

Dated: January 10, 2020



*Daniel P. Collins*

Daniel P. Collins, Bankruptcy Judge

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**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF ARIZONA**

**In re:** )  
)  
**THE ROOMSTORES OF PHOENIX,** )  
**L.L.C., D/B/A THE ROOMSTORE,** )  
)  
**Debtor.** )  
\_\_\_\_\_)  
)  
**DAVID GONZALES, CREDITOR** )  
**TRUSTEE ON BEHALF OF THE** )  
**ROOMSTORE LIQUIDATING** )  
**TRUST,** )  
)  
**Plaintiff,** )  
)  
**v.** )  
)  
**JAMIE R. SELZNICK, AS** )  
**PERSONAL REPRESENTATIVE OF** )  
**THE PROBATE ESTATE OF** )  
**DANIEL P. SELZNICK;** )  
**MASTERMIND DEFINED BENEFIT** )  
**PENSION,** )  
\_\_\_\_\_)  
**Defendants.** )

Chapter 11 Proceedings  
Case No.: 2:15-bk-15898-DPC  
Adversary No.: 2:17-ap-00336-DPC

**UNDER ADVISEMENT ORDER**  
**[NOT FOR PUBLICATION]**

This adversary proceeding (“Adversary Proceeding”) concerns the characterization of three sums of money as either loans, equity contributions or equity distributions. David Gonzales (“Plaintiff” or “Trustee”), trustee of the Roomstore Liquidating Trust (“Trust”), seeks the following: (1) to have an obligation (“Selznick Obligation”) determined to be due and owing to the Trust from the probate estate of Daniel P. Selznick (“Selznick”); (2) to have the \$101,316 proof of claim filed by Selznick (“Selznick Claim”) either recharacterized as an equity contribution to the Roomstores of Phoenix, L.L.C.

1 (“Roomstores” or “Debtor”) and disallowed in its entirety or equitably subordinated to all  
2 allowed unsecured creditors; and (3) to have the \$1,262,632.53 proof of claim  
3 (“MasterMind Claim”) filed by defendant MasterMind Defined Benefit Pension  
4 (“MasterMind”) either recharacterized as an equity contribution to Roomstores and  
5 disallowed in its entirety or equitably subordinated to all allowed unsecured creditors.  
6 Selznick and MasterMind (“Defendants”) ask the Court to deny Plaintiff’s requests to  
7 either recharacterize or equitably subordinate the Selznick Claim or the MasterMind  
8 Claim and to deny Plaintiff’s request to have the Selznick Obligation determined to be  
9 due and owing. Selznick contends the Selznick Obligation was actually an equity  
10 distribution made by Roomstores to Selznick.

11 After considering the evidence at trial, hearing the arguments of counsel and reading  
12 the parties’ briefs, the Court now rules that Selznick owes the Roomstores bankruptcy  
13 estate the principal sum of \$835,000 plus interest at 4% per annum. The Court also finds  
14 that Plaintiff has failed to carry his burden of proof on his claims for equitable  
15 subordination or state law recharacterization of debt as equity. Selznick’s Claim #306-1  
16 is allowed in the principal amount of \$93,334 plus interest at 4% per annum.  
17 MasterMind’s Claim #307-1 is allowed in the principal amount of \$881,666 plus interest  
18 at 4% per annum. Since Selznick failed to demonstrate that his claim is entitled to setoff  
19 against the debt Selznick owes to Roomstores, Selznick must pay the full amount owed to  
20 Roomstores whereas the Selznick Claim against Roomstores is entitled to share pro rata  
21 in the 9% to 10% return expected to be paid to unsecured creditors.

## 22 23 **I. BACKGROUND**

24 Prior to filing its December 18, 2015 (“Petition Date”) bankruptcy,<sup>1</sup> Roomstores  
25 operated as a furniture retailer with eleven showrooms throughout Arizona. The three  
26 members of the Roomstores limited liability company were Alan Levitz (33.5%), Phillip  
27 Levitz (33.5%) and Selznick (33%). Selznick passed away prior to the March 7, 2017

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<sup>1</sup> Administrative DE 1. “Administrative DE” references a docket entry in the administrative bankruptcy case 2:15-bk-15898-DPC.

1 effective date of the Debtor’s confirmed plan of liquidation (“Plan”). Selznick’s estate is  
2 being administered in a probate proceeding in the Superior Court of Maricopa County.<sup>2</sup>  
3 Selznick’s daughter, Jamie R. Selznick (“Ms. Selznick”), is the personal representative of  
4 the Selznick probate estate.

