Honorable Mike K. Nakagawa
United States Bankruptcy Judge

Entered on Docket
November 09, 2016

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

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In re:	Case No.: 12-22097-MKN (Lead)
	Chapter 11
SUBMARINA, INC.,	
	Jointly Administered with
Debtor.	Case No.: 11-24352-MKN
	Chapter 11
KERENSA INVESTMENT FUND 1, LLC,	Date: October 5, 2016
	Time: 9:30 a.m.
Debtor.	

ORDER ON EMERGENCY MOTION TO EXTEND TIME IN WHICH TO FILE AN AMENDED PLAN OF REORGANIZATION AND DISCLOSURE STATEMENT[1]

On October 5, 2016, the court heard the Emergency Motion to Extend Time in Which to File an Amended Plan of Reorganization and Disclosure Statement ("Emergency Motion"). The appearances of counsel were noted on the record. After arguments were presented, the matter was taken under submission.

BACKGROUND

On September 9, 2011, a voluntary Chapter 11 proceeding was commenced by Kerensa

[1] In this Order, all references to "ECF No." are to the numbers assigned to the documents filed in the bankruptcy case indicated as they appear on the docket maintained by the clerk of the court. All references to "AECF" are to the documents filed in any adversary proceedings discussed in the Order. All references to "Section" are to the provisions of the Bankruptcy Code, 11 U.S.C. §§ 101-1532. All references to "FRBP" are to the Federal Rules of Bankruptcy Procedure.

Investment Fund 1, LLC ("Kerensa 1"), denominated Case No. 11-24352-MKN.[2] Kerensa 1's primary asset consists of shares of stock in Submarina, Inc., a Nevada corporation ("Submarina").[3] The bankruptcy petition is signed by Bruce Rosenthal ("Rosenthal") as the managing member of Kerensa 1. According to the List of Equity Security Holders (Kerensa ECF No. 8), Rosenthal owns 99 percent of the interest in Kerensa 1 with the remaining 1 percent owned by Kerensa & Co. Incorporated ("Kerensa & Company").[4]

On October 25, 2012, Submarina filed a voluntary Chapter 11 petition for reorganization. (Submarina ECF No. 1). The bankruptcy petition is also signed by Rosenthal as the president and chief executive officer of Submarina. According to the List of Equity Security Holders, the voting common stock of Submarina is held by: Kerensa 1 (2,198,958 shares), Robert Pina (532,500 shares), Zeller (169,926 shares) and Rosenthal (19,064 shares). (Submarina ECF No. 11).[5] Submarina is the franchiser of restaurants that specialize in the sale of submarine sandwiches. As of the petition date, Submarina had numerous franchisees who operated restaurants under the Submarina name primarily in Southern California.

On December 24, 2012, Submarina filed a motion to assume and reject certain franchise agreements and executory contracts ("Assumption Motion"). (Submarina ECF No. 36).

On March 27, 2013, Submarina commenced Adversary Proceeding No. 13-01051-MKN ("First Adversary"), against numerous franchisees seeking damages for breach of the individual

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[2] The bankruptcy petition originally named the petitioner as Kerensa Investment Fund, LLC, and later was amended to name the petitioner as Kerensa Investment Fund 1, LLC.

[3] According to Kerensa 1's personal property Schedule "B," its only assets consist of its shares of common stock in Submarina, possible accounts receivable owed by Submarina in an unknown amount, and possible claims against Marie Zeller ("Zeller") in the amount of $2,363,431. (Kerensa ECF No. 8).

[4] Item 21 of Kerensa 1's statement of financial affairs ("SOFA") identifies "Kerensa ECO Incorporated" as the holder of the remaining 1 percent interest. (Kerensa ECF No. 8). The court assumes that this is a typographical error.

[5] Submarina's creditor Schedules "D," "E," and "F," do not list Kerensa 1 as a creditor. Additionally, Submarina's personal property Schedule "B" does not list a claim against Zeller. (Submarina ECF No. 11).

franchise agreements with each named defendant. The adversary complaint asserted that the named defendants failed to pay royalties and certain fees related to marketing and promotion of the Submarina brand.

On July 24, 2013, an order was entered granting Submarina's motion to obtain postpetition, debtor in possession financing ("DIP Loan") not to exceed $450,000, from an entity known as Kerensa Investment Fund 2, LLC ("Kerensa 2"). (Submarina ECF No. 192). Kerensa 2 is owned and managed by Rosenthal.[6]

On September 12, 2013, an order was entered requiring the Submarina and Kerensa 1 reorganization proceedings to be jointly administered, with the Submarina proceeding designated as the lead case.

On January 13, 14, 16, and 17, 2014, a combined trial was conducted encompassing factual and legal issues arising in connection with the Assumption Motion and the First Adversary.

