Honorable Mike K. Nakagawa
United States Bankruptcy Judge

Entered on Docket
January 17, 2017

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: January 5, 2017
	Time: 1:30 p.m.
Debtor.	

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

On January 5, 2017, the court heard the Motion to Reconsider Order on Emergency Motion to Extend Time in Which to File an Amended Plan of Reorganization and Disclosure Statement ("Reconsideration Motion") brought by Kerensa Investment Fund 2, LLC.

BACKGROUND

On September 9, 2011, a voluntary Chapter 11 proceeding was commenced by Kerensa Investment Fund 1, LLC ("Kerensa 1"), denominated Case No. 11-24352-MKN.[2] Kerensa 1's

[1] In this Memorandum Decision, 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 proceeding discussed in this Memorandum. 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.

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

primary asset consists of shares of stock in Submarina, Inc., a Nevada corporation ("Submarina").[3] The bankruptcy petition was 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). Submarina's primary liquid assets consist of accounts receivable owed by various franchisees ("Franchisee AR's") and a limited amount of equipment.[5] The bankruptcy petition was 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).[6] 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

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[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 schedules of assets and liabilities (Submarina ECF No. 11) lists no interests in real property. Submarina's schedule of personal property assets lists the value of its trade name and franchise agreements at $6,000,000 based on a 2009 appraisal.

[6] 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).

("First Adversary"), against numerous franchisees seeking damages for breach of the individual 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").[7] (Submarina ECF No. 192). Kerensa 2 is owned and managed by Rosenthal.[8]

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

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[7] 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). Submarina did not grant nor did Rosenthal seek a lien against any assets of Submarina. The Promissory Note accompanying Submarina's request 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.

[8] 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.

as the lead case.[9]

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.[10]

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 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 reorganization proceeding to a Chapter 7 liquidation proceeding whereupon a bankruptcy trustee would be

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[9] The two Chapter 11 proceedings were ordered to be jointly administered, but the separate bankruptcy estates were not substantively consolidated.

[10] On December 18, 2013, Kerensa 1 and Submarina filed another complaint commencing Adversary Proceeding No. 13-01223-MKN. Defendants named in the complaint included Scott D. Freedland and CQG Restaurants, Inc., which already had been named as defendants in the First Adversary. All other named defendants subsequently were dismissed with prejudice. Kerensa 1 and Submarina have attempted to obtain entry of default and default judgments against the remaining defendants. Those attempts have not been successful due to defects in attempting to effectuate adequate service of the adversary complaint and summons.

appointed. The Conversion Motion was noticed to be heard on May 18, 2016.[11]

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 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, an order was entered scheduling the requested settlement conference with respect to all disputes. (AECF No. 247).[12]

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).

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[11] 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).

[12] 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).

On May 16, 2016, a settlement conference was held but without success.[13] 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 and Kerensa 1 to complete their 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 the debtors in possession to confirm a joint Chapter 11 plan.

On June 23, 2016, Submarina filed a proposed Chapter 11 plan as debtor in possession ("DIP Plan") along with a proposed disclosure statement in compliance with the Conversion Order.[14] (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

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[13] 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. According to Submarina's bankruptcy schedules, the value of the Submarina trade name and franchise agreements were appraised at $6,000,000. See note 5, supra.

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

("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.[15] (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 complaint ("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.[16]

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 noticed to be heard 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 DIP Plan.

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[15] 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).

[16] The First Adversary and Second Adversary, along with the additional adversary proceeding against Scott D. Freedland and CQG Restaurants, will be referred to collectively at the "Adversary Actions."

(Submarina ECF No. 496). Both of those objections were joined by creditor Zeller.[17] (Submarina ECF Nos. 497, 498). On the same date, an objection to final disclosure statement approval 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 its Emergency Motion to Extend Time in Which to File An Amended Plan of Reorganization and Disclosure Statement ("Emergency Motion") by which it sought 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 sought relief from the confirmation bar date established by the Conversion Order for an indeterminate amount of time.[18] 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 DIP 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. (Submarina ECF Nos. 516,

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[17] 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.

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

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.[19]

On November 9, 2016, an order was entered denying the Emergency Motion and scheduling a further status hearing on November 30, 2016, with respect to the Subros Parties' Conversion Motion ("Emergency Motion Order"). (Submarina ECF No. 535). In the Emergency Motion Order, the court concluded that in response to the Conversion Order, Submarina had filed a proposed plan of reorganization that could not be confirmed under Section 1129. Among the reasons that the DIP Plan could not be confirmed, there was no accepting impaired class of creditors to satisfy Section 1129(a)(10). More important, even assuming there was an accepting impaired class to permit cramdown to be attempted under Section 1129(b), the treatment of dissenting unsecured creditors still did not satisfy the fair and equitable requirements of Section 1129(b)(2)(B) as interpreted by the Supreme Court in Bank of America Nat'l Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership (In re 203 North LaSalle Street Partnership), 526 U.S. 434 (1999).[20] Accordingly, the court denied the Emergency Motion, and scheduled a status hearing on the Conversion Motion inasmuch as Kerensa 1 and Submarina had failed to confirm a joint plan of reorganization, and had not obtained an extension of the deadline to do so. In the Emergency Motion Order, the court also notified the

[19] On the morning of the hearing on the Emergency Motion, 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.

[20] The deficiencies in the DIP Plan are discussed in detailed from pages 8 through 16 of the Emergency Motion Order.

Chapter 11 debtors in possession, as well as all parties in interest, that the court would consider the appointment of a Chapter 11 trustee under Section 1104(a)(2), or dismissal of the Chapter 11 proceeding under Section 1112(b)(1), in lieu of converting the proceeding to Chapter 7.

On November 21, 2016, Kerensa 2, rather than the debtors in possession, filed the instant Reconsideration Motion. (Submarina ECF No. 539). On the same date, Kerensa 2 filed a joint plan of reorganization ("Kerensa 2 Plan") along with a proposed disclosure statement ("Kerensa 2 Disclosure Statement"). (Submarina ECF Nos. 540, 541). Kerensa 2 noticed its Reconsideration Motion to be heard on January 18, 2017. (Submarina ECF No. 543).

