UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA—LOS ANGELES DIVISION

In re: Phenomenon Marketing & Entertainment, LLC, Debtor and Debtor-in-Possession.	Case No.: 2:22-bk-10132-ER Chapter: 11 **MEMORANDUM OF DECISION SUSTAINING 5900 WILSHIRE LLC'S OBJECTION TO THE DEBTOR'S ELIGIBLITY TO PROCEED UNDER SUBCHAPTER V OF CHAPTER 11** **[RELATES TO DOC. NO. 74]** Date: April 12, 2022 Time: 1:30 p.m. Location: Courtroom 1568 Roybal Federal Building 255 East Temple Street Los Angeles, CA 90012

At the above-captioned date and time, the Court conducted a hearing on the objection of 5900 Wilshire LLC ("5900 Wilshire") to the Debtor's eligibility to proceed under Subchapter V of Chapter 11 (the "Objection").[1] For the reasons set forth below, the Objection is **SUSTAINED**, and the Court finds that the Debtor is *not* eligible to proceed under Subchapter V.

[1] The Court considered the following papers in adjudicating this matter:

1) Notice of Objection and Objection to Debtor Phenomenon Marketing & Entertainment, LLC's Subchapter V Election Pursuant to Federal Rule of Bankruptcy Procedure 1020(b) [Doc. No. 74]
2) Debtor's Opposition to Creditor 5900 Wilshire Owner LLC's Objection to Debtor's Subchapter V Election Pursuant to Federal Rule of Bankruptcy Procedure 1020(b) [Doc. No. 90]

I. Facts and Summary of Pleadings

On January 10, 2022 (the "Petition Date"), Phenomenon Marketing & Entertainment, LLC (the "Debtor") filed a voluntary Chapter 11 petition and elected treatment under Subchapter V. On January 10, 2022, the United States Trustee appointed Susan K. Seflin as the Subchapter V Trustee. Doc. No. 10. The Debtor is a marketing agency. The filing of the petition was precipitated by a decline in the Debtor's net revenue from approximately $22 million in 2019 to approximately $13 million in 2020. The Debtor projects that net revenue for 2021 will be approximately $13 million.

On January 25, 2022, the Court authorized the Debtor to reject a commercial office lease with 5900 Wilshire. Doc. Nos. 24, 25, 33, and 35.

5900 Wilshire moves for a finding that the Debtor is not eligible to proceed under Subchapter V. 5900 Wilshire argues that the Debtor is not eligible to proceed under Subchapter V because it is an "affiliate" of one or more entities that are "issuers" of securities within the meaning of the Securities Exchange Act of 1934.

The Debtor opposes the Motion. It contends that its only affiliate is Sleeping Bear Capital, LLC, and that Sleeping Bear Capital is not an issuer because it is not a publicly-traded company.

II. Findings of Fact and Conclusions of Law

A. The Debtor Has the Burden of Proof to Establish Its Eligibility to Proceed Under Subchapter V

The statute does not specify who has the burden of proof regarding a debtor's eligibility to proceed under Subchapter V. The vast majority of courts addressing the issue have found that the debtor bears the burden of proof to establish eligibility to proceed under Subchapter V. *See, e.g.*, *In re Rickerson*, 636 B.R. 416, 422 (Bankr. W.D. Pa. 2021) ("Before turning to the issue of the Debtor's eligibility to proceed under Subchapter V, a preliminary question is whether it is the Debtor's burden to establish that she is eligible, or the Movants' burden to show that she is not. It has generally been held that the burden of proof in establishing eligibility for bankruptcy relief lies with the party filing the bankruptcy petition. The large majority of the cases that have considered issues of eligibility specific to Subchapter V have adopted that same view."); *In re Blue*, 630 B.R. 179, 187 (Bankr. M.D.N.C. 2021) ("When a party challenges a debtor's eligibility to file under a particular chapter of the United States Bankruptcy Code, the debtor carries the burden of establishing such eligibility."); *In re Offer Space, LLC*, 629 B.R. 299, 304 (Bankr. D. Utah 2021) ("[T]he Debtor … bears the burden of proving its eligibility under Subchapter V"); *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 235 (Bankr. S.D. Tex. 2021) ("If a party-in-interest objects, the debtor bears the burden of proving eligibility under

