IT IS ORDERED as set forth below:

Date: October 19, 2020

Sage M. Sigler
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE: SERENDIPITY LABS, INC., Debtor.	Chapter 11 (Subchapter V) Case No. 20-68124-sms
HALL LOS ANGELES WTS, LLC, Movant, vs. SERENDIPITY LABS, INC., Respondent.	CONTESTED MATTER

MEMORANDUM OPINION

Serendipity Labs, Inc. ("Debtor") filed its bankruptcy petition electing to proceed under Subchapter V.[1] Debtor's disputed secured lender, Hall Los Angeles WTS, LLC ("Hall"), objects

[1] Subchapter V was enacted through the Small Business Reorganization Act of 2019 (the "SBRA"), Pub. L. No. 116-54, 133 Stat. 1079, and amended by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"),

to Debtor's Subchapter V election on the ground that it is not eligible for Subchapter V.[2] The Court concludes that, because a publicly traded company holds more than 20% of Debtor's voting shares, 11 U.S.C. § 1182(1)(B)(iii) renders Debtor ineligible for Subchapter V.[3]

I. Summary of the Parties' Arguments

Hall argues that Debtor is ineligible to proceed under Subchapter V because Debtor is an affiliate of Steelcase, Inc. ("Steelcase"), an issuer under the Securities Exchange Act of 1934, which precludes eligibility under 11 U.S.C. § 1182(1)(B)(iii).[4] Debtor argues that Steelcase is not an affiliate as defined by § 101(2)(A) because it owned only 6.51% of the shares authorized to vote on Debtor's bankruptcy filing, which Debtor submits are the only relevant "voting securities." Neither the United States Trustee nor the Subchapter V Trustee took a position on Debtor's Subchapter V eligibility at the Hearing.

II. Jurisdiction and Venue

The Court has jurisdiction pursuant to 28 U.S.C. §§ 1334(a) and 157(a). This matter is a statutory core proceeding under 28 U.S.C. § 157(b)(2)(A) and a constitutionally core proceeding

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Pub. L. No. 116-136, 134 Stat. 281. It is codified as new 11 U.S.C. §§ 1181-1195 and amends scattered sections of Title 11 (the "Bankruptcy Code") and Title 28 of the U.S. Code.

[2] Pursuant to Interim Rule 1020 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), Hall timely filed its *Objection to Serendipity Labs, Inc.'s Subchapter V Election* on August 3, 2020 (Doc. 61, the "Objection"), and Debtor filed its *Brief in Opposition to Hall's Objection* on September 9, 2020 (Doc. 114, the "Response"). On October 2, 2020, Debtor filed its *Supplemental Brief in Opposition to Hall Los Angeles WTS, LLC's Objection to Subchapter V Election* (Doc. 146, the "Supplemental Response") and Hall filed its *Brief in Support of Hall Los Angeles WTS, LLC's Objection to Serendipity Labs, Inc.'s Subchapter V Election* (Doc. 147, the "Supplemental Objection"). The Court held an evidentiary hearing on October 7, 2020 (the "Hearing").

[3] Debtor argued that Hall, as the objecting party, bears the burden of proof on the issues before the Court. Hall did not state its position regarding the burden either at the Hearing or in its papers. The Bankruptcy Code and Bankruptcy Rules are silent regarding the burden of proof as to a debtor's eligibility to proceed under Subchapter V. The limited caselaw on this issue is generally consistent in placing the burden on the moving party. *See In re Body Transit, Inc.*, No. 20-10014-ELF, 2020 WL 1486784, *8 n. 15 (Bankr. E.D. Pa. Mar. 24, 2020) (objecting party bears the burden of establishing a debtor's ineligibility); *see also In re Roots Rents, Inc.*, 420 B.R. 28, 40 (Bankr. D. Idaho 2009) (the party seeking to change the (pre-SBRA) small business designation bears the burden). Even if the moving party has the burden of proof, Hall has carried that burden.