On November 30, 2016, the status hearing was held on the Conversion Motion. As a result of the status hearing, the hearing on the Reconsideration Motion was rescheduled for January 5, 2017, and deadlines were set for oppositions and replies to be filed. (Submarina ECF No. 550). The hearings on all other pending motions were continued.

On December 22, 2016, opposition to the Reconsideration Motion was filed by the Subros Parties ("Subros Opposition"), along with numerous declarations from various franchisees. (Submarina ECF Nos. 556, 557, 558, 559, 560,561, 562, 563, 564). On the same date, a joinder in that opposition was filed by creditor Zeller ("Zeller Joinder"). (Submarina ECF No. 565).

On December 29, 2016, Kerensa 2 filed its reply ("Kerensa 2 Reply"). (Submarina ECF No. 568). The reply was accompanied by numerous declarations from various creditors stating that "If given the opportunity I would vote to approve the Plan of Reorganization proposed by Kerensa Investment Fund 2, LLC.". (Submarina ECF Nos. 569, 570, 571, 572, 573, 574, 575, 576).[21]

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[21] At the hearing on the Reconsideration Motion, counsel for Kerensa 2 represented that he prepared the declarations at the request of Rosenthal, but does not know who obtained the creditor declarations signed under penalty of perjury, even though counsel electronically filed each of them and affirmatively states that "Kerensa 2 has obtained declarations" from the creditors. See Kerensa 2 Reply at 7:13-20. Counsel represented that the Kerensa 2 Plan and proposed disclosure statement are on the court's docket in the case and could have been accessed by the public, including the declarants. A review of the schedules filed by the debtors in possession, as well as the claims register, reflects that all of the creditors who submitted these declarations live or are located outside of Nevada, thereby limiting their ability to physically

On January 5, 2017, the rescheduled hearing was conducted on the Reconsideration Motion. The appearances of counsel were noted on the record. After arguments were presented, the matter was taken under submission.

DISCUSSION

The court having reviewed the Reconsideration Motion, the response filed by the Subros Parties, the joinder by Zeller, the Plan and First Amended Disclosure Statement previously filed Submarina, the Kerensa 2 Plan, the Kerensa 2 Disclosure Statement, and the entire record in this proceeding, concludes that the Reconsideration Motion must be denied. Moreover, the court also concludes that the appointment of a Chapter 11 trustee is appropriate pursuant to Section 1104(a)(2).

1. No Relief from the Emergency Motion Order Has Been Requested.

At the outset, the court notes that the Reconsideration Motion is brought by Kerensa 2, an insider, postpetition creditor, rather than by either of the Chapter 11 debtors, i.e., Kerensa 1 and Submarina. Moreover, neither of the Chapter 11 debtors filed a written joinder in the Reconsideration Motion although a belated oral motion for joinder was made at the hearing.[22] The absence of a prior written joinder from the debtors in possession, however, is understandable because the Reconsideration Motion itself does not even allege that the Emergency Motion

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access the public records maintained at the bankruptcy court. Several of the creditors are attorneys who might subscribe to the Public Access to Court Electronic Records ("PACER") service, but other creditors are not. This suggests that some or all of the creditors who filed declarations obtained a copy of the Kerensa 2 Plan and the declarations from a human source, or are attesting that they would vote for the Kerensa 2 Plan sight unseen. Under Section 1125(b), the acceptance or rejection of a plan may not be solicited during a Chapter 11 proceeding unless a written disclosure statement approved by the court, after notice and a hearing, is transmitted to the creditor along with a copy of the proposed plan or a summary of the proposed plan. On its face, the record strongly suggests that Kerensa 2 may have violated Section 1125(b) merely by transmitting the declarations for the creditors to attest that they would vote for the Kerensa 2 Plan, or by orally soliciting the declarations. An obvious consequence of such a violation would be that Kerensa 2 could not meet Section 1129(a)(2), i.e., that the plan proponent "complies with the applicable provisions of this title." Whether the conduct of Kerensa 2 separately warrants the imposition of sanctions under FRBP 9011 or other source of authority is not presently under consideration by the court.

[22] The Subros Parties objected to the oral motion.

should have been granted. There is no suggestion that Kerensa 1 and Submarina had met the deadlines set forth in the Conversion Order, that the DIP Plan filed and proposed by Submarina was even confirmable, or that either Kerensa 1 or Submarina had provided evidence that they could confirm a plan of reorganization within a reasonable time. In fact, the Reconsideration Motion does not even request that Kerensa 1 and Submarina should be given more time to propose and confirm a joint Chapter 11 plan of reorganization.[23] Thus, even if the court vacates the findings contained in the Emergency Motion Order, there would be no evidentiary basis on which to grant Kerensa 1 or Submarina additional time to confirm a joint Chapter 11 plan. Instead, Kerensa 2, a postpetition creditor owned solely by Rosenthal, wants time to propose and confirm its own Chapter 11 plan under the guise of seeking "reconsideration" of the Emergency Motion Order.[24]

As presented, there is no relief requested from the operative provisions of the Emergency

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[23] The Reconsideration Motion is brought pursuant to FRBP 9023, incorporating FRCP 59(e) and pursuant to FRBP 9024, incorporation FRCP 60(b)(2) and FRBP 60(b)(6). See Reconsideration Motion at 4:8-16. The only "newly discovered" evidence offered by the moving party under FRCP 60(b)(2) is an unauthenticated copy of a cashier's check in the amount of $35,217.50, dated November 7, 2016, received from JTM Inc. Id. at Exhibit "1." Because the check is dated after the date the Emergency Motion was heard, i.e., October 5, 2016, it arguably was "discovered" after the hearing on the Emergency Motion was completed and could not have been part of the record at that time. (Strangely, Kerensa 2 asserts that the cashier's check was received two days prior to the hearing on the Emergency Motion, see Kerensa 2 Reply at 3:24-27, when in fact it was dated over a month after the hearing.)