5 Defendants filed proofs of claim in the Administrative Case.<sup>3</sup> On February 21,  
6 2017, an Order Confirming the Plan was entered establishing the Trust and approving  
7 Plaintiff as the Trust’s liquidating trustee.<sup>4</sup> Plaintiff commenced this Adversary  
8 Proceeding by filing an eight-count complaint against Defendants.<sup>5</sup> Plaintiff later filed an  
9 amended complaint (“Amended Complaint”) asserting ten causes of action.<sup>6</sup> Defendants  
10 filed their answer to the Amended Complaint (“Answer”).<sup>7</sup>

11 Plaintiff filed a Motion to Exclude Testimony (“Plaintiff’s Motion to Exclude”)  
12 seeking to have Defendants’ expert’s testimony excluded from trial.<sup>8</sup> Defendants filed a  
13 Response to Plaintiff’s Motion to Exclude.<sup>9</sup> This Court entered an Order Granting  
14 Plaintiff’s Motion to Exclude.<sup>10</sup>

15 Defendants filed a Motion to Exclude Testimony (“Defendants’ Motion to  
16 Exclude”)<sup>11</sup> seeking to have Plaintiff’s sole witness, Trustee, excluded from testifying at  
17 trial. Plaintiff filed a Response in Opposition to Defendants’ Motion to Exclude.<sup>12</sup> Prior  
18 to the start of the trial, this Court entered an order denying Defendants’ Motion to  
19 Exclude.<sup>13</sup>

20 Plaintiff and Defendants filed a Joint Pre-Trial Statement (“Joint Pre-Trial  
21 Statement”).<sup>14</sup> On October 1, 2019, this Court conducted a one-day trial (“Trial”) and  
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23 <sup>2</sup> The probate proceeding is case number PB 2017-051044.

24 <sup>3</sup> See proofs of claim 306-1 and 307-1.

25 <sup>4</sup> Administrative DE 646 at page 8, paragraph B.

26 <sup>5</sup> DE 1, June 2, 2017. “DE” references a docket entry in this Adversary Proceeding 2:17-ap-00336-DPC.

27 <sup>6</sup> DE 3, July 18, 2017.

28 <sup>7</sup> DE 6, October 20, 2017.

<sup>8</sup> DE 44, September 16, 2019.

<sup>9</sup> DE 51, September 25, 2019.

<sup>10</sup> DE 55, September 26, 2019.

<sup>11</sup> DE 56, September 27, 2019.

<sup>12</sup> DE 57, September 30, 2019.

<sup>13</sup> DE 63, October 1, 2019.

<sup>14</sup> DE 60, September 30, 2019.

1 heard testimony from Ms. Selznick and Trustee. At Trial, Plaintiff dismissed Counts II,  
2 VI, VII, VIII, IX and X of his Amended Complaint.<sup>15</sup> The remaining claims are contained  
3 in Counts I, III, IV and V.<sup>16</sup> On October, 29, 2019, Defendants filed a Post-Trial Brief  
4 (“Defendants’ Brief”).<sup>17</sup> On the same day, Plaintiff filed Plaintiff’s Closing Brief  
5 (“Plaintiff’s Brief”).<sup>18</sup>

## 6 7 **II. JURISDICTION**

8 This Court has jurisdiction over the Adversary Proceeding under 28 U.S.C.  
9 §§ 157(b)(2)(A), (B), and (O).

## 10 11 **III. TRIAL**

12 After hearing oral argument on Defendants’ Motion to Exclude, the parties  
13 delivered brief opening comments. Plaintiff called the Trustee as his sole witness.  
14 Defendants called Ms. Selznick as their sole witness.

### 15 **A. Testimony of David Gonzales, Trustee**

16 Trustee testified as to the contents of Exhibits 44, 45, 46 and 57 – 66. Trustee  
17 testified that Selznick ran the Roomstores until September 2015. Trustee testified that  
18 during Selznick’s time as manager of Roomstores, Selznick was paid in two different  
19 manners: (1) as a consultant through MasterMind and (2) via withdrawals from  
20 Roomstores recorded on Roomstores’ book as loans.<sup>19</sup>

21 Trustee testified that Exhibits 44, 45 and 46 were reconciliations prepared by  
22 Roomstores or Trustee based on Roomstores’ financial records.<sup>20</sup> Exhibit 44 is a summary  
23 of the cash paid to Selznick and MasterMind. Exhibit 45 is a summary of the amounts  
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<sup>15</sup> DE 63 at page 3.

