptcy courts find their general equitable powers"); FDIC v. Colonial Realty Co., 966 F.2d 57, 59 (2d Cir. 1992) ("Courts have consistently found the authority for substantive consolidation in the bankruptcy court's general equitable powers as set forth in 11 U.S.C. § 105."); In re Standard Brands Paint Co., 154 B.R. 563, 567 (Bankr. C.D. Cal. 1993) ("The caselaw often refers to § 105 of the Code (the catch−all section stating the court can issue orders necessary to carry out the provisions of the Code) as being the source of authority to substantively consolidate."). Back To Text

[97] See 11 U.S.C. § 105(a) (1994). Back To Text

[98] S. Rep. No. 95−989, at 51 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5837; H.R. Rep. No. 95−595, at 342, reprinted in 1978 U.S.C.C.A.N. 5963, 6298 (1977) (stating that bankruptcy courts have power of court of equity pursuant to All Writs Statute). Contemporaneously with enactment of § 105(a), Congress explicitly vested bankruptcy courts with the powers of a "court of equity" pursuant to 28 U.S.C. § 1481. However, this jurisdictional grant was later repealed in the Congressional response to the Marathon case. See supra note 55 and accompanying text. Back To Text

[99] Act of July1, 1848, ch. 541, 30 Stat. 544. Back To Text

[100] See, e.g., Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.), 860 F.2d 515, 518 n.1 (2d Cir. 1988) ("Courts have found the power to consolidate substantively in the court's general equitable powers as set forth in 11 U.S.C. § 105"); In re Donut Queen, Ltd., 41 B.R. 706, 708−09 (Bankr. E.D.N.Y. 1984) (stating that power of court comes from § 105(a)); In re Richton Int'l Corp., 12 B.R. 555, 557 (Bankr. S.D.N.Y. 1981) (identifying authorization under § 105 for general equity jurisdiction of bankruptcy courts). Back To Text

[101] 2 Collier supra note 54, ¶ 105.04[2], at 105−62 to 105−63. Back To Text

[102] See Mistretta v. United States, 488 U.S. 361, 383 (1989) (observing that Judicial Branch should not be assigned tasks better suited for other branches); see also Robert F. Nagel, Separation of Powers and the Scope of Federal Equitable Remedies, 30 Stan. L. Rev. 661, 667 (1978) ("Because the federal judiciary was never delegated any power other than the 'judicial Power,' the language of the 10th amendment strongly implies that the states are protected from the judicial exercise of legislative or executive powers."). Furthermore, the constitutional problem with the delegation of judicial powers directly to an Article I court was identified in Marathon. See supra note 52 and accompanying text. Back To Text

[103] Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988). Back To Text

[104] In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 830−31 (1st. Cir. 1990). Back To Text

[105] See Feld v. Zale Corp. (In re Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (explaining how § 105 injunction exceeded authority of bankruptcy court because it acted to discharge debts of nondebtor); Landsing Diversified Properties−II v. First Nat'l Bank & Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.), 922 F.2d 592, 601 (10th Cir. 1991) (pre−empting exercise of § 105 when inconsistent with other more specific Code provisions); Southern Ry. Co. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985) (holding that § 105 application does not authorize rights not otherwise available under applicable law). Back To Text

[106] See In re Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993) (stating that court may exercise its equitable powers only for specific areas of Code); In re Morristown & Erie R.R. Co., 885 F.2d 98, 100 (3d Cir. 1989) (exercising equitable power under § 105 is valid as long as it is consistent with Bankruptcy Code). Back To Text

[107] In re Fesco Plastics Corp., 996 F.2d at 154. Back To Text

[108] Raleigh v. Illinois Dep't of Revenue, 120 S. Ct. 1951, 1957 (2000). The Raleigh case concerned the burden of proof as between a bankruptcy trustee and the Illinois Department of Revenue. While the Court did not interpret § 105 in the Raleigh decision, its limitations on the exercise of equitable relief is consistent with the § 105 caselaw cited above. Back To Text

[109] An individual debtor and spouse may file a "joint case" under § 302 of the Code. In such event, the court is given discretion to order the debtors' estates be consolidated. See 11 U.S.C. § 302(a) (1994) (outlining when joint case in bankruptcy may be filed). See, e.g., Chan v. Austin Bank of Chicago (In re Chan), 113 B.R. 427, 428 (N.D. Ill. 1990) (discussing consolidation in bankruptcy and explaining that it should be decided on case by case analysis); In re Knobel, 167 B.R. 436, 439−41 (Bankr. W.D. Tex. 1994) (discussing joint filing of claims and substantive consolidation). Back To Text

[110] 11 U.S.C. § 1123(a)(5)(C) (1994). Back To Text

[111] See Pension Benefit Guaranty Corp., Continental Air Lines, Inc. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983) (explaining that before reorganization plan may be passed parties and courts must satisfy requirements set forth in § 1129); see also In re Gillette Assoc., Ltd., 101 B.R. 866, 872 (Bankr. N.D. Ohio 1989) ("To qualify as confirmable, a plan must satisfy all the requirements of 11 U.S.C. Sec. 1129."); In re Trail's End Lodge, Inc., 54 B.R. 898, 902−03 (Bankr. D. Vt. 1985) (holding that court has duty to determine whether

reorganization plan has met requirements of Code prior to confirmation and that burden of proof is on proponent of plan). Back To Text