As the moving party, Kerensa 2 also offers as "newly discovered" evidence copies of Kerensa 2 Plan and Kerensa 2 Disclosure Statement. See Reconsideration Motion at 5:7-9. Obviously, those documents were simply newly created rather than newly discovered. The Reconsideration Motion also includes copies of declarations from various franchisees that were tardily filed on the day before the hearing on the Emergency Motion, but which were stricken by the court. See Emergency Motion Order at 16 n.28. Kerensa 2 offers those pre-existing declarations as evidence that under FRCP 59(e), "manifest injustice" to various franchisees would occur if Submarina does not reorganize. See Kerensa 2 Reply at 8:26 to 9:3.

[24] To a certain degree, Kerensa 2's strategy was successful inasmuch as the court delayed converting or dismissing the cases, or appointing a Chapter 11 trustee. In other words, Kerensa 2 succeeded in buying time.

Motion Order and therefore no grounds for reconsideration under FRCP 59(e) or FRCP 60(b).[25]

2. The Debtors in Possession Have Abdicated Their Fiduciary Duties to Creditors.

The court also notes that Kerensa 2 currently is represented by counsel who previously represented the Chapter 11 debtors in these proceedings.[26] Upon inquiry by the court, counsel for Kerensa 2 represented that conflict waivers had been obtained from Kerensa 1 and Submarina to allow him to represent Kerensa 2. Counsel also represented that the respective clients (Kerensa 1, Submarina, and Kerensa 2) had been advised of the conflict and to seek independent counsel before executing such waivers.

Whether or not such waivers were ever executed is immaterial, however, because all of the clients are controlled by the same individual, i.e., Rosenthal. It is hardly a surprise that Rosenthal would execute a written waiver that directly benefits himself. The actual surprise is that both Kerensa 1 and Submarina, as Chapter 11 debtors in possession, have largely ignored their fiduciary obligations to creditors of their bankruptcy estates. See B.E.S. Concrete Products, Inc., 93 B.R. 228, 235 (Bankr.E.D.Cal. 1988)("Although parties can waive the conflict upon appropriate disclosures, the waiver is more difficult in a chapter 11 case because the debtor in possession stands in a fiduciary capacity that constrains its ability to make such a waiver."). See also Woodson v Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610, 614 (9th Cir. 1988) ("[Debtor's] failure to notice his creditors of the $1 million in a timely fashion is troubling because [Debtor] is not an ordinary litigant. As debtor in possession he is the trustee of his own

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[25] For these reasons, the oral motion by the debtors in possession to join in the Reconsideration Motion is denied.

[26] When Submarina filed its Financing Motion that led to the DIP Loan obtained from Kerensa 2, numerous supporting declarations prepared by Submarina's bankruptcy counsel were filed by Rosenthal, see discussion at note 8, supra, but there was no appearance by separate counsel on behalf of Kerensa 2. It appears that Kerensa 2 was not represented by counsel at the time, but bankruptcy counsel for Kerensa 1 and Submarina as debtors in possession were prohibited from representing Rosenthal personally. Compare In re Perez, 30 F.3d 1209, 1219 (9th Cir. 1994)("Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually."). Additionally, bankruptcy counsel for the debtors in possession clearly could not represent Kerensa 2 in the transaction without disclosure and authorization from the court, if at all.

estate and therefore **stands in a fiduciary relationship to his creditors**.") (emphasis added). That fiduciary responsibility also rests with bankruptcy counsel for the debtor in possession. See In re Perez, 30 F.3d at 1219. When Kerensa 1 and Submarina filed a proposed plan that changed Kerensa 2 and Rosenthal's status from a lender to the debtors in possession to that of the sole owner of the debtors in possession,[27] the need to protect the interests of other creditors of the bankruptcy estates was at its highest.[28]

The failure of Kerensa 1, Submarina, and now Kerensa 2, to appreciate the fiduciary obligations of a debtor in possession is amply illustrated by the Kerensa 2 Plan and the arguments presented at the hearing.[29]

3. The Kerensa 2 Plan and Disclosure Statement Are Patently Deficient.

Instead of the seven classes proposed in the DIP Plan, the Kerensa 2 Plan consists of only three classes, with no class at all for the equity interest holders of Kerensa 1 and Submarina. See Kerensa 2 Plan at 6:16 to 7:1.[30] The DIP Plan had only two impaired classes consisting of a

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[27] This process of going from critical lender to new owner appears to repeat the manner in which Rosenthal originally obtained ownership of Submarina from Warfield in 2009. See discussion at note 13, supra.

[28] As the court previously noted, confirmation of the DIP Plan as a reorganization would have resulted in an immediate discharge of Kerensa 1 and Submarina's personal liability to its prepetition creditors. See Emergency Motion Order at 14:13-23. Additionally, confirmation of the DIP Plan would have given sole ownership of the Submarina operations to Kerensa 2 and Rosenthal. Id. at 14:4-9. No distributions were required to be made to the class of general unsecured creditors. Id. at 13:2 to 14:3. Instead of safeguarding the interests of unsecured creditors, it left them at the mercy of an insider's discretion to pursue the only source of their payments.

[29] The cavalier attitude to a debtor in possession's fiduciary duty to creditors is reflected in the plan proponent's assertion that "Kerensa 2 is free to choose whatever counsel it chooses and such choice does not imply some kind of ill intent." Kerensa 2 Reply at 6 n.4. A creditor is not free to choose a debtor in possession's former bankruptcy counsel, nor is a debtor in possession's ongoing counsel free to waive a former attorney's obvious conflict involving a former client.

[30] In its disclosure statement accompanying the proposed plan of reorganization, however, the plan proponent informs creditors that there are five separate classes of creditors, that Class 1, Class 2 and Class 3 are not entitled to vote, and that only Classes 4 and 5 are entitled to vote. See Kerensa 2 Disclosure Statement at 31:9-14. Unfortunately, there is no

class of general unsecured creditors and a class of equity interest holders. The equity interest holder class consisted of insiders whose acceptance could not satisfy Section 1129(a)(10) and the DIP Plan therefore was unconfirmable absent acceptance by the general unsecured creditor class. The evidentiary record demonstrated that the general unsecured creditor class, dominated by Zeller's unsecured claim, would not accept. In essence, the DIP Plan was dead on arrival.