[4] Hall also argues that Debtor's debts exceed $7,500,000, which would make Debtor ineligible under § 1182(1)(A). Because Debtor is ineligible under § 1182(1)(B)(iii), the Court need not consider this argument.

under the standards of *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2495 (2011). Venue is proper under 28 U.S.C. §§ 1408 and 1409.[5]

III. Findings of Fact

At the Hearing, Debtor and Hall introduced exhibits that were admitted into evidence[6] and elicited testimony from John Arenas, Debtor's Chief Executive Officer; Roger Stone, Debtor's Chief Financial Officer; and Bryan Tolbert, Hall's Vice President of Finance.

Debtor filed its petition for relief on July 15, 2020, electing to proceed under Subchapter V of Chapter 11 of the Bankruptcy Code. Debtor is the parent company of a group of affiliated entities that franchise, manage, and in some cases own, 35 co-working spaces nationally branded as "Serendipity Labs." Debtor's co-working spaces were forced to shut down due to the COVID-19 pandemic and various stay-at-home orders. The combination of COVID-related closures and decreases in revenue, and Debtor's need to refinance its debt with Hall, which matured in August 2020, prompted Debtor to file the instant bankruptcy case. Debtor's bankruptcy filing was approved by its board of directors as well as the majority of its Series C Group shareholders.

Debtor currently has 33 stockholders, the largest of which is Steelcase owning 21.1799% of Debtor's fully diluted ownership.[7] When all non-voting options, restricted stock units, and

[5] Hall previously filed a *Motion to Transfer Venue* (Doc. 60, the "Venue Motion") challenging the appropriateness of this venue. The Venue Motion was denied by the Court on September 2, 2020 (Doc. 107). Hall appealed the Court's ruling on the Venue Motion but did not seek a stay pending appeal and the District Court has not yet issued its ruling. *See* Case No. 20-cv-03872-LMM (N.D. Ga.).

[6] The parties filed their exhibits in advance of the Hearing. (Docs. 118–119, 144–145). At the hearing, the Court admitted into evidence Hall's exhibits 1–3, 5, 9–11, 19, 20, 23–30, 40–46 and Debtor's exhibits 8, 15, 22, 23–28, 35, 40, 46–55, 57, 58, 60–62.

[7] Debtor has one common stock class and four series of preferred stock. The total outstanding shares of each stock class are as follows: 750,000 shares of Series A Preferred, 588,315 Series B Preferred, 143,021 Series C-1 Preferred, 822,354 of Series C Preferred (the Series C-1 and Series C Preferred together the "Series C Group"), and 1,000,000 Common Shares. On a percentage basis, Steelcase holds 100% of Debtor's outstanding Series A Preferred stock, 15.52% of Debtor's outstanding Series B Preferred stock, 6.51% of Debtor's outstanding Series C Group shares, and 4.3% Debtor's outstanding common warrants. *See* Hall Ex. 9.

common warrants are excluded, Debtor has 3,303,690 outstanding shares with voting rights. Steelcase owns 27.7% (904,148) of those voting shares.

Debtor's charter grants the holders of Common Stock and each of the various types of preferred stock one vote per share. *See* Hall Ex. 11. The Series C Group stock has exclusive voting rights with respect to certain enumerated tasks, including actions to reorganize or liquidate the business.[8]

IV. Analysis and Conclusions of Law

For the reasons set forth below, the Court concludes that pursuant to § 1182(1)(B)(iii), Debtor is ineligible to be a Subchapter V debtor because it is an affiliate of Steelcase, which is an issuer under the Securities Exchange Act of 1934 (the "Securities Act").

Section 1182 of the Bankruptcy Code governs Subchapter V eligibility and provides that:

> (1) Debtor.—The term "debtor"—
>
> > (A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor; and
> >
> > (B) does not include--
> >
> > > (i) any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $7,500,000 (excluding debt owed to 1 or more affiliates or insiders);
> > >
> > > (ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

[8] It is this stock that Debtor argues exercises true control over the company, and in particular, the ability to file bankruptcy. Hall contests this argument and points to Debtor's board, which includes a Steelcase representative, as controlling Debtor and issuing the resolution to file the bankruptcy case. The Court need not resolve this dispute because, as explained below, the Court concludes that *all* voting securities owned by Steelcase must be considered for purposes of § 101(2)(A).

> (iii) 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).