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a) Declaration of Michael Jay Berger in Support of Debtor's Opposition to Creditor 5900 Wilshire Owner LLC's Objection to Debtor's Subchapter V Election Pursuant to Federal Rule of Bankruptcy Procedure 1020(b) [Doc. No. 93]

3) Reply Brief in Support of Objection to Debtor Phenomenon Marketing & Entertainment, LLC's Subchapter V Election Pursuant to Federal Rule of Bankruptcy Procedure 1020(b) [Doc. No. 94]

a) Evidentiary Objections to Declaration of Ranvir Gujral Filed by Debtor Phenomenon Marketing & Entertainment, LLC in Support of Opposition to Objection to Debtor's Subchapter V Election Pursuant to Federal Rule of Bankruptcy Procedure 1020(b) [Doc. No. 95].

Subchapter V."); *In re Sullivan*, 626 B.R. 326, 330 (Bankr. D. Colo. 2021) ("[T]he Debtor bears the burden to demonstrate satisfaction of the eligibility requirements for subchapter V.").

The Debtor cites *In re Body Transit, Inc.*, 613 B.R. 400, 409 (Bankr. E.D. Pa. 2020) for the proposition that 5900 Wilshire bears the burden of showing that the Debtor is ineligible to proceed under Subchapter V. *Body Transit* held that the creditor had the burden to prove that a debtor was ineligible to proceed under Subchapter V because the creditor was the *de facto* moving party. *Body Transit,* 613 B.R. at 409 n. 15.

The Court declines to follow *Body Transit*, which is the minority approach. As explained by one court, Subchapter V offers many advantages to debtors that are unavailable in standard Chapter 11 cases:

> [Subchapter V] has a more streamlined process, which translates into less administrative costs. For example, the Debtor does not have to submit a disclosure statement for court approval. It also eliminates some of the most difficult hurdles of chapter 11, like satisfaction of the absolute priority rule. Instead of wiping out the ownership interests in a small business, it merely requires a showing that the debtor is paying its projected disposable income over the life of the plan. But to be able to take advantage of these and other benefits, a debtor must satisfy subchapter V's eligibility requirements.

In re Sullivan, 626 B.R. 326, 330 (Bankr. D. Colo. 2021).

Consistent with the vast majority of courts that have addressed the issue, the Court finds it appropriate to place the burden of establishing eligibility for Subchapter V upon the debtor, not an objecting creditor. As noted, Subchapter V affords debtors substantial benefits. Certain of those benefits, such as the elimination of the absolute priority rule, inure to the detriment of creditors. In exchange for receiving these benefits, it is reasonable to require the debtor to prove that it is eligible to proceed under Subchapter V. In addition, allocation of the burden of proof to the debtor is consistent with cases finding that a debtor generally bears the burden of proving its eligibility to proceed under a particular chapter of the Bankruptcy Code. *See, e.g.*, *City of San Bernardino, Cal.*, 499 B.R. 776, 785 (Bankr. C.D. Cal. 2013) ("The chapter 9 petitioner has the burden to show that it is eligible to file under § 109(c).").

B. The Debtor Has Failed to Prove its Eligibility to Proceed Under Subchapter V

Section 1182[2] governs Subchapter V eligibility. Section 1182(1)(B)(iii) provides that the "term 'debtor' does not include any debtor that is an affiliate of an issuer, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)." Section 101(2)(A) defines an "affiliate" as an "entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor …." The Securities Exchange Act of 1934 (the "Exchange Act") defines an "issuer" as "any person who issues or proposes to

[2] Unless otherwise indicated, all "Civil Rule" references are to the Federal Rules of Civil Procedure, Rules 1–86; all "Bankruptcy Rule" references are to the Federal Rules of Bankruptcy Procedure, Rules 1001–9037; all "Evidence Rule" references are to the Federal Rules of Evidence, Rules 101–1103; all "LBR" references are to the Local Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California, Rules 1001-1–9075-1; and all statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532.

issue any security." 15 U.S.C. § 78c(a)(8). The Exchange Act defines a "security" broadly to include, among other things, any "stock" or "investment contract." 15 U.S.C. § 78c(a)(10).