All three classes in the Kerensa 2 Plan are impaired and all three classes are unsecured. Zeller's unsecured claim is paid in a substantially reduced amount in separate Class One, unsecured claims that are less than or which are voluntarily reduced to $1,000 or less will be paid 50 cents on the dollar in separate Class Two, and all other unsecured claims will be paid pro rata in separate Class Three. Even though Section 1123(a)(1) requires Chapter 11 plans designate, inter alia, classes of interests, the Kerensa 2 Plan does not designate a class at all for the current interest holders of Kerensa 1 and Submarina.[31]

A. The Plan Fails to Properly Classify Claims and Interests.

Class 4 or Class 5 in the proposed plan at all and Class One, Class Two and Class Three actually are the only impaired voting classes. This carelessness amply illustrates why a plan proponent may not solicit plan acceptance without prior court approval of the required disclosure statement.

[31] Article I of the Kerensa 2 Plan purports to be a summary of the proposed plan of reorganization. Among other things, the plan proponent represents that the Kerensa 2 Plan "also classifies the pre-petition equity holder's ownership of Kerensa 1, which will be extinguished on Plan Confirmation." Kerensa 2 Plan at 3:22-23; Kerensa 2 Disclosure Statement at 3:16-17. Article II of the Kerensa 2 Plan is entitled "Classification of Claims and Interests." Under Article II, Section 2.01 sets forth three categories of "unclassified" claims consisting of Kerensa 2's super-priority administrative claim for repayment of the DIP Loan ("Super-Priority Administrative Claim"), professional compensation and other administrative expense claims ("General Administrative Claims"), and administrative fees owed to unspecified insiders of Kerensa 1 and Submarina ("Insider Priority Claims"). Under Article II, Section 2.02, unsecured, non-priority Class One, Class Two and Class Three are listed. In spite of the plan proponent's express representation, the Kerensa 2 Plan does not classify at all the equity holders' interests in either Kerensa 1 or Submarina. As previously discussed at 2, the equity holders of Kerensa 1 are Rosenthal and Kerensa & Company. In addition to this incorrect, but express representation, Article IV, Section 4.01 of the Kerensa 2 Plan refers to Zeller having an unsecured claim in the amount of $421,151.67 as of March 4, 2013, appearing in "Class 4." Just like the Kerensa 2 Plan includes no class at all for equity interest holders, it also includes no Class 4 with respect to Zeller. Although the latter discrepancy may be excused as a typographical error, the affirmative misstatement of compliance with Section 1123(a)(1) cannot.

According to Kerensa 2's counsel, Zeller's unsecured claim under the Kerensa 2 Plan can be separately classified from other general unsecured creditors, because Zeller's claim is against both Chapter 11 estates[32] while the claims of the other unsecured creditors are only against either Kerensa 1 or Submarina, but not both.[33] A business or economic justification, of course, will permit otherwise similar claims to be separately classified. See Life Ins. Co. of Va. v. Barakat (In re Barakat), 99 F.3d 1520, 1526 (9th Cir. 1996). But the treatment afforded to all three classes of unsecured claims under the Kerensa 2 Plan, however, negates any business or economic justification for separately classifying Zeller's claim, or, for that matter, any of the unsecured claims.

Under Class One, Zeller's unsecured claim in the amount of $431,151.57 is treated by giving her a three-year $300,000 promissory note ("Zeller Note") apparently payable by an entity identified as Sub Solutions Company, LLC ("SSC"). See Kerensa 2 Plan at 4:1-1; Kerensa 2 Disclosure Statement at 3:18-22. According to the representations made at the hearing on the Reconsideration Motion, SSC, as the issuer of the promissory note, is owned and controlled by Rosenthal.[34] The Zeller Note will not bear interest, nor are periodic payments required. According to the plan summary in Article I, the Zeller Note will be secured by the assets of Kerensa 1, see Kerensa 2 Plan at 4:4, or possibly by the assets of both Kerensa 1 and Submarina, see Kerensa 2 Plan at 8:12 and Kerensa 2 Disclosure Statement at 26:24, or, the

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[32] Zeller filed separate proofs of claim in the Submarina and Kerensa 1 proceedings. See discussion at note 17.

[33] In the proposed plan and accompanying proposed disclosure statement, Kerensa 2 represents that the unsecured creditor schedules signed by Rosenthal under penalty of perjury in the Kerensa 1 and Submarina proceedings are inaccurate because they listed some of Submarina's creditors as creditors of Kerensa 1. See Kerensa 2 Plan at 3 n.1 and 6 n.2. See also Kerensa 2 Disclosure Statement at 3 n.1. In the DIP Plan, Submarina as plan proponent made no similar representation as to any inaccuracies appearing in the unsecured creditor schedules. The DIP Plan and the Kerensa 2 Plan were both signed by Rosenthal on behalf of the plan proponents.

[34] The proposed plan represents that "both Kerensa 1 and SSC member's interest is held by the same parties . . ." Kerensa 2 Plan at 14:3. As previously mentioned at 2, supra, the equity interests in Kerensa 1 are held 99 percent by Rosenthal and 1 percent by Kerensa & Company.

Zeller Note might simply be guaranteed by Submarina and the guaranty secured by all of the assets of Submarina.[35] See Kerensa 2 Plan at 5:9-10. Whether or not the Zeller Note is secured or simply guarantied with the guaranty secured, the face amount of the note might never be paid. Instead, the $300,000 note will be deemed paid in full if Zeller receives $100,000 within one year, or $150,000 within two years.[36] On the three-year maturity date, Zeller must be paid the full amount of the note by SSC, or will relegated to either foreclosing on her collateral or pursuing Submarina on its guaranty. It appears that the balance of her $431,151.57 unsecured claim will receive zero at whatever point the promissory note is paid.[37] It also appears, however,

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[35] According to the monthly operating report through November 2016, the current market value of Submarina's assets is $1,181,613, consisting primarily of accounts received having a net value of $1,117,626. (Submarina ECF No. 567). The same report also assigns a value of $300,000 for certain "development rights" and intangibles.