<sup>16</sup> *Id.* Count V calls for disallowance of the Selznick Claim and the MasterMind Claim and, therefore, is essentially  
a subset of the relief sought by Plaintiff in Counts III and IV.

<sup>17</sup> DE 68.

<sup>18</sup> DE 69.

<sup>19</sup> Trial Transcript at DE 64, page 31, lines 19 – 24.

<sup>20</sup> *Id.* at page 40, lines 3 – 11.

1 claimed due to Selznick and MasterMind. Exhibit 46 is a summary of amounts owed to  
2 Philip Levitz, Selznick and MasterMind.

3 Trustee also testified that Exhibits 57 – 66 (collectively the “Trade Vendor  
4 Letters”) were letters sent out on a quarterly basis by Selznick to Roomstores’ trade  
5 vendors. Specifically, Trustee identified Exhibit 58 as a letter that is substantially similar  
6 to all the letters admitted as Exhibits 57 – 66. Trustee focused on the Exhibit 58 paragraph  
7 which states: “From August of 2008 to August 2010 the [Roomstores’] Members injected  
8 nearly \$3,500,000 of cash in the form of long-term subordinated debt.” Trustee also  
9 testified as to the contents of the one-page consolidated balance sheet which was attached  
10 to the Trade Vendor Letters.

11 Trustee testified that the two largest classifications of unsecured creditors in  
12 Roomstores’ bankruptcy were lessors and trade vendors. The Trade Vendor Letters were  
13 sent only to trade vendors.<sup>21</sup>

14 Finally, Trustee testified about Exhibit 1, the proof of claim filed by Selznick at  
15 306-1. Trustee testified that the other two Roomstores members (Phil and Al Levitz) did  
16 not file proofs of claim.

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18 B. Testimony of Ms. Selznick

19 Ms. Selznick testified that Selznick passed away on December 9, 2016, and she is  
20 handling Selznick’s probate estate as the personal representative. Ms. Selznick worked at  
21 Roomstores between October 2004 and January 2016 and discussed its business with  
22 Selznick on a daily basis. Ms. Selznick discussed Selznick’s employment at Roomstores  
23 between 1993 and 2015 and highlighted his time as merchandising manager. Ms. Selznick  
24 stated that Selznick’s position as merchandising manager involved working with  
25 Roomstores’ vendors. Ms. Selznick testified that Selznick was not a certified public  
26 accountant, nor did he have an accounting background.

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<sup>21</sup> *Id.* at page 48, lines 14 – 15.

1 Ms. Selznick testified about the Selznick Claim and MasterMind Claim.  
2 Ms. Selznick stated her belief that Selznick “definitely” expected to be repaid on both  
3 loans and that when Selznick passed away he only had \$150,000 in retirement funds  
4 between MasterMind and his 401K. Ms. Selznick discussed Exhibits 87, 89 and 90 and  
5 testified that these e-mails demonstrated Selznick’s disapproval with how Roomstores’  
6 financials were being handled.

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8 **IV. LEGAL ANALYSIS**

9 **A. § 542<sup>22</sup> Turnover of Property**

10 Under § 542(b),

11 an entity that owes a debt that is property of the estate and that is  
12 matured...shall pay such debt to, or on the order of, the trustee, except to  
13 the extent that such debt may be offset under section 553 of this title against  
a claim against the debtor.

14 In a cause of action for turnover under § 542, the trustee has the burden of proof. *In re*  
15 *Bruner*, 561 B.R. 397, 403 (BAP 6th Cir. 2017); *In re Crowson*, 431 B.R. 484, 489 (BAP  
16 10th Cir. 2010); see also Collier on Bankruptcy, ¶ 542.03 (16th ed. 2019).

17 Section 553 permits a creditor to

18 offset a mutual debt owing by such creditor to the debtor that arose before  
19 the commencement of the case under this title against a claim of such  
20 creditor against that the debtor that arose before the commencement of the  
case...

21 Section 553 does not create an independent right to setoff and has generally been  
22 understood to preserve the common-law right of setoff. *In re Cascade Roads, Inc.*,  
23 34 F.3d 756, 763 (9th Cir. 1994). The burden of proving an enforceable right to setoff is  
24 on the party asserting the right. *Matter of Pester Refining Co.*, 845 F.2d 1476, 1486 (8th  
25 Cir. 1988).

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<sup>22</sup> Unless indicated otherwise, statutory citations refer to the U.S. Bankruptcy Code, 11 U.S.C. §§ 101 – 1532.