[112] See 11 U.S.C. § 1129(a)(8) (1994) (outlining one requirement necessary to pass reorganization plan); 11 U.S.C. § 1126(c) (1994) (setting forth requisite majorities necessary to affirm reorganization plan); see also In re Fur Creations by Varriale, Ltd, 188 B.R. 754, 758 (Bankr. S.D.N.Y. 1995) (explaining that reorganization plan may be affirmed by affirmative vote of impaired classes). Back To Text

[113] See 11 U.S.C. § 1129(a)(7) (1994) (setting forth "best interest test" utilized to determine if plan should be confirmed); 11 U.S.C. § 1129(a)(8) (1994) (setting forth requirement of vote of impaired creditors in reorganization); 11 U.S.C. § 1129(b) (1994) (outlining "cramdown" alternative to § 1129(a)(8) if debtor cannot meet required voting which requires debtor to meet "best interest test" as well as "absolute priority rule"). See generally Robert A. Sauro, Chapter 11 Confirmation: Increasing Judicial Discretion, 4 Bankr. Dev. J. 191, 192, 213−14 (1987) (discussing § 1129(b) and requirements which must be satisfied to confirm reorganization plan). Back To Text

[114] In re Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993) (holding that courts may not use equitable powers to accomplish any goal not intended by Code). See 11 U.S.C. § 105(a) (1994) (giving courts power to carry out provisions of Bankruptcy Code); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (declaring that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."); In re A.H. Robins Co., 182 B.R. 128, 134 n.5 (Bankr. E.D. Va. 1995) (explaining that equitable provisions exercised by courts must be "strictly confined" within established boundaries set forth by Code); Back Bay Restorations Co. v. City of Boston (In re Back Bay Restorations, Inc.), 118 B.R. 166, 170 (Bankr. D. Mass. 1990) (interpreting § 105 to help courts in carrying out law by limiting them to powers set forth in Code). Back To Text

[115] Southmark Corp. v. Grosz (In re Southmark Corp.), 49 F.3d 1111, 1116 (5th Cir. 1995). See, e.g., Bundy v. Donovan (In re Donovan), 183 B.R. 700, 702 (Bankr. W.D. Pa. 1995) (interpreting § 105 and finding that it restricts right of court to create substantive rights not given to them); Phar−Mor, Inc. v. General Elec. Capital Corp. (In re Phar−Mor, Inc. Sec. Litig.), 166 B.R. 57, 61 (W.D. Pa. 1994) (analyzing restriction on courts prohibiting them from creating substantive rights in favor of debtors). Back To Text

[116] In re Southmark Corp., 49 F.3d at 1116 (quoting United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986)). Back To Text

[117] See In re Dow Corning Corp., 244 B.R. 721, 744 (Bankr. E.D. Mich. 1999) (holding that plan's injunction against third party suits could not be enforced against non−consenting creditors); id. (noting that "the ground rules laid down by Grupo Mexicano" limits the bankruptcy court's discretion to fashion the requested remedy). Back To Text

[118] To be sure, there are reasonable policy arguments, both pro and con, concerning the merits of the remedy of substantive consolidation. See Jonathan M. Landers, A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy, 42 U. Chi. L. Rev. 589, 628−33 (1975) (setting forth policy arguments in favor of substantive consolidation). But see Richard A. Posner, The Rights of Creditors of Affiliated Corporations, 43 U. Chi. L. Rev. 499, 524−26 (1976) (presenting counter−arguments to Landers, 42 U. Chi. L. Rev. 589). However, in light of Grupo Mexicano, the merits of the doctrine should be resolved by legislatures and Congress, rather than the present sui generis approach developed by the courts. In 1999 legislation was introduced in Congress which would have eliminated the equitable discretion of a bankruptcy court to substantively consolidate assets which were transferred to a properly constituted entity in connection with a securitization. The holding in Grupo Mexicano appears to eliminate the need for such legislation. If Grupo Mexicano is applied beyond the injunction context, post−1789 equitable remedies are not available, except to the extent Congress grants a bankruptcy court the discretion to exercise the remedy, on such terms as Congress may establish. Back To Text

[119] 4 B.R. 407 (Bankr. E.D. Va. 1980). Back To Text

[120] Id. at 409. Back To Text

[121] Obviously, the arguments presented herein have not been tested in the federal courts as of the time of publication. The author does not expect that rating agencies will curtail their appetite for legal opinions on this subject until these contentions are resolved by at least several circuit courts. Until this occurs, parties to bankruptcy cases, and parties to structure finance transactions, will remain subject to the existing legal precedents. Until then, one is reminded of the precarious position of Galileo, who, when rebuffed by the temporal authority, muttered, "Eppur si muove." ("And yet it moves."). Back To Text