[36] By deeming Zeller's $300,000 note to be paid in full even though she might receive far less under the Kerensa 2 Plan, federal income tax consequences to Zeller might certainly arise separate from the receipt of distributions on a general unsecured claim. Section 1125(a) was amended in 2005 to specifically require a Chapter 11 disclosure statement to include "a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holder of claims or interests in the case." 11 U.S.C. § 1125(a)(1). See generally 7 COLLIER ON BANKRUPTCY, ¶ 1125.01[2] n.1 (Alan N. Resnick and Henry J. Sommer, eds., 16th ed. 2016). See also HR Rep. No. 31, 109th Cong., 1st Sess. 717 (2005)("As the tax consequences of a plan can have a significant impact on the debtor's reorganization prospects, section 717 amends section 1125(a) of the Bankruptcy Code to require that a chapter 11 disclosure statement discuss the plan's potential material Federal tax consequences to the debtor, any successor to the debtor, and to a hypothetical investor that is representative of the claimants and interest holders in the case."). See, e.g., In re South Beach Securities, Inc., 606 F.3d 366, 373 (7th Cir. 2010)("Amendments made to the Bankruptcy Code in 2005...makes this disclosure requirement explicit."). Absent a sufficient discussion of such consequences, a disclosure statement does not contain adequate information and cannot be approved. See, e.g., In re Zaruba, 384 B.R. 254, 256-57 (Bankr. D. Alaska 2008). As to the tax consequences to Zeller (and other creditors), the plan proponent merely states that it does not know how much will be paid on each claim and advises the creditor to consult their own tax advisor. See Kerensa 2 Disclosure Statement at 30:3-9; see also Kerensa 2 Plan at 14:12-18. As to Zeller, this appears to be incorrect because the Zeller Note will be deemed paid in full upon the happening of certain events. In other words, there is no legal uncertainty if the designated event occurs and the potential material federal tax consequences to Zeller must be discussed to provide her with the information specifically required by Section 1125(a).

[37] Zeller apparently is the former chief executive officer of Submarina who obtained a large judgment against both debtors in possession. See Subros Opposition at 10:3-4. Zeller

that the sole source of payment of the Zeller Note will be from the net proceeds of the recoveries from the Adversary Actions. See Kerensa 2 Plan at 11:2-6.

Under Class Two, general unsecured creditors holding claims of $1,000 or less, or who agree to reduce their claims to $1,000, will be paid 50 percent of that claim either within 30 days of the effective date of the Kerensa 2 Plan, see Kerensa 2 Plan at 8:19-23 and Kerensa 2 Disclosure Statement at 27:8-9, or perhaps on the effective date of Kerensa 2 Plan itself. See Kerensa 2 Plan at 5:11-12. The unsecured claims in Class Two will be paid solely from the funds already recovered from the Adversary Actions in the amount of $35,217.50, see Kerensa 2 Disclosure Statement at 4:25-28 and Reconsideration Motion Reply at Exhibit "1," with any remaining portion of those funds being paid to unsecured claims in Class Three.

Under Class Three, all other general unsecured creditors that Kerensa 2 estimates to have claims totaling approximately $700,000, will be paid pro rata solely from amounts recovered from the Adversary Actions. See Kerensa 2 Plan at 5:16-21 and 8:26 to 9:3; Kerensa 2 Disclosure Statement at 27:15-19. Before general unsecured creditors in Class Three receive any distribution, however, Kerensa & Company must be paid $675,000 from the recoveries in the Adversary Actions (not including the $35,217.50 already received). See Kerensa 2 Plan at 4:18 to 5:7 and 11:1-6. In addition to payment of $675,000 to Kerensa & Company, the "Insider Administrative Claim" as well as all other general administrative claims, and the Zeller Note in Class One must be satisfied, id. at 9:1-4, before general unsecured creditors receive any funds at all.

"Insider Administrative Claim" is not defined in the Kerensa 2 Plan, but the term presumably was meant to refer to Insider Priority Claims defined under Section 2.01(C) of the proposed plan. But exactly what "administrative fees are due to insiders of the Debtors?"

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adamantly opposes the Reconsideration Motion, and asserts that the Kerensa 2 Plan "is essentially the same as Debtor's unconfirmable plan but adds an administrative convenience class to get around Zeller's 'no' vote....Zeller would rather take the risk of what a Chapter 7 trustee can generate because of the total lack of trust in management's ability to collect. An independent party such as a Chapter 7 trustee can look at the cost of litigation and collect and come up with a reasonable settlement and obtain case." See Zeller Joinder at ¶ 2.

Kerensa 2 itself is an insider of the Debtors. Under the Kerensa 2 Plan, SSC will pay Kerensa 1 the amount of $312,000 to "purchase 100% of the equity of Kerensa 1." Kerensa 2 Plan at 10:16-17. This makes little sense because the equity in Kerensa 1 is held by 99 percent by Rosenthal and 1 percent by Kerensa & Company. Is SSC purchasing Rosenthal's and Kerensa & Company's interests in Kerensa 1? Kerensa 1 owns 2,198,958 shares of voting common stock in Submarina, while 532,500 shares are owned by Robert Pina, 169,926 shares are owned by Zeller, and 19,064 shares are owned by Rosenthal. Is SSC purchasing Kerensa 1's equity interest in Submarina? The latter seems more plausible as it would give Kerensa 1 a source of funds to make a new value contribution. Kerensa 1 will then contribute the $312,000 received from SSC to Submarina in exchange for 312,200,000 shares of stock in Submarina. Id. at 4:8-9. Submarina will then use the same funds to pay Kerensa 2 the $312,000 balance owing on the DIP Loan as of November 21, 2016. Id. at 4:11-12. Presumably, this payment satisfies the "Super-Priority Administrative Claim" referenced at Section 2.01(A) of the Kerensa 2 Plan, and evidently is not made through the recoveries on the Adversary Actions. At the end of the day, SSC will own the 2,198,958 shares of common stock in Submarina originally held by Kerensa 1, Kerensa 1 will own 312,200,000 shares of stock in Submarina, Kerensa 2 will have the $312,200 paid by SSC to acquire the 2,198,958 shares in Submarina originally held by Kerensa 1, and Rosenthal will own all or the controlling interest in SSC, Kerensa 2, Kerensa 1, and Submarina.[38]

Kerensa & Company also is an insider of the Debtors. But Kerensa & Company already is being paid $675,000 from the Adversary Action proceeds. So if it is not Kerensa 2 nor Kerensa & Company, who or what are the other insiders of the Debtors who may have administrative claims? Apparently, the disclosed insiders, according to Kerensa 2, are: Rosenthal, Victoria A. Wofford, Kerensa 1, Kerensa 2, SSC, Kerensa & Company, and

[38] Although the proposed plan does not include a class of interest holders as required by Section 1123(a)(1), it elsewhere states that "any existing claims to ownership or economic interest in Kerensa 1 will be eliminated and the value of the Pre-Petition Submarina stock will become negligible." See Kerensa 2 Plan at 14:20-23; see also Kerensa 2 Disclosure Statement at 30:11-13. As a result, if SSC exchanges $312,000 for "100% of the equity of Kerensa 1," the consideration received will be illusory at best.