11 U.S.C. § 1182.

In arguing that Debtor is gaming the Subchapter V process, abusing bankruptcy provisions intended for small businesses, and twisting the law to protect the equity of its directors and officers, Hall reads elements into § 1182 that are not there. The statute does not require the Court to evaluate Debtor's motives for seeking to proceed as a Subchapter V debtor, or what outcomes may be afforded to various interest holders as a result. Likewise, Debtor's origin as an "entrepreneurial startup" does not shield it from the eligibility requirements set forth in the Subchapter V. Debtor urges that finding it ineligible for Subchapter V will complicate the administration of the case, increase costs, and destroy value for all stakeholders. While that may be true, Congress enumerated specific eligibility requirements under § 1182 without affording courts discretion to consider the potential effect of the election on the bankruptcy estate. The benefits of Subchapter V are available to debtors who qualify and are not available to those who do not.

A. Steelcase is an "Issuer"

Subchapter V excludes from eligibility 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)." 11 U.S.C. § 1182(1)(B)(iii). With certain inapplicable exceptions, the Securities Act defines "issuer" as "any person who issues or proposes to issue any security," and defines "security" to include stock. 15 U.S.C. §§ 78c(a)(8), (10).

The testimony at the Hearing established that Steelcase is a publicly traded company whose shares are traded on a stock exchange. Hall introduced into evidence a copy of Steelcase's most

recent form 10-K, which the Securities Act requires issuers to file with the SEC.[9] *See* 15 U.S.C. § 78m.

Because Steelcase is a company publicly traded on a stock exchange, it necessarily issues stock. Steelcase would not file a form 10-K with the SEC were it not an issuer. The evidence therefore establishes that Steelcase is an "issuer" as defined in § 78c(a)(8) of the Securities Act and for purposes of analyzing Debtor's eligibility under § 1182(1)(B)(iii).[10]

B. Steelcase is an Affiliate of Debtor

Because Steelcase is an "issuer," Debtor is ineligible to proceed under Subchapter V if it is an affiliate of Steelcase. With exceptions not applicable here, the Bankruptcy Code defines "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." 11 U.S.C. § 101(2)(A) (emphasis added). Steelcase owns more than 27% of Debtor's voting securities and is therefore an affiliate of Debtor.

1. Steelcase's Shares of Debtor Are Voting Securities

"Voting securities" is not defined in the Bankruptcy Code or the Securities Act. The SEC has defined "voting securities" to mean "securities the holders of which are presently entitled to vote for the election of directors." 17 C.F.R. § 230.405. The SEC definition is unambiguous, and the appropriate one to use in the context of §101(2)(A). *See In re Piece Goods Shops Co.*, 188 B.R. 778, 797 (Bankr. M.D.N.C. 1995). Each class of Debtor's securities held by Steelcase (Series A,

[9] *See* Hall Ex. 10. Debtor objected to the introduction of the form 10-K to the extent Hall was introducing it to establish the truth of statements made therein but did not challenge the authenticity of the exhibit. The Court admitted the exhibit over Debtor's objection, allowing it for the purpose of establishing that Steelcase filed the 10-K with the Securities and Exchange Commission (the "SEC").

[10] Hall asserts that Steelcase is an issuer. Debtor did not present argument or evidence that Steelcase is not an issuer but argued it did not concede Steelcase's issuer status.

Series B, and Series C Group) is entitled to vote on the election of Debtor's directors. All of Steelcase's shares of Debtor, therefore, constitute "voting securities" for purposes of § 101(2)(A).

2. All Voting Securities Owned by Steelcase Must be Included in the § 101(2)(A) Calculation

Steelcase owns more than 27% of Debtor's voting securities. Hall argues this makes Steelcase an affiliate and the inquiry ends there. Debtor argues, however, that only those shares "with power to vote" on the matter before the Court—Debtor's bankruptcy filing—count, and Steelcase owns less than 20% of those shares. The question then is whether mere 20% ownership of voting securities mandates affiliate status, or whether the owner must also have the power to vote those securities specifically with respect to the matter before the Court.

The Court concludes that it must simply consider whether Steelcase (1) owns 20% or more of Debtor's voting securities; (2) controls 20% or more of Debtor's voting securities; or (3) holds 20% or more of Debtor's voting securities with the power to vote those securities. Steelcase owns 27.36% of Debtor's voting securities and is therefore an affiliate of Debtor. It is irrelevant what percentage of the voting securities held by Steelcase were authorized to vote on Debtor's bankruptcy filing or Subchapter V election.