In a declaration submitted in support of the Debtor's motion to obtain post-petition financing, Ranvir Gujral ("Gujral"), the representative of the Debtor who signed the petition on the Debtor's behalf, has testified regarding the Debtor's ownership structure. *See* Declaration of Ranvir Gujral in Support of Debtor's Reply to 5900 Wilshire Owner LLC's Limited Objection to Debtor's Motion for Order Authorizing Post-Petition Financing [Doc. No. 72] (the "Gujral Declaration"). According to Gujral:

1) Phe.no LLC ("Phe.no") is the sole member of the Debtor. (Phe.no has also filed a voluntary Chapter 11 petition that is pending before the Court as Case No. 2:22-bk-10715-ER).
2) Phenomenon Holdings, LLC ("Holdings") is the sole member of Phe.no.
3) Holdings has a number of members, including the following members who hold more than 20% of the membership interests in Holdings:
    a) Phenomenon Blocker LLC ("Blocker"), whose sole member is SBC Berggruen, LLC ("SBC Berggruen"); and
    b) Phe.no Holdings Inc. ("Phe.no Inc."), which is majority owned by Krishnan Menon.
4) Sleeping Bear Capital LLC ("Sleeping Bear") is on the Board of Managers of Holdings. Gujral is the sole member of Sleeping Bear.

Gujral Declaration at ¶ 6.

Section 101(2)(A) defines an "affiliate" as an entity "that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor …." Phe.no owns 100% of the Debtor, and Holdings owns 100% of Phe.no. Therefore, under the plain language of the Bankruptcy Code, , both Phe.no and Holdings are "affiliates" of the Debtor.

In a declaration filed in opposition to the Motion, Gujral testifies that "[t]he only entity that has more than 20% of the Debtor's voting securities is Sleeping Bear Capital LLC, which is the only affiliate to the Debtor under the Bankruptcy Code as it relates to Debtor's Subchapter V eligibility." Doc. No. 90 at ¶ 14. Gujral does not attempt to reconcile this statement with his own testimony that Phe.no owns 100% of the Debtor and that Holdings owns 100% of Phe.no. Phe.no and Holdings are clearly "affiliates" of the Debtor under the definition set forth in § 101(2)(A). Gujral's conclusory assertion to the contrary does not change this fact.

Phe.no is a Delaware corporation. As such, by definition, Phe.no has stockholders, and therefore has either issued or is proposing to issue stock. Corporate stock qualifies as a "security" under the plain language of the Exchange Act. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 687 (1985). Consequently, Phe.no is an "issuer" under the Exchange Act.

Holdings is a limited liability company. A membership interest in a limited liability company constitutes a "security" under the Exchange Act if the membership interest is an "investment contract." *D.R. Mason Const. Co. v. GBOD, LLC*, 2018 WL 1306425, *5 (S.D. Cal. 2018). An investment contract is "(1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits produced by the efforts of others." *Salameh v. Tarsadia Hotel*, 726 F.3d 1124, 1130 (9th Cir. 2013).

The Debtor has failed to produce the operating agreement for Holdings. Because the Debtor has the burden of proof with respect to its eligibility to proceed under Subchapter V, its failure to

produce the operating agreement for Holdings must be construed against it. Gujral has testified that Holdings has at least two members—Blocker and Phe.no—and that Holders is governed by a Board of Managers. Gujral Decl. at ¶ 6. Krishnan Menon, the Debtor's former president, has filed a proof of claim, in which he asserts that in 2019 he received "a substantial minority Class A membership interest in [Holdings]." Menon also claims to have invested an additional $500,000 in a Class B membership interests in Holdings.

The Court finds that Menon's various membership interests in Holdings qualify as investment contracts, and therefore as securities under the Exchange Act. Menon would not have invested funds in Holdings had he not anticipated receiving a profit from the efforts of others. By virtue of the fact that it issued securities to Menon, Holdings is an "issuer" under the Exchange Act.

At least two of the Debtor's affiliates are "issuers" under the Exchange Act. As a result, the Debtor is not eligible to proceed under Subchapter V. It is worth emphasizing that there is a high likelihood that certain of the Debtor's other affiliates are also "issuers" under the Exchange Act. It is only because the Debtor has provided very limited disclosure with respect to its ownership structure that the Court cannot make a determination as to whether these other entities are also "issues."

The arguments advanced by the Debtor in support of its position that it is not an "affiliate" of any "issuer" are without merit. As noted, Gujral's testimony that Sleeping Bear is its only affiliate contradicts Gujral's testimony that the Debtor is 100% owned by Phe.no, which in turn is 100% owned by Holdings.