Submarina. See Kerensa 2 Disclosure Statement at 11:16 to 12:7. Although specific treatment of the insider administrative claims of Kerensa 2 and Kerensa & Company is set forth in the proposed plan, there also is no bar date established for the approval of administrative claims - insider or non-insider - under the proposed plan. Likewise, the disclosure statement accompanying the Kerensa 2 Plan does not include any estimate of the potential amount of these additional Insider Priority Claims that must be paid ahead of Class Three general unsecured creditors.

The other "general administrative claims" that also are paid from the Adversary Action recoveries, before Class Three general unsecured creditors are paid, are non-insiders. Under the Kerensa 2 Plan, these claims are limited to professional fees allowed under Section 330, as well as any other non-insider priority claims under Section 507(a)(1). See Kerensa 2 Plan at § 2.01(B).[39] Kerensa 2 estimates that the professional fees of bankruptcy counsel and special counsel for the debtors in possession, in addition to statutory fees of the Office of the United States Trustee, to be approximately $191,325. See Kerensa 2 Disclosure Statement at 25:23 to 26:5. This estimate of professional fees, however, does not include an estimate of any additional professional fees incurred in prosecuting the Adversary Actions after plan confirmation. This is critical inasmuch as only the net recoveries from the Adversary Actions will be distributed to pay priority and non-priority claims under the proposed Kerensa 2 Plan.

As the foregoing discussion illustrates, for Class One and Class Two, there is certainty that even under the best of circumstances, none of the holders of the unsecured claims will be paid in full. For Class Three, there is virtual certainty that none of the holders of unsecured claims will be paid in full.

As proposed under the terms of the Kerensa 2 Plan, the net recoveries from the Adversary Actions therefore are paid as follows: (a) $675,000 to Kerensa & Company, (b) an

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[39] It is not entirely clear how the priority payment provisions for domestic support obligations under Section 507(a)(1) would apply to non-individual debtor entities. Presumably, the plan proponent is referring to the second level priority under Section 507(a)(2) for payment of administrative expenses under Section 503(b)(2), which includes professional compensation awarded under Section 330.

undetermined amount to insider administrative claimants other than Kerensa & Company and Kerensa 2, (c) $191,325 to allowed professional fees and UST fees (estimated as of the Kerensa 2 Disclosure Statement), and (d) up to $300,000 to Zeller on the promissory note. Anything remaining after that could go to Class Three general unsecured creditors, but even Kerensa 2 concedes that the value of any favorable judgments in the Adversary Actions is uncertain at best. See Kerensa 2 Disclosure Statement at 18:3-25.[40]

Moreover, the proposed plan on its face requires Submarina to assign to Kerensa & Company all of the net proceeds of the Adversary Actions until Kerensa & Company receives $675,000. See Kerensa 2 Plan at 4:18 to 5:7. After that amount is paid, Submarina apparently retains the balance of any net proceeds to pay general administrative claims of the bankruptcy estate. Id. at 5:16-18. The proposed plan then requires Submarina to pay SSC's promissory note to Zeller until it is deemed satisfied. Submarina, however, is not the obligor on the Zeller Note, but at most is the guarantor. Thus, Submarina would be using the net recoveries from the Adversary Actions to pay SSC's postpetition obligation to Zeller for which Submarina will not have any personal liability once the Chapter 11 plan is confirmed. See 11 U.S.C. § 1141(d)(1)(A)(i).[41]

Based on the foregoing, there is no business justification for placing Zeller's unsecured claim into a separate class because there is no on-going business relationship to be preserved, see, e.g., In re U.S. Truck Co., Inc., 800 F.2d 581, 587 (6th Cir. 1986)(continuing relationship

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[40] 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.

[41] Zeller receives a promissory note from SSC that is secured by the assets of Kerensa 1, see Kerensa 2 Plan at 4:4, that also will be guarantied by Submarina, which guaranty is secured by the assets of Submarina. Id. at 5:9-10. According to Submarina's latest monthly operating reports, the value of Submarina's assets consists almost entirely of accounts receivable owed by its franchisees. (Submarina ECF No. 567). The terms of the guaranty have not been presented to the court. If the guaranty requires Zeller to pursue SSC as the principal of the promissory note before she can pursue Submarina on the guaranty, it may have little value because any Franchisee AR's may be exhausted. Neither the language of the proposed plan nor the accompanying disclosure statement specify whether Submarina will waive such a requirement.

governed by collective bargaining agreement), nor does Zeller supply any essential services or goods necessary to the continued business operations of Kerensa 1 or Submarina. Compare In re Kmart Corp., 359 F.3d 866, 872-73 (7th Cir. 2004)(pre-confirmation payment of prepetition unsecured claim of critical vendors authorized only on proof that other creditors will be as well off and that preferred payment is a matter of business necessity). Likewise, there is no economic justification for placing Zeller's unsecured claim into a class separate from general unsecured creditors because the only source of payment of both classes is exactly the same: the net recoveries from the Adversary Actions.[42]