This Court is unaware of any decisions on this issue in a Subchapter V context, but there is a split of authority—and no controlling authority—from courts analyzing affiliate status in the context of insider status and venue.

i. The "Opportunity to Control" Approach

Some courts have characterized the relevant inquiry as whether the alleged affiliate had the opportunity to exert control over the debtor through its voting securities. *See, e.g.*, *UVAS Farming Corp. v. Laviana Investments, N.V. (In re UVAS Farming Corp.)*, 89 B.R. 889, 891–94 (Bankr. D.N.M. 1988); *see also Roost v. Timber Components, Inc. (In re Tyee Timbers, Inc.)*, 139 B.R.

520, 524–25 (Bankr. D. Ore. 1992) (citing *UVAS Farming* and holding that "[t]his court agrees that the concept of voting power is the appropriate measure to determine whether or not [debtor's president] was an affiliate of the debtor "); *see also In re Piece Goods Shops Co.*, 188 B.R. at 796–97 (noting that Congress did not redefine "voting securities" for bankruptcy purposes and that the legislative history of § 101(2) indicates that "affiliate" is "intended to cover situations where there is an opportunity to control" a debtor).

If an alleged affiliate does not have an "opportunity to control" with respect to at least 20% of the stock of the debtor, then that entity is not an affiliate under § 101(2). *See In re UVAS Farming Corp.*, 89 B.R. at 892 (holding that certain shareholders were not affiliates because, although they "own 34.2% of the stock of the debtor, they have an 'opportunity to control' with only 13.5% of the stock, their voting power"). But "opportunity to control" is subsumed within the definition of "voting securities"—it is not a separate element of § 101(2)(A), nor do *UVAS Farming* or *Piece Goods* hold that it is.[11]

Debtor, however, conflates the "opportunity to control" concept with the "power to vote" language in § 101(2)(A) and argues that only those shares eligible to vote on Debtor's bankruptcy filing, of which Steelcase owns 6.5%, count for purposes of § 101(2)(A). *See In re Tyee Timbers, Inc.*, 139 B.R. at 524–25 (calculating debtor's president's percentage of ownership for purposes of affiliate status in a preference action as including only those shares with power to control "the right to direct payment of corporate debts" and not including other shares despite their right to vote on other matters).

[11] The *UVAS Farming* Court appears to have recalculated the percentage of voting securities held by the alleged affiliates based upon the votes per share afforded to the different classes of stock, not to have limited the definition of "voting securities" to only shares entitled to vote on the specific matter before the court. *See In re UVAS Farming Corp.*, 89 BR at 891–92. Here, Debtor's shares are afforded equal votes regardless of class. Steelcase holds more than 27% of Debtor's voting securities and each class of those securities has the opportunity to control Debtor through the ability to elect of board members. Indeed, a Steelcase representative sits on the board.

Debtor asks the Court to limit the calculation of "voting securities" for purposes of § 101(2)(A) to those with the "power to vote" on the matter before the Court. But this limitation does not exist within the language of § 101(2)(A) and this Court declines to follow the rationale set forth in *Tyee Timbers*. *See In re Tyee Timbers, Inc.*, 139 B.R. 520.

ii. The Plain Meaning Approach

Hall advocates a second approach that dissects the language of §101(2)(A) without reading an additional "opportunity to control" element into the statute. *See, e.g.*, *Agresti v. EBAR East, Inc. (In re Elephant Bar Restaurant, Inc.)*, 196 B.R. 747, 751 (Bankr. W.D. Penn. 1996); *In re Interlink Home Health Care, Inc.*, 283 B.R. 429 (Bankr. N.D. Tex. 2002). This is the better-reasoned approach.

These cases hold that "power to vote" modifies only the holding of securities—not their ownership or control. The *Interlink* Court carefully analyzed the grammatical structure of § 101(2)(A), observing that:

> [T]he Court considers it significant that there is a comma following the word "controls", but none preceding the words "with the power to vote." Had Congress intended the latter clause to apply to an entity that owned or controlled voting securities, such a comma would have been inserted. The Supreme Court, interpreting an identical grammatical construction in 11 U.S.C. 506(b), concluded that the initial comma demonstrated a clear intent to separate the first noun clause (in that case "interest on such claim") from the modifier ("provided for under the agreement"). The absence of a comma between the second noun clause ("any reasonable fees, costs, or charges") required that the latter be read together with the modifier. In § 101(2)(A), comparable punctuation dictates that the clause "with power to vote" applies only to the verb "holds."