Proceeding upon the incorrect premise that Sleeping Bear it its only affiliate, the Debtor argues that Sleeping Bear is not an "issuer" because Sleeping Bear is not a publicly-traded company. Even if it were true that Sleeping Bear is the Debtor's only affiliate (which is not the case), there is no merit to the Debtor's assertion that Sleeping Bear is not an "issuer" because it is not publicly-traded. Under the Exchange Act, an "issuer" is defined as "any person who issues or proposes to issue any security." 15 U.S.C. § 78c(a)(8). The Exchange Act's definition of "security" is extremely broad, and is not limited to securities that trade on public exchanges:

> The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10).

Therefore, an entity can still qualify as an "issuer" even if the securities that it issues are not publicly listed.

Although the Debtor's limited disclosure prevents the Court from determining whether Sleeping Bear is an issuer, it is worth emphasizing that there is a high probability that Sleeping Bear is an issuer. At the § 341(a) meeting of creditors, Gujral testified that "Sleeping Bear Capital's objective is to make investments … and then ultimately create value … and effectively make money … for ourselves and our limited partners …." It is difficult to fathom how an entity such as Sleeping Bear could operate without having issued securities within the meaning of the Exchange Act. Ultimately, whether Sleeping Bear is an issuer is immaterial given that the Debtor is an affiliate of Phe.no and Holdings, two entities that clearly are issuers.

Some commentators have argued that Congress intended to exclude only affiliates of publicly-traded companies from eligibility for relief under Subchapter V, and that the broader exclusion contained in § 1182(1) is the result of a drafting error. A recent article in the *American Bankruptcy Institute Journal* sets forth this argument:

> Given the expansive definition of an "issuer" in the Exchange Act, the amended CARES Act language, as drafted, now facially excludes debtors from qualifying for subchapter V simply by virtue of being an affiliate of an "issuer" of a security, even if such issuer is not a public company. As a result, practitioners face a daunting challenge of having to convince a bankruptcy court that their otherwise-qualified debtor should be eligible to file under subchapter V even though one of its major, nonpublic shareholders technically qualifies as an "issuer." Conforming the limitation of small-business-debtor eligibility in § 1182(1)(B)(iii) with respect to an affiliate to match the limitation contained in § 1182(1)(B)(ii) with respect to the debtor itself would eliminate the uncertainties created by the usage of the term "issuer" and provide clarity to practitioners and the courts, while simultaneously furthering the original congressional intent of the SBRA to exclude public companies or their affiliates from qualifying for subchapter V….
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> To alleviate the unintended complexities and potential over-exclusion of debtors from subchapter V eligibility created by usage of the term "issuer," Congress should amend § 1182(1)(B)(iii) to read "any debtor that is an affiliate subject to the reporting requirements under section 13 or 15(d) of the Exchange Act of 1934 (15 U.S.C. 78m, 78o(d))."

Mark T. Power et. al., *Not So Technical: A Flaw in the Cares Act's Correction to "Small Business Debtor,"* Am. Bankr. Inst. J., February 2022, at 32, 32 and 45.

"[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6, 120 S. Ct. 1942, 1947, 147 L. Ed. 2d 1 (2000) (internal citations and quotation marks omitted). The plain language of the statute may be disregarded only where its application "would lead to 'patently absurd consequences' that 'Congress could not *possibly* have intended.'" *Pub. Citizen v. U.S. Dep't of Just.*, 491 U.S. 440, 470, 109 S. Ct. 2558, 2575, 105 L. Ed. 2d 377 (1989) (Kennedy, J., concurring) (internal citations omitted); *see also Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 565, 125 S. Ct. 2611, 2624, 162 L. Ed. 2d 502 (2005) (stating that where an omission from a statute is "odd" but "not absurd," it "is up to Congress rather than the courts to fix it").

The exclusion from Subchapter V eligibility of a debtor who is an affiliate of any type of issuer—as opposed to the exclusion of only those debtors who are affiliates of issuers that are also publicly-traded companies—is not absurd. SBRA was enacted to ensure "that when mom-and-pop businesses fall on hard times, they have a chance to recover and be successful." *In re Progressive Sols., Inc.*, 615 B.R. 894, 898 (Bankr. C.D. Cal. 2020) (quoting remarks made by Sen. Amy Klobuchar). Congress could have intended that businesses, such as the Debtor here, that are only one component of a more complex corporate structure are not the type of "mom-and-pop" small businesses that should be entitled to take advantage of Subchapter V's streamlined procedures. Here, the Debtor is directly and indirectly owned and/or controlled by a variety of sophisticated investment entities, including without limitation Sleeping Bear (which describes itself as a "founder-first private equity firm that invests in business unit spinouts and venture-backed technology"),[3] SBC Berggruen (which states that it has "made well over 100 investments using … proprietary capital" that "range from modest commitments" to a "multimillion dollar single transaction"),[4] and Phe.no. Excluding an entity with this type of sophisticated ownership structure from eligibility under Subchapter V is far from absurd. To the extent that Congress did intend entities such as the Debtor to benefit from Subchapter V, it is the role of Congress, not this Court, to amend the statute accordingly.