Under these circumstances, the plan proponent's dubious attempt to place Zeller into a class separate from general unsecured creditors reflects the type of prohibited classification often known as gerrymandering. See In re Barakat, 99 F.3d at 1526. A plan proponent's unsuccessful attempt to manipulate voting classes does not necessarily violate the classification parameters of Section 1122(a), but may imply that the plan is not proposed in good faith as required by Section 1129(a)(3). See 7 COLLIER ON BANKRUPTCY, supra, ¶ 1129.02[3][a][ii][B], citing, e.g., Sandy Ridge Dev. Corp. v. Louisiana Nat'l Bank (In re Sandy Ridge Dev. Corp.), 881 F.3d 1346, 1353 (5th Cir. 1989). Thus, there is no basis for classifying Zeller's unsecured claim separate from general unsecured creditors in Class Three.[43]

B. The Plan Fails the Fair and Equitable Requirement for Cramdown.

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[42] That Zeller's unsecured claim is required to be paid in Class One from the same proceeds, before unsecured claims in Class Three receive a dime, also reflects the type of unfair discrimination between classes that is prohibited by Section 1129(b)(1). See In re Tucson Self-Storage, Inc., 166 B.R. 892, 898 (B.A.P. 9th Cir. 1994)(cramdown under 1129(b)(1) prohibits unfair discrimination amongst classes and also requires fair and equitable treatment of each dissenting class).

[43] Separating a modest number of unsecured creditors for treatment in an "administrative convenience" category in Class Two also appears to be neither reasonable nor necessary under Section 1122(b). Kerensa 2 acknowledges that there likely are only 10 creditors in this class having aggregate claims of less than $2,000. See Kerensa 2 Disclosure Statement at 27:5-10. Administrative convenience classes ordinarily are created to facilitate the immediate payment and satisfaction of large numbers of minor claims so that the reorganized debtor can administer more significant claims after confirmation. See In re Tucson Self-Storage, 166 B.R. at 898. There is nothing to suggest that creation of such a class for a handful of creditors having minimal claims is necessary or reasonable.

But even assuming that impaired Class Two or impaired Class Three are properly classified, and that both accept plan treatment, the Kerensa 2 Plan cannot be confirmed over Zeller's objection without meeting the requirements for cramdown under Section 1129(b)(2)(B)(ii). As discussed in connection with the DIP Plan, a plan proponent that does not pay a dissenting unsecured class in full must satisfy the requirements of Section 1129(b)(2)(B)(ii). That provision prohibits junior interests from retaining or receiving any property under the plan unless the dissenting unsecured class is paid in full. That provision also is commonly referred to as the "absolute priority rule."[44] In this instance, the proposed plan does not pay any unsecured creditor class in full. Therefore, unless the holders of claims in each impaired class vote to accept plan treatment in dollar amounts and numbers sufficient to constitute acceptance by the entire class under Section 1126(c), i.e., two-thirds in dollar amount and a majority in number, cramdown will be required.

As previously emphasized, Zeller not only opposes the Reconsideration Motion, but also rejects her proposed treatment under the Kerensa 2 Plan. See discussion at note 37, supra. The record further indicates that a variety of unsecured creditors in either Class Two or Class Three would accept the proposed treatment under the Kerensa 2 Plan, but it also is clear that their votes were not solicited in compliance with Section 1125(b). See discussion at note 21, supra.[45] It

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[44] Under the absolute priority rule, existing owners of a reorganizing entity cannot retain their ownership interests unless objecting unsecured creditors are paid in full. See In re Perez, 30 F.3d at 1214 ("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 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.

[45] Kerensa 2 even represents that the ill-gotten declarations are for creditors who would be in Class Two and Class Three of its proposed plan. See Kerensa 2 Reply at 7:14-16.

thus appears that cramdown may be required for all three impaired unsecured classes under the Kerensa 2 Plan.

The DIP Plan previously proposed by Kerensa 1 and Submarina provided for Rosenthal through Kerensa 2 to acquire all of the controlling interest in the debtors' operations without providing any opportunity for other parties in interest to acquire the same interests. See Emergency Motion Order at 11:1-11 & n.20. The DIP Plan also did not provide for Kerensa 2 or Rosenthal to contribute any new "money or money's worth" to acquire that interest, but instead allowed Kerensa 2 to credit bid its DIP Loan. See id. at 13:8-10 & n.26. By granting the existing equity holders of the debtors in possession an exclusive opportunity to acquire those interests, the DIP Plan did not comply with the unsecured creditor cramdown requirements articulated by the Court in 203 North LaSalle.[46]

The Kerensa 2 Plan obviously is not proposed in the name of Kerensa 1 and Submarina, but it is equally obvious that it is proposed by the same principal, Rosenthal. Kerensa 2 suggests that its proposed plan somehow avoids the exclusive opportunity prohibition discussed in 203 North LaSalle because the plan is proposed by a creditor rather than the debtors in possession. See Kerensa 2 Reply at 5:17-20. At the hearing on the Reconsideration Motion, Kerensa 2 also argued that the expiration of the plan exclusivity period years ago allowed any other party in interest to propose a Chapter 11 plan to distribute property of the bankruptcy estates, including the interests in the debtor entities.

Inasmuch as Kerensa 2 concedes that the member interests in Kerensa 1 and SSC are held by the same parties[47] and its plan increases their ownership interest in Submarina from 75.95% to

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[46] 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, that 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.

[47] Those same parties are 99% Rosenthal and 1% Kerensa & Company. See discussion at 2, supra.

99.5%, see Kerensa 2 Disclosure Statement at 29:22-23, it is readily apparent that the opportunity to acquire the Submarina operations under the Kerensa 2 Plan is again provided exclusively to the current equity holders of the debtors in possession. Kerensa 2 is correct that the plan exclusivity period expired in February 2012, thereby permitting other parties in interest, including the dissenting creditors, from proposing their own Chapter 11 plans. As the court previously noted, however, the expiration of the plan exclusivity period, even under 203 North LaSalle, still would not relieve a plan proponent of the fair and equitable requirement for cramdown of unsecured classes. See Emergency Motion Order at 11:1-11. Absent payment of dissenting unsecured classes in full, the new value exception to the absolute priority rule requires the contribution of money or money's worth equal to the value of the interest that is retained. Id. at 10 n.19.