On March 24, 2016, Submarina filed in the First Adversary an Ex-Parte Motion for Preliminary Injunction on an Order Shortening Time (AECF No. 218) without filing a request for an order shortening time as required by Local Rules 9014(a)(2) and 9006(a).

On March 29, 2016, the clerk of the court issued a notice informing Submarina

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[6] On May 13, 2013, "Debtor's Motion Seeking an Order Authorizing the Debtor to Obtain Post-Petition Financing, Granting Super-Priority Administrative Expense Status, and Modifying the Automatic Stay on an Order Shortening Time" was filed by Submarina ("Financing Motion"). (Submarina ECF No. 141). Attached as Exhibit "A" to the Financing Motion is a copy of an unsecured Promissory Note in favor of Kerensa 2. An initial Declaration of Bruce Rosenthal ("First Rosenthal Financing Declaration") was filed in support of that motion. (Submarina ECF No. 142). A further Declaration of Bruce Rosenthal ("Second Rosenthal Financing Declaration") was filed in support of a reply to numerous objections. (Submarina ECF No. 163). A supplemental Declaration of Bruce Rosenthal ("Third Rosenthal Financing Declaration") also was filed in support of the motion. (Submarina ECF No. 171). Not only is Kerensa 2 owned and managed by Rosenthal, see First Rosenthal Financing Declaration at ¶ 16 and Second Rosenthal Financing Declaration at ¶ 7, Kerensa 2 is a special purpose entity that did not come into existence until after Submarina ran out of cash to pay its postpetition operating expenses. See First Rosenthal Financing Declaration at ¶ 20, and Second Rosenthal Financing Declaration at ¶¶ 10, 11 and 13. Moreover, Rosenthal is the manager of an entity known as Kerensa & Company, which manages the day-to-day operations of Submarina. See Second Rosenthal Financing Declaration at ¶¶ 5 and 6.

that the ex parte motion had an incorrect case caption as well as incorrect defendant names.

On March 30, 2016, Submarina filed an Amended Ex-Parte Motion for Preliminary Injunction on an Order Shortening Time ("PIJ Motion") (AECF No. 222), but again did not file a request for order shortening time.

On April 11, 2016, Submarina finally filed a request for order shortening time to hear its PIJ Motion. (AECF No. 225).

On April 13, 2016, a Motion to Convert ("Conversion Motion") was filed by SD Subros, Inc., Subros, Inc., EDRC LLC, J&C Mason Inc., JTJM Inc., J & J Subs Inc., Masquerade, Inc., JTW Area Developers Inc., Vonnie Audibert and Paul Simmons ("Subros Parties"). (Submarina ECF No. 426). Some of the moving parties were also named as defendants in the First Adversary. All of the moving parties sought to convert the Chapter 11 proceeding to a Chapter 7 liquidation proceeding whereupon a bankruptcy trustee would be appointed. The Conversion Motion was noticed to be heard on May 18, 2016.[7]

On April 14, 2016, an order was entered scheduling the PIJ Motion to be heard on April 28, 2016. (AECF No. 226). On April 15, 2016, Submarina finally served its motion on the entities for which it sought injunctive relief. (AECF No. 228).

On April 15, 2016, an order was entered granting the Assumption Motion. (Submarina ECF No. 433). On the same date, a judgment was entered in the First Adversary awarding damages against numerous defaulting franchisees in favor of Submarina. (AECF No. 230). Contemporaneously with that order and the judgment, a combined memorandum decision was entered setting forth the court's findings of fact and conclusions of law with respect to both matters ("Trial Decision"). (Submarina ECF No. 432 and AECF No. 229).

On April 28, 2016, counsel for Submarina and the Subros Parties (and perhaps others) appeared before the court in connection with Submarina's PIJ Motion. Counsel requested that a settlement conference be scheduled in light of the judgment entered in the First Adversary. The

[7] On May 2, 2013, many of the same moving parties had filed a prior motion seeking to dismiss the Chapter 11 proceeding or to convert it to Chapter 7. (Submarina ECF No. 123). Submarina and Kerensa 1 opposed dismissal of the case. (Submarina ECF No. 156). On July 24, 2013, an order was entered denying that motion. (Submarina ECF No. 193).

hearing on the PIJ Motion was continued to May 18, 2016, i.e., the same date as the hearing on the Conversion Motion.

On April 29, 2016, at the request of the parties, an order was entered scheduling a settlement conference with respect to all disputes. (AECF No. 247).[8]

On May 6, 2016, Submarina filed opposition to the Conversion Motion. (Submarina ECF No. 442).

On May 13, 2016, the Subros Parties filed their reply in support of the Conversion Motion. (Submarina ECF No. 445).

