UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In Re:

FLEXSEAL MEDICAL PACKAGING CORPORATION,

Debtor.

BK. No. 93-22373

In Re:

FLEXSEAL PACKAGING CORPORATION,

Debtor.

BK. No. 93-22374

DECISION & ORDER

BACKGROUND

On October 27, 1993, the Debtor, Flexseal Packaging Corp. ("Flexseal") and Flexseal Medical Packaging Corp. ("Medical"), owned 75% by Flexseal, each filed a petition initiating a Chapter 11 case.

On September 22, 1994, the Court issued a Decision and Order on a motion (the "Conversion Motion") by Flexseal's Creditors Committee to convert the Flexseal Chapter 11 case to a Chapter 7 case. That Decision and Order provides a brief procedural history of the Flexseal Chapter 11 case.

On May 25, 1994, Flexseal and Medical filed a motion (the "Consolidation Motion") to substantively consolidate their Chapter 11 cases. The Consolidation Motion was made returnable on June 8, 1994, the initial return date of the Conversion Motion.

The Consolidation Motion indicated that Medical is not an operating corporation, but its sole business is the ownership of some equipment which is rented and used by Flexseal. The Consolidation Motion asserted that: (1) the lease of Medical's equipment by Flexseal is essentially a capital lease, since Flexseal will pay more than 90% of the equipment's fair market value over the term of the lease, and therefore, the economic reality is that Flexseal is the owner of the equipment; (2) Flexseal guaranteed the purchase price of the Medical equipment and granted a security interest to Shawmut Bank ("Shawmut") to secure the guaranty; (3) Flexseal and Medical intend to file consolidated tax returns; (4) Flexseal and Medical have prepared and filed consolidated financial

statements with the Court in their Chapter 11 cases; (5) Medical has only two creditors, Shawmut and M & T Bank ("M & T") which hold security interests in Medical's equipment; (6) Shawmut and M & T are also secured creditors of Flexseal and must be treated in a consistent fashion in any individual or consolidated plan filed by Flexseal or Medical; (7) Flexseal and Medical have been operated as a unitary entity; (8) no creditor would be prejudiced by the consolidation; and (9) substantive consolidation would save the expenses of having to prepare and have confirmed two separate plans of reorganization.

On June 6, 1994, Shawmut filed an Objection to the Consolidation Motion which asserted that: (1) Shawmut and M & T have always intentionally treated Flexseal and Medical as two separate and distinct corporations in order to fully protect their respective lien positions in the assets of the two corporations (Shawmut having a first lien on the assets of Medical and a second lien on the assets of Flexseal; M & T having a first lien on the assets of Flexseal and a second lien on the assets of Medical); (2) Shawmut was contemplating moving to dismiss both the Flexseal and the Medical Chapter 11 cases; and (3) Flexseal and Medical had no hope of reorganizing. Shawmut asserted that both cases should be dismissed since neither debtor had any unsecured assets available for payments to unsecured creditors or had made any progress toward reorganizing, and Flexseal projected losing substantial amounts of money in the near future.

The Court reserved decision on the Consolidation and the Conversion Motions on the same date.

DISCUSSION

The power of a Bankruptcy Court to substantively consolidate two or more pending cases is not specifically provided for in the Bankruptcy Code. However, it has been recognized that the Bankruptcy Court, pursuant to its general equitable powers under Section 105(a), does have the power, in its discretion and in appropriate circumstances, to substantively consolidate two or more

pending cases. *See In re Augie/Restivo Baking Co., Ltd.,* 860 F.2d 515 (2d Cir. 1988).

The United States Court of Appeals for the Second Circuit in *Augie/Restivo* indicated that the sole purpose of substantive consolidation is to ensure the equitable treatment of creditors, and it established two factors to be considered when making a determination whether to substantively consolidate two or more pending cases.[1] These factors are: (1) whether creditors dealt with the entities to be consolidated as a single economic unit and did not rely on their separate identity in extending credit; and (2) whether the affairs of the entities are so entangled that consolidation will benefit all creditors. *Augie Restivo,* 860 F.2d at 518.

In this case, Shawmut, one of only two Medical creditors and its primary secured creditor, has opposed the request for consolidation. After considering the factors established by the Court of Appeals, the opposition of Shawmut and all of the pleadings and proceedings in the Flexseal and Medical Chapter 11 cases, the Court believes that exercising its discretion to substantively consolidate these Chapter 11 cases is not warranted. In this case, Flexseal and Medical's bank creditors, Shawmut and

M & T, had insisted that Flexseal and Medical remain separate entities, the affairs of the two debtors

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[1] The Court acknowledged numerous variants of these factors as considerations relevant to deciding the issue of equitable treatment. Such considerations include whether creditors knowingly deal with corporations as a unit and whether entanglement of business affairs was so extensive that the cost of untangling would outweigh any benefit to creditors. *See In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988). Some courts have adopted the formula set out in *In re Food Fair, Inc.*, 10 B.R. 123, 126 (Bankr. S.D.N.Y. 1981), a seven-part objective inquiry into the interrelationship of entities to be consolidated:

1. the presence or absence of consolidated financial statements;
2. the unity of interests and ownership between the various corporate entities;
3. the existence of parent and inter-corporate guarantees on loans;
4. the degree of difficulty in segregating and ascertaining individual assets and liability;
5. the transfer of assets without formal observance of corporate formalities;
6. the commingling of assets and business functions;
7. the profitability of consolidation at a single physical location.

See, e.g., In re Stevenson, 153 B.R. 52, 53 (Bankr. D.Idaho 1993). An excellent discussion of the general legal principles governing substantive consolidation can be found in *In re Murray Industries, Inc.,* 119 B.R. 820, 827-30 (Bankr. M.D.Fla. 1990), where it is noted that "while substantive consolidation has a disarmingly innocent sound, consolidation in bankruptcy is no mere instrument of procedural convenience, but instead it is a measure vitally affecting substantive rights." *Id.* at 829 (citing *In re Flora Mir Candy Corp.*, 432 F.2d 1060 (2d Cir. 1970).

are easily kept separate, and consolidation, although it may reduce some expenses, is not necessary to insure the equitable treatment of creditors.

CONCLUSION

The Motion by Flexseal and Medical to Substantively Consolidate their Chapter 11 cases is in all respects denied.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY COURT JUDGE

Dated: September 27, 1994