C. The Sunsetting of Amendments to the SBRA Made by the CARES Act Does Not Affect the Debtor's Eligibility to Proceed Under Subchapter V

At the hearing, the Debtor noted that certain changes made to the Bankruptcy Code by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") (Public Law 116-136, 134 Stat. 281) had sunsetted on March 27, 2022. The Debtor requested the opportunity to provide further briefing with respect to the effect of these changes on the Debtor's eligibility to proceed under Subchapter V. Specifically, the Debtor postulated that the sunsetting of the modifications made by the CARES Act to § 1182's definition of "debtor" may have removed the restriction on the eligibility of debtors who are affiliates of issuers to proceed under Subchapter V.

The Court questions whether changes to the Bankruptcy Code that became effective subsequent to the Petition Date could retroactively modify the Debtor's eligibility to proceed under Subchapter V. However, the Court need not decide this issue, because even if the changes to § 1182 resulting from the sunsetting of the CARES Act could be applied retroactively, those changes would not make the Debtor eligible for Subchapter V.

The CARES Act temporarily amended the definition of "debtor" set forth in § 1182(1). The primary purpose of this temporary amendment was to increase the Subchapter V debt limit from $2,725,625 to $7,500,000. The language of the temporarily-amended § 1182(1)(B) is identical to the language of § 101(51B).

Bankruptcy Judge Paul W. Bonapfel explains the changes made by the CARES Act amendment as follows (emphasis added):

> The effect of the CARES Act is that until March 27, 2022, new (and amended) § 1182(1) states the definition of a debtor eligible to be a sub V debtor. After that, revised

[3] Greger Decl. [Doc. No. 74] at ¶ 5 and Ex. 4 (printout from Sleeping Bear's website).
[4] *Id.* at ¶ 7 and Ex. 5 (printout from SBC Berggruen's website).

> § 101(51D) will state the definition. The *only difference* in the language of the two statutes is the higher debt limit in the temporary CARES Act version of § 1182(1).

Hon. Paul W. Bonapfel (U.S. Bankruptcy Judge, N.D. Georgia), *A Guide to the Small Business Reorganization Act of 2019* at § III(A), available at https://www.ganb.uscourts.gov/sites/default/files/sbra_guide_pwb.pdf.

That is, the only effect of the sunsetting of the CARES Act amendments will be to reduce the Subchapter V debt limit. The sunsetting has no effect upon the eligibility of affiliates of issuers to elect treatment under Subchapter V. The Debtor's request for a further opportunity to brief this issue is **DENIED** as unnecessary.

D. The Finding that the Debtor Is Not Eligible to Proceed Under Subchapter V Compels a Finding that the Debtor is Not a "Small Business Debtor"

In addition to objecting to the Debtor's election to proceed under Subchapter V, 5900 Wilshire also objects to the Debtor's statement that it is a "small business debtor" within the meaning of § 101(51D). The definition of "small business debtor" in § 101(51D) is the same as the definition of "debtor" in § 1182(1). Therefore, the Court's finding that the Debtor does not qualify as a "debtor" for purposes of § 1182(1) because it is an affiliate of an issuer also means that the Debtor is not a "small business debtor" for purposes of § 101(51D).

III. Conclusion

Based upon the foregoing, 5900 Wilshire's Objection to the Debtor's eligibility to proceed under Subchapter V is **SUSTAINED** and the Debtor's Subchapter V election is **REVOKED**. In addition, the Court finds that the Debtor is not a "small business debtor" for purposes of § 101(51D), which means that this case may not proceed as a "small business case." Instead, this case shall proceed under the other applicable provisions of Chapter 11. The Court will enter an order consistent with this Memorandum of Decision.

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Date: April 28, 2022

Ernest M. Robles
United States Bankruptcy Judge