On May 16, 2016, a settlement conference was held without success.[9] Because the parties did not settle their differences, the hearing went forward on the Conversion Motion.

On May 23, 2016, an order was entered denying the Conversion Motion ("Conversion Order"), but setting specific deadlines for Submarina to complete its reorganization. (Submarina ECF No. 449). That order required Submarina to file a joint plan of reorganization along with a proposed disclosure statement no later than June 23, 2016. The order further established a deadline of August 24, 2016, for Submarina to confirm a Chapter 11 plan.

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[8] The fourteen-day period to appeal the order on the Assumption Motion as well as the judgment entered in the First Adversary, also expired on April 29, 2016, under FRBP 8002(a)(1).

[9] Jeffrey Warfield ("Warfield") is the former president and chief executive officer of Submarina. Submarina originally was co-founded by Warfield's father in 1976, and Warfield first started working for the company when he was eleven years old. Over the years he worked in many different roles with the company before he ultimately took over as president of Submarina in 1999, a position he held through 2009. During his tenure as president, Warfield expanded the company from twelve to sixty-nine franchise stores. He also personally owned a franchise store located in Escondido, California, which he opened in 1998 and sold in 2001.

In late 2008, Submarina began to struggle. Warfield contacted Rosenthal for assistance in procuring a potential investor, or alternatively, a purchaser of the company. Rosenthal apparently was unable to secure an outside investor, but he made several personal loans to the ailing Submarina operation. In September 2009, Rosenthal purchased Submarina through his company, Kerensa Investment Fund 1, LLC. After the sale of the company to Rosenthal, Warfield resigned as CEO, and, in lieu of stock, he received certain "area developer rights" for Riverside County as part of his separation agreement. At the time the separation agreement was entered, along with an area developer agreement for Riverside County, there were eight Submarina stores operating in the area, which he thereafter expanded to eighteen stores. See Trial Decision at 9-10.

On June 23, 2016, Submarina filed a proposed Chapter 11 plan ("Plan") along with a proposed disclosure statement in compliance with the Conversion Order.[10] (Submarina ECF Nos. 455, 454).

On July 22, 2016, Submarina filed a First Amended Disclosure Statement (Submarina ECF No. 457) along with an ex parte motion to conditionally approve that disclosure statement ("Conditional Approval Motion"). (Submarina ECF No. 458).

On July 25, 2016, an order was entered denying the Conditional Approval Motion without prejudice to Submarina filing an ex parte request to extend the plan confirmation deadline set forth in the Conversion Order.[11] (Submarina ECF No. 459).

On August 2, 2016, an order was entered extending the confirmation deadline, conditionally approving the First Amended Disclosure Statement, and scheduling a combined hearing on final disclosure statement approval and plan confirmation for September 28, 2016. (Submarina ECF No. 476).

On August 10, 2016, Submarina commenced an additional adversary proceeding denominated Adversary No. 16-01095, naming a variety of existing and former franchisees, many of which were named as defendants in its previous adversary complaints ("Second Adversary"). Many of the defendants are parties who brought the Conversion Motion, or are parties that were the subject of the PIJ Motion that was never rescheduled for hearing.

On September 2, 2016, a Motion to Compel Arbitration ("Arbitration Motion") was filed by various defendants in the Second Adversary. (AECF No. 66). That motion sought to compel arbitration of the claims set forth in the Second Adversary proceeding under the arbitration clauses of the underlying franchise agreements. The Arbitration Motion was noted to be heard

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[10] The proposed Plan was filed solely under the Submarina caption, although the Submarina and Kerensa 1 proceeding are jointly administered. Likewise, the accompanying disclosure statement was filed solely with the Submarina caption.

[11] Even if the First Amended Disclosure Statement had been conditionally approved, a combined hearing on final approval and plan confirmation could not have been scheduled in time before the August 24, 2016 deadline in order to give sufficient notice of the objection deadline required by FRBP 2002(b).

on October 5, 2016. (AECF No. 68). The Arbitration Motion was amended (AECF No. 70), but was noticed to be heard on the same date. (AECF No. 71).

On September 12, 2016, an objection to the First Amended Disclosure Statement was filed by the Subros Parties and perhaps others, many of whom are franchisees. (Submarina ECF No. 495). Those same parties also objected to confirmation of the proposed Plan. (Submarina ECF No. 496). Both of those objections were joined by creditor Zeller.[12] (Submarina ECF Nos. 497, 498). On the same date, an objection to final disclosure statement approval also was filed by the Office of the United States Trustee ("UST"). (Submarina ECF No. 499).

On September 20, 2016, Submarina filed opposition to the Arbitration Motion. (AECF No. 85).