In this instance, Kerensa 2 argues that a new value contribution is made by SSC's payment of $320,000 to Kerensa 1 which will in turn be contributed to Submarina to pay the $320,000 balance owed to Kerensa 2 on the DIP Loan. None of these funds, however, will ever be distributed to unsecured creditors. At the hearing on the Reconsideration Motion, Kerensa 2 argued that this contribution is equal to the value of the interest retained by current equity holders because unsecured creditors will receive at least what they would receive in a Chapter 7 liquidation. In other words, because liquidation of Kerensa 1 and Submarina would produce zero funds to distribute to unsecured creditors in Chapter 7, the value of the interests held and to be retained by existing equity holders is zero. Although the net result suggested by Kerensa 2's argument may comply with the best interests test under Section 1129(a)(7), the argument ignores that the cramdown requirements under Section 1129(b)(1) already assumes that best interests test has been met and imposes additional requirements for fair and equitable treatment of dissenting unsecured classes under Section 1129(b)(2)(B).

The very language of Section 1129(b)(2)(B)(ii) prohibits any of the existing equity holders of Submarina, i.e., Kerensa 1, Robert Pina, Zeller, and Rosenthal, from retaining any property of Submarina, i.e., the Franchisee AR's, unless senior interests, i.e., the dissenting unsecured creditors, are paid in full. Similarly, the language of Section 1129(b)(2)(B)(ii)

prohibits any of the existing equity holders of Kerensa 1, i.e., Rosenthal and Kerensa & Company, from retaining any property of Kerensa 1, i.e., the shares of stock in Submarina, unless the dissenting unsecured creditors of Kerensa 1 are paid in full. Kerensa 2 has proposed a plan that by its terms assures that unsecured creditors will not be paid in full, while assuring that all of the equity interest holders in Kerensa 1 and Submarina retain property of the respective debtors. In essence, current equity holders are contributing nothing to retain their interests in the operations of the debtors in possession because all of the funds return to them.

By refusing to expose the equity interests in Kerensa 1 and Submarina to the market, see 203 North LaSalle, 526 U.S. at 457, the plan proponent assures that such interests have zero value. On its face, however, those interests may have value to the dissenting unsecured creditors as well as any defaulting franchisees, including some of the Subros Parties, who may want to wrest control of the franchisor's operations away from Rosenthal. As the Court observed in 203 North LaSalle:

> While it may be argued that the opportunity has no market value, being significant only to old equity holders owing to their potential tax liability, such an argument avails the Debtor nothing, for several reasons. It is to avoid just such arguments that the law is settled that any otherwise cognizable property interest must be treated as sufficiently valuable to be recognized under the Bankruptcy Code...Even aside from that rule, the assumption that no one but the Debtor's partners might pay for such an opportunity would obviously support no inference that it is valueless, let alone that it should not be treated as property. And, finally, the source in tax law of the opportunity's value to the partners implies in no way that it lacks value to others. It might, indeed, be value to another precisely as a way to keep the Debtor from implementing a plan that would avoid a Chapter 7 liquidation. (Emphasis added.)

526 U.S. at 455 (citations omitted). To suggest that those interests must have a value equal only to the amount the unsecured creditors would receive in Chapter 7 is unsupportable.[48]

Moreover, the so-called new value contribution by Kerensa 1, the benefit of which never reaches dissenting unsecured creditors of either debtor in possession, would not permit the other

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[48] Kerensa 2's additional suggestion that termination of plan exclusivity alone would satisfy the concerns expressed in 203 North LaSalle is misplaced. As the majority opinion concluded: "It is enough to say, assuming a new value corollary, that plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibitions of § 1129(b)(2)(B)(ii)." 526 U.S. at 458 (emphasis added).

equity holders, i.e., Robert Pina, Zeller, and Rosenthal, to retain any interest in Submarina. Additionally, there is no new value contribution at all that would permit Rosenthal and Kerensa & Company to retain any property of Kerensa 1. The cramdown requirements under Section 1129(b)(2)(B)(ii), separate and apart from the requirements discussed in 203 North LaSalle, are not satisfied by the Kerensa 2 Plan. Instead, Kerensa 2 has managed to achieve a trifecta of sorts: it has proposed a plan of reorganization that violates the absolute priority rule with respect to all three of its impaired classes of unsecured claims.[49]

On its face, the Kerensa 2 Plan is not confirmable and provides no legal or equitable basis to grant relief from the Emergency Motion Order.

4. Appointment of a Chapter 11 Trustee is Appropriate.

As discussed above, Kerensa 1 and Submarina have been remiss in carrying out their fiduciary obligations to all creditors of the estate in light of their relationship with the various entities controlled by Rosenthal. Two Chapter 11 plans of reorganization have now been proposed by entities owned or controlled by the same principal, and neither survive careful scrutiny.

Continued operation of the business may be financially possible but only prolonged and continuous litigation is assured. At this juncture, appointment of a Chapter 11 trustee to independently examine the viability of the franchise operation, in lieu of immediately converting the proceedings to a Chapter 7 liquidation, offers the best hope of producing an objectively reasonable basis for reorganization. The court having considered the record and history in this matter concludes that such appointment is in the best interests of the creditors, the bankruptcy

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[49] This is not surprising because the debtors in possession, also controlled by Rosenthal, proposed to do essentially the same thing. Submarina in its proposed plan of reorganization to allow Kerensa 2 to convert the balance it was owed on the DIP Loan as of June 23, 2016, into ownership of 100% of the Debtor. See DIP Plan, Article I, pages 2-3. In other words, the previous plan proposed by the debtors in possession allowed Rosenthal to convert the postpetition loan from Kerensa 2 to a sole ownership interest in Submarina without contributing any new money or money's worth to payment of unsecured creditors. Under the Kerensa 2 Plan, the same result is achieved through a so-called equity purchase by another entity owned by Rosenthal, with 100% of the sale proceeds used to pay another entity owned by Rosenthal, and again without any payment of unsecured creditors.

estates, and all parties in interest, including the franchisees, within the meaning of Section 1104(a)(2).

CONCLUSION

In light of the foregoing, the Reconsideration Motion will be denied and a Chapter 11 trustee will be appointed. A separate order has been entered contemporaneously herewith.

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

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