In re Interlink Home Health Care, Inc., 283 B.R. at 437.

The *Interlink* Court examined the origins of § 101(2)(A), but more importantly, considered the implications of reading § 101(2)(A) to couple the "power to vote" with ownership or control.

Beyond "render[ing] the words 'directly or indirectly' in § 101(2)(A) a virtual nullity," the Court found that this alternative reading of § 101(2)(A) would yield absurd results:

> An owner whose stock is subject to a voting trust or which is the parent of a parent . . . would not satisfy the definition of an affiliate. Yet it is certain that the term "affiliate" was intended to be broad enough to include a parent of a parent, even though its immediate subsidiary, not it, would have the legal power to vote the debtor's stock.
>
> Moreover, that the entity that owns a debtor's stock happens to lose or surrender the power to vote the stock (while retaining ownership) should not change that entity's status as an affiliate. Besides excluding from the definition of affiliate the beneficial owner of 20% of a debtor's voting stock, ascribing such a result to the transfer of voting power would invite manipulation of bankruptcy powers, not only in the area of venue, but also in other contexts, such as recovery of insider preferences.

Id. at 438-39.

Looking to the plain language of § 101(2)(A), the *Interlink* Court found three conditions upon which affiliation to a debtor exists:

> (1) ownership of 20% or more of debtor's voting securities;
> (2) control of 20% or more of debtor's voting securities; or
> (3) the holding of 20% or more of debtor's voting securities *if* the holder has the power to vote the securities.

Id. at 436. If either of the first two conditions are met, "the power to vote the securities is unnecessary to establish an affiliate relationship." *Id.* "An entity that owns 20% or more of the voting securities of a chapter 11 debtor is an affiliate of the debtor, whether or not it has the power to vote those securities." *Id.* at 439.

Steelcase owns more than 20% of Debtor's voting securities, and the Court's inquiry ends there.

V. Conclusion

Steelcase is an issuer as defined by the Securities Act and is an affiliate of Debtor because it owns more than 20% of Debtor's voting securities. Debtor is therefore ineligible to proceed

under Subchapter V of the Bankruptcy Code. Because Debtor is not eligible to be a Subchapter V debtor under 11 U.S.C. § 1182(1)(B)(iii), it is unnecessary for the Court to determine whether Debtor's debts exceed the limits set forth in § 1182(1)(A). Accordingly, it is

ORDERED that the Objection is **SUSTAINED**, Debtor's Subchapter V election is **REVOKED**, and this case shall proceed under the other applicable provisions of Chapter 11.

END OF ORDER

DISTRIBUTION LIST

Lee B. Hart
Nelson Mullins Riley & Scarborough, LLP
Suite 1700
201 17th Street, NW
Atlanta, GA 30363

Frank J Wright
Law Offices of Frank J. Wright, PLLC
Suite 730
2323 Ross Avenue
Dallas, TX 75201

Michael Charles Sullivan
Parker Hudson Rainer & Dobbs LLP
Suite 3600
303 Peachtree Street, NE
Atlanta, GA 30308

Shawna Staton
Office of the United States Trustee
362 Richard Russell Building
75 Ted Turner Drive, SW
Atlanta, GA 30303

Deborah M. Perry
Munsch Hardt Kopf & Harr, PC
500 N. Akard Street
Suite 3800
Dallas, TX 75201-6659

Jay H. Ong
Munsch Hardt Kopf & Harr P.C
Suite 250
1717 West 6th Street
Austin, TX 78703

Kelly D. Schneid
Moritt Hock & Hamroff LLP
400 Garden City Plaza
Garden City, NY 11530

Garrett A. Nail
Portnoy Garner Nail LLC
Suite 460
3350 Riverwood Parkway
Atlanta, GA 30339

Lydia M Hilton
Berman Fink Van Horn, P.C.
3475 Piedmont Road, N.E., Suite 1100
Atlanta, GA 30305