On September 21, 2016, Submarina filed the instant Emergency Motion by which it now seeks to extend the time to file a proposed amended plan of reorganization and amended disclosure statement until ninety days after resolution of the Second Adversary. In other words, Submarina seeks relief from the confirmation bar date established by the Conversion Order for an indeterminate amount of time.[13] A separate joinder in the Emergency Motion was filed by Kerensa 2. (Submarina ECF No. 511).

On September 23, 2016, an order shortening time was entered so that the Emergency Motion could be heard on September 28, 2016, along with the combined hearing on final approval of the First Amended Disclosure Statement and on confirmation of the Debtor's

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[12] On March 4, 2013, Zeller filed Proof of Claim 19-1 in the Submarina proceeding, in the amount of $431,151.67, based on a prebankruptcy judgment entered on July 10, 2012, by the Superior Court for the State of California, County of San Diego, in Case No. 37-2010-00059134-CU-BC-NC. The Zeller claim was disclosed by Submarina in its unsecured creditor Schedule "F" in the amount of $412,351.88, but is alleged to be subject to setoff. Submarina's First Amended Disclosure Statement does not disclose any claim against Zeller that could be subject to sefoff against the Zeller claim.

On October 14, 2011, Zeller had filed Proof of Claim 2-1 in the Kerensa 1 proceeding, in the approximate amount of $338,000, based on a promissory note executed by Kerensa 1, dated December 31, 2009.

[13] On December 1, 2016, a hearing on motions for partial summary judgment brought by Submarina and by various defendants is scheduled before the court. (AECF No. 81).

proposed Plan. (Submarina ECF No. 513).

On September 27, 2016, opposition to the Emergency Motion was filed by the Subros Parties, accompanied by the Declaration of Jeanette E. McPherson ("McPherson Declaration"). (Submarina ECF Nos. 516, 517). Joinder in that opposition was filed by creditor Zeller. (Submarina ECF No. 519).

On September 28, 2016, a reply in support of the Arbitration Motion was filed. (AECF No. 86).

On September 28, 2016, the Emergency Motion was continued to October 5, 2016, to be heard concurrently with the Arbitration Motion.

After the Emergency Motion and Arbitration Motion were heard on October 5, 2016, both matters were taken under submission.[14]

DISCUSSION

The court having reviewed the Emergency Motion, the response filed by the Subros Parties, the joinder by Zeller, the previously filed Plan and First Amended Disclosure Statement, and the entire record in this proceeding, concludes that the Emergency Motion must be denied.

Submarina's proposed Plan consists of seven classes of claims or interests, the seventh of which consist of its equity interest holders. As previously mentioned, the shareholders of Submarina are: debtor Kerensa 1 (2,198,958 shares), Robert Pina (532,500 shares), Zeller (169,926 shares) and Rosenthal (19,064 shares). The equity interest in Kerensa 1 is held 99 percent by Rosenthal and 1 percent by Kerensa & Company. For purposes of Section 1129(a)(10), acceptance by at least one impaired class is determined without reference to acceptance by an insider class. Under Section 101(31), the equity interest holders are insiders of

[14] On the morning of the hearing, Submarina filed four separate declarations of various franchisees who oppose conversion of the Chapter 11 to Chapter 7. (Submarina ECF Nos. 522, 523, 524, 525). The declarations had never been provided in advance to counsel for the Subros Parties. Counsel therefore objected orally to consideration of the declarations and the court took the objection under submission.

Submarina as well as Kerensa 1.[15]

The only other impaired class under the proposed Plan is Class Six, which consists of the general unsecured creditors of Submarina. Holders of claims in the general usecured creditors class either get paid in full if Submarina is able to collect on judgments obtained against various franchisees, or, get paid on a pro rata basis from the judgment collections over a period of 120 months. If no funds are recovered on the judgments, Class Six does not provide any other source of funds for any payments to unsecured creditors. Zeller apparently is the holder of the largest unsecured claim in Class 6. See First Amended Disclosure Statement at 27 n.3. After the order was entered granting conditional approval of the First Amended Disclosure Statement, Submarina apparently solicited acceptances of the Plan from the holders of unsecured claims in Class Six. The record indicates that Submarina received four ballots[16] in response to the solicitation, consisting of two acceptances (American Express and Osborn Law) totaling

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[15] Submarina apparently believes that its insiders consist solely of Rosenthal and an individual identified as Victoria A. Wofford ("Wofford"). See First Amended Disclosure Statement at Article II, B, page 10. In Submarina's monthly operating report ending July 31, 2016 ("July MOR") ("Submarina ECF No. 490), Wofford is identified as a "relative" of someone. Presumably, Wofford is related to Rosenthal, who controls Submarina as its president and chief executive officer. As an affiliate of Submarina under Section 101(2), Kerensa 1 also is an insider of Submarina under Section 101(31E). Both Rosenthal and Kerensa & Company also appear to be insiders of Kerensa 1.

[16] The ballots themselves incorrectly state that claims in Classes 1, 6, and 7 are impaired. Class 1 consists only of Submarina's estimated post-petition administrative expenses which the Plan itself describes as an unimpaired class. See Plan at § 4.01, page 5. Included in those post-petition administrative expenses, however, is an amount totaling $556,250 owed to Kerensa & Company as a management fee and claim for reimbursement of expenses. See First Amended Disclosure Statement at Article III, B, 1, page 24. See also Plan at Article IV, § 4.01, page 6. Those amounts are to be paid as a priority ahead of all other claims, except for attorneys fees, from the "Creditor Payment Pool" created by the Plan. That Creditor Payment Pool is described as an accumulation of the amounts collected on judgments obtained against defaulting franchisees plus a possible settlement of a $45,658.97 claim against one franchisee. See First Amended Disclosure Statement at Article II, H, page 19. According to the July MOR for Submarina, management fees totaling $232,880 already had been disbursed during the case, presumably to Kerensa & Company.

$128,741.61 and two rejections (Subros and Zeller) totaling $432,003.64.[17]

That four creditors submitted ballots on the proposed Plan raises the inference that sufficient information was provided for a hypothetical reasonable investor to vote to accept or reject Submarina's proposed Plan. Adequacy of the disclosure aside, however, the ballots submitted in Class Six more clearly evidence that Submarina currently has zero possibility of confirming a plan. The Plan consists of only two impaired classes, Classes Six and Seven, and Class Seven cannot satisfy the acceptance requirement for plan confirmation under Section 1129(a)(10). Because the only other impaired class, i.e., unsecured Class Six, rejects the proposed plan treatment, there are no impaired accepting classes at all. Without any impaired accepting classes, Submarina has no ability whatsoever to seek to cramdown its proposed treatment of claims in Class Six pursuant to Section 1129(b)(2)(B).[18]

Even if Submarina could obtain acceptance by some other impaired accepting class, any attempt to cramdown on a dissenting unsecured class likely runs afoul of the absolute priority rule[19] as determined in Bank of America Nat'l Trust and Sav. Ass'n v. 203 North LaSalle Street

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[17] Copies of the ballots returned to Submarina as of August 16, 2016, were obtained by counsel for the Subros Parties by subpoena to counsel for Submarina. See McPherson Declaration at ¶ ¶ 4-5.

[18] Presumably, any ballots received by Submarina's counsel after complying with the subpoena did not change the calculus under Section 1126(c) for determining impaired class acceptance, i.e., more than fifty percent in number and at least two-thirds in dollar amount of all ballots cast in Class Six. Submarina believes that the amount of the timely filed unsecured claims in this case total $908,021. See Plan, Article IV, at page 9 & n.4. It appears that the Zeller claim exceeding $400,000 would significantly impact the outcome of any vote by the unsecured class.

[19] A simple statement of the absolute priority rule is that owners of a reorganizing entity cannot retain their ownership interests unless objecting unsecured creditors are paid in full. See Everett v. Perez (In re Perez), 30 F.3d 1209, 1214 (9th Cir. 1994) ("because claims of equity holders are always junior to claims of creditors, this means that a bankruptcy court may not approve a plan that gives the debtor any interest in the reorganized estate unless the plan provides for full payment of claims of creditors in the objecting class."). This principle is reflected by the language of Section 1129(b)(2)(B)(i) and Section 1129(b)(2)(B)(ii), and also is captured in the general bankruptcy distribution scheme set forth in Section 726(a). Prior to the enactment of Section 1129(b)(2)(B)(ii), the Supreme Court recognized that existing owners may retain their interests in the reorganizing entity if they contribute "new value" in the form of

Partnership (In re 203 North LaSalle Street Partnership), 526 U.S. 434 (1999). In the instant case, Submarina's proposed Plan confers on an affiliate of its existing equity holders the exclusive opportunity to acquire the controlling interest in Submarina going forward. The prior owner of the business, Warfield, as well as the numerous franchisees, are not given any opportunity to overbid. Although the plan exclusivity period under Section 1121(b) was never extended and therefore expired on or about February 22, 2012, the equities in the case would not relieve Submarina from its obligation to propose fair and equitable treatment of dissenting unsecured classes. Instead of proposing to pay all holders of claims in the dissenting unsecured class in full, the proposed Plan affords Rosenthal, through Kerensa 2, the exclusive opportunity to retain his interest in Submarina and to pay unsecured creditors an uncertain amount, possibly nothing, over a ten year period.[20]

Under Class Seven, which curiously is described as both impaired and unimpaired by the Plan, see Plan at Article IV, page 10, consists solely of the equity interest holders. As previously mentioned, the shareholders of Submarina are: debtor Kerensa 1 (2,198,958 shares), Robert Pina (532,500 shares), Zeller (169,926 shares) and Rosenthal (19,064 shares). The equity interest in Kerensa 1 is held 99 percent by Rosenthal and 1 percent by Kerensa & Company. Kerensa & Company itself is owned entirely by Rosenthal. Under Class Seven, the interests of Rosenthal and Kerensa & Company will be cancelled and 100% of the shares in the reorganized debtor will be conferred upon Kerensa 2, an entity that was organized, owned and managed by Rosenthal

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money or money's worth equal to the value of the interest that is retained. See generally Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 118 (1939). This "new value exception" to the absolute priority rule continued to be applied by lower courts after the enactment of Section 1129(b)(2)(ii), without a definitive ruling by the Supreme Court as to the continued validity of the exception.

[20] The 203 North LaSalle decision involved a real estate limited partnership where the Chapter 11 plan proposed to give the existing partners the exclusive opportunity to contribute additional funds to retain their equity positions in the reorganized debtor. The Court declined to decide whether a "new value corollary" of "new value exception" to the absolute priority rule existed after the enactment of Section 1129(b)(2)(B)(ii). 526 U.S. at 449-454. The Court did decide, however, the giving the existing partners the exclusive opportunity to contribute new value to retain their equity positions does violate the absolute priority rule. Id. at 456-457.

specifically to provide the DIP Loan to Submarina.[21] Additionally, the interests of Kerensa 1 will be liquidated and the proceeds, if any, distributed pro rata.[22]

Generally, the sole source of any payments made under the proposed Plan will be from operating income and collection of judgments obtained against defaulting franchisees. See First Amended Disclosure Statement at Article II, C, 1, page 28; Plan at Article VII, 1, pages 13-16. However, the sole source of payments to Class Six unsecured creditors, including Zeller, will be from collection of the judgments, if any, over ten years. There is no provision in the Plan for unsecured creditors to be paid from the reorganized debtor's operating income or from any other source. Additionally, under the proposed Plan there will be no payments at all to Class Six unsecured creditors until the Class One administrative claims, including a management fee and expense reimbursement in excess of $556,000, is paid to Kerensa & Company.[23] Thus, unsecured creditors in this case get paid nothing until Kerensa & Company gets paid at least the unpaid amount of a fee for management services for which, apparently, it already has been paid

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[21] Submarina represents that as of June 22, 2016, the outstanding principal owed to Kerensa 2 for its postpetition DIP financing is $310,000. See First Amended Disclosure Statement at Article II, G, 1, page 12.

[22] As previously discussed at note 3, the only scheduled assets of Kerensa 1 consisted of its interest in Submarina, any claims owed by Submarina to Kerensa 1, and unspecified claims against Zeller estimated at $2,363,431. As previously discussed, Submarina did not list any debts owed to Kerensa 1, and it appears that Kerensa 1 did not file a proof of claim in any amount in the Submarina proceeding. Moreover, it also appears that Zeller already obtained judgments on her claims against both Submarina and Kerensa 1. See First Amended Disclosure Statement at Article II, A, 2, page 9 ("On September 24, 2010 Marie Zeller filed suit against both [Kerensa 1] and Submarina relating to the default on these notes. Ultimately she was awarded a Judgement against both [Kerensa 1] and Submarina."). In light of the admitted judgment that Zeller already obtained against Kerensa 1, the assertion of any claims Kerensa 1 may have had against Zeller appear to be barred by the doctrine of claim preclusion. Under these circumstances, it appears that any attempt in bankruptcy to set off the now unenforceable claim against Zeller also would be barred.

[23] The Plan only provides for the equity interest of Kerensa & Company to be cancelled, not for the payment of its administrative claims to be waived.

in excess of $230,000 through July 2016.[24]

According to Rosenthal's written testimony, any judgments obtained against defaulting franchisees, including Warfield, may be uncollectible.[25] Under the proposed Plan, even if there are funds collected on judgments against defaulting franchisees, Submarina's attorneys, along with one of the entities controlled by Rosenthal, get paid in full under Class 1 before unsecured creditors in Class Six receive anything. Under Class Six, the amorphous timeline for unsecured creditors to be paid extends over a period of ten years from the date of plan confirmation. Immediately upon confirmation, however, Kerensa 2 receives all of the equity interest in the reorganized Submarina without being required to contribute a single new dollar in exchange for that interest.[26] In essence, Submarina's proposed Plan provides no assurance that Class Six

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[24] As previously noted at 21, Submarina represents that Kerensa 2 is owed $310,000 as of June 22, 2016, under the DIP Loan. In its July MOR, Submarina attests that it has disbursed $232,880 in total management fees through July 31, 2016. It is unclear what portion of the $310,000 owed to Kerensa 2 is for the management fees already paid to Kerensa & Company.

[25] In support of Submarina's request to obtain DIP financing from Kerensa 2, Rosenthal attested that its litigation against various franchisees, including Warfield, had legal risks and that the judgments it obtains from any defaulting franchisees may be uncollectible. See First Rosenthal Financing Declaration at ¶ 13.

[26] No mention is made in the implementation portion of the proposed Plan, see Plan, Article VII, pages 13-16, or in the implementation portion of the proposed disclosure statement, see First Amended Disclosure Statement at Article III, C, pages 28-29, what "money or money's worth" would be contributed by Kerensa 2 to acquire all of the equity interest in the reorganized Submarina entity. Compare 203 North LaSalle Street Partnership, 526 U.S. at 442-49 (discussing new value corollary to absolute priority rule). The only reference to how Kerensa 2 ends up owning the reorganized debtor appears in one sentence appearing in the prefatory "summary" of the proposed Plan: "The DIP Lender [Kerensa 2] will convert the entire principal outstanding balance, $310,000 as of June 23, 2016, on the DIP loan to equity of the Debtor, and upon confirmation, will own 100% of the Debtor." Plan, Article I, pages 2-3. Kerensa 2 is not a secured creditor of Submarina that would be eligible to credit bid an allowed secured claim under a plan that proposes to cramdown on a dissenting secured class through a sale under Section 1129(b)(2)(A)(ii). Moreover, if Kerensa 2 was a non-insider entity attempting to purchase the equity interests of Submarina by credit bidding its unsecured, priority administrative expense claim to the extent allowed, it could do so only through a duly noticed sale motion brought under Section 363(b), or a sale provision disclosed in the proposed plan. The proposed Plan does not contemplate a sale of any type, but simply gives the equity interest in the reorganized debtor only to Kerensa 2, an entity owned by Rosenthal.

unsecured creditors will receive any property from the bankruptcy estate, while assuring that an entity owned by Rosenthal will receive on an exclusive basis, the entire interest in the reorganized debtor.

In this instance, Kerensa 2 is an affiliated insider of Submarina that is owned by Rosenthal. Rosenthal directly owns substantially all of the equity interest in Kerensa 1, which in turn owns more than 75% of the equity interest in Submarina. Under the proposed Plan, Kerensa 2 receives not just the exclusive opportunity to acquire the equity interest in the reorganized Submarina entity, but is simply given the entire equity interest in the reorganized Submarina entity. Even if there is an impaired class that accepted the proposed Plan, and even if the new value corollary to the absolute priority rule is valid, Submarina's proposed treatment of its unsecured creditors fails to meet the fair and equitable requirements of Section 1129(b)(2)(b)(ii). See 203 North LaSalle Street Partnership, 526 U.S. at 454-58.

More important, the Plan proposed by Submarina transfers all of the interest in the reorganized entity to Kerensa 2 and then the reorganized debtor proceeds as an operating entity, rather than liquidating. The legal result of confirming the proposed Plan would be that the reorganized debtor receives a discharge of all of its unsecured debts pursuant to Section 1141(d)(1)(A) because the disability imposed by Section 1141(d)(3) would not apply. The discharge would be effective immediately upon confirmation because there is no provision in the Plan delaying its effective date. See Plan, Article IX, page 21. The revested debtor, controlled by Rosenthal through his interest in Kerensa 2, would be relieved of personal liability for all prepetition claims, without any requirement that the claims in Class Six ever get paid if there are no funds collected from defaulting franchisees beyond the amounts needed to pay administrative claims of the professionals and Kerensa & Company.

Confirmation under Chapter 11 requires that the subject plan of reorganization be proposed in good faith. 11 U.S.C. § 1129(a)(3). It is well established that a plan of reorganization is proposed in good faith only if, under all of the circumstances, it will "fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code." Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.), 314 F.3d 1070, 1074-75 (9th Cir.

2002). See also In re City of Stockton, California, 542 B.R. 261, 278-79 (B.A.P. 9th Cir. 2015); In re Windmill Durango Office, LLC, 481 B.R. 51, 68 (B.A.P. 9th Cir. 2012). Congress's purpose in permitting reorganization in Chapter 11 was to allow a business to "continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners." United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983). In this instance, the proposed Plan preserves the operations of Submarina for a handful of employees, serves neither of the other objectives of Chapter 11, and violates the fair and equitable requirement for cramdown. Instead, the proposed Plan assures only that Rosenthal owns the reorganized Submarina through Kerensa 2, and that the reorganized Submarina receives a discharge. Moreover, if any creditor claims are satisfied, the postpetition claims of Submarina's attorneys and Kerensa & Company get paid first, and then prepetition unsecured claims get paid only if there are any funds remaining from the judgments against defaulting franchisees. Under these circumstances, there is nothing to suggest that the current Plan was proposed in good faith under Section 1129(a)(3).

The Plan proposed by Submarina evidences that after more than five years in Chapter 11, Kerensa 1 and Submarina are unable or perhaps unwilling to propose a confirmable plan of reorganization. Submarina seeks additional time to propose an amended plan some point after it obtains an additional judgment against various defaulting franchisees in the Second Adversary, even though it already obtained a prior judgment in the First Adversary against various defaulting franchisees. As previously discussed at note 25, Rosenthal has acknowledged that any judgments obtained by Submarina against defaulting franchisees may well be uncollectible. No evidence is offered of a different reality that will exist if Submarina prevails in the Second Adversary.

On the uncollectibility score, Rosenthal may well be correct, but that possibility does not prevent Submarina from proposing a confirmable plan. Nothing prevents the holders of equity interests in Submarina, Kerensa 1, or any business for that matter, from contributing new capital to protect their original investments in an ongoing business. Outside of bankruptcy, there are few impediments to equity interest holders taking such steps at the risk of "throwing good money after bad." Inside any bankruptcy proceeding, however, court approval is required for the

disposition of estate property because the risk of loss falls upon unsecured creditors.[27]

In a Chapter 11 proceeding, fair and equitable treatment of dissenting unsecured creditors requires that they be paid in full under Section 1129(b)(2)(B)(i). Alternatively, dissenting unsecured creditors must have an opportunity under Section 1129(b)(2)(B)(ii) to acquire equity in the reorganizing debtor. Finally, even if unsecured creditors are provided an opportunity to acquire equity in the reorganizing debtor, new value in the form of money or money's worth must be contributed by existing equity holders that want to retain an equity position in compliance with Section 1129(b)(2)(B)(ii). There is no mystery to these requirements and the limitations imposed by the Court in its 203 North LaSalle Street Partnership decision existed for more than a decade before Kerensa 1and Submarina sought relief in Chapter 11.

The court already granted so Submarina and Kerensa 1 on an ex parte basis, one extension of the confirmation deadline set forth in the Conversion Order. In light of the previous discussion, Submarina and Kerensa 1 have failed to meet their burden of establishing that an additional extension of the plan confirmation deadline is warranted.

The court is mindful that other franchisees have an interest in the ongoing operations of Submarina.[28] The court therefore will consider whether the appointment of a Chapter 11 trustee under Section 1104(a)(2), or dismissal of the Chapter 11 proceeding under Section 1112(b)(1) is

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[27] The DIP Loan sought by Submarina and proposed by Rosenthal to make through Kerensa 2, was for repayment as an administrative claim with priority over all other administrative claims under Section 364(c)(1). See Financing Motion at 3:8-11. Submarina did not grant nor did Rosenthal seek a lien against any assets of Submarina. The Promissory Note accompanying the Financing Motion was an unsecured instrument. Submarina did not propose and Rosenthal did not seek a lien against any assets of Submarina under Section 364(c)(2 and 3) or Section 364(d). Kerensa 2 is simply an unsecured creditor with repayment priority inside of bankruptcy, but with no lien priority outside of bankruptcy. The attempt by Submarina and Kerensa 1 to allow Kerensa 2 to credit bid its administrative expense claim conflates Kerensa 2's priority position with a lien against Submarina's assets. Moreover, by allegedly credit bidding its priority administrative expense claim, Kerensa 2 would not be providing any "new value" at all to retain or obtain property of the estate. There is no factual or legal basis to support such an approach.

[28] The oral motion to strike the late-filed declarations of various franchisees, see note 14, supra, is granted inasmuch as Submarina offered no explanation for why the declarations were not available at the time the Emergency Motion was filed.

more appropriate than conversion to Chapter 7.

IT IS THEREFORE ORDERED that the Emergency Motion to Extend Time in Which to File an Amended Plan of Reorganization and Disclosure Statement, Docket No. 503, be, and the same hereby is, **DENIED**.

IT IS FURTHER ORDERED that an additional status hearing on the Motion to Convert brought by SD Subros, Inc., Subros, Inc., EDRC LLC, J&C Mason Inc., JTJM Inc., J & J Subs Inc., Masquerade, Inc., JTW Area Developers Inc., Vonnie Audibert and Paul Simmons, Docket No. 426, **will be held on November 30, 2016, at 11:00 a.m.**

Copies sent to all parties via BNC and via CM/ECF ELECTRONIC FILING

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