1                   B. Recharacterization of Debt as Equity

2                   Bankruptcy courts have the authority to recharacterize claims in bankruptcy  
3 proceedings. *In re Fitness Holdings Intern., Inc.*, 714 F.3d 1141, 1147 (9th Cir. 2013)  
4 (overruling *In re Pacific Express, Inc.*, 69 B.R. 112 (BAP 9th Cir. 1986) and holding that  
5 a court may recharacterize an obligation that does not constitute “debt” under state law).  
6 “In order to determine whether a particular obligation owed by the debtor is a ‘claim’ for  
7 purposes of bankruptcy law, it is first necessary to determine whether that obligation gives  
8 the holder of the obligation a ‘right to payment’ under state law.” *In re Fitness*, 714 at  
9 1149 (citing *In re Lothian Oil*, 650 F.3d 539, 542-43 (5th Cir. 2011)). “When interpreting  
10 state law, federal courts are bound by decisions of the state’s highest court. In the absence  
11 of such a decision, a federal court must predict how the highest court would decide the  
12 issue using intermediate appellate court decisions, decisions from other jurisdictions,  
13 statutes, treatises, and restatements as guidance.” *Lewis v. Tel. Employees Credit Union*,  
14 87 F.3d 1537, 1545 (9th Cir. 1996) (internal quotations and citations omitted).

15                   The Court has not been supplied, nor has the Court found, an Arizona case which  
16 establishes a standard for determining whether an amount transferred to an entity is  
17 properly denoted as a loan or an equity investment.<sup>23</sup> In the absence of controlling Arizona  
18 law, Arizona courts look first to the Restatement and then to California law.<sup>24</sup> The Court  
19 found no reference to a standard in any Restatement nor in any case establishing a standard  
20 under California law.<sup>25</sup> Other states have applied a multi-factor test developed in the  
21 context of federal tax law. See *In re Lothian Oil*, 650 at 544 (stating that Texas courts  
22 imported a test from federal tax law to distinguish between debt and equity).<sup>26</sup> See also

23                   <sup>23</sup> Plaintiff’s citation to *Jackson v. Low Cost Auto Parts, Inc.*, 25 Ariz. App. 515, 517 (1976) is not particularly  
24 informative. That case simply stands for the proposition that, when substantial evidence is submitted to a trial court  
25 that refutes the contention that a sum of money was loaned as opposed to invested, that determination will be upheld.

26                   <sup>24</sup> *In re Shields’ Estate*, 15 Ariz. App. 447, 448 (Ariz. Ct. App. 1971) (stating that when statutes have been adopted  
27 from California, it is appropriate to look to interpretation of the California statutes for guidance.)

28                   <sup>25</sup> A recent bankruptcy case in the Central District of California was similarly unable to find California state law  
addressing the question of when debt should be recharacterized as equity. *In re L. Scott Apparel, Inc.*, 2019 WL  
1768235 at 57 (Bankr. C.D. Cal. January 29, 2019) (stating “It does not appear that California state law has definitely  
addressed the question of when debt should be recharacterized as equity.”).

<sup>26</sup> *Lothian Oil* cites to the Texas case, *Arch Petroleum, Inc. v. Sharp*, 958 S.W.2d 475, 477 n. 3 (Tex. Ct. App. 1997)  
which then cites to *Fin Hay Realty Co. v. United States*, 398 F.2d 694, 696 (3d Cir. 1968) for “an oft-cited discussion  
of the distinction between debt and equity, including a list of sixteen distinguishing factors.”

1 *Official Committee of the Unsecured Creditors of Color Tile, Inc. v. Blackstone Family*  
2 *Investment Partnership, L.P. (In re Color Tile, Inc.)*, 2000 WL 152129, at \*4 (D. Del.  
3 2000) (citing 7 factors including the intent of the parties). Other courts have applied  
4 slightly different multi-factor tests which also have their roots in federal tax law. *In re*  
5 *AutoStyle Plastics, Inc.*, 269 F.3d 726, 749 (6th Cir. 2001) (adopting the 11-factor test  
6 used by the Sixth Circuit in the tax case *Roth Steel Tube Co. v. C.I.R.*, 800 F.2d 625).

7 As discussed below, this Court predicts that the Arizona Supreme Court would  
8 utilize most, if not all, of the *AutoStyle* factors when it ultimately has occasion to tackle  
9 the question of appropriate standards for a trial court to review in determining when an  
10 entity's debt should be recharacterized as equity.

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12 C. § 510 Subordination

13 Under section 510(c),

14 ...after notice and a hearing, the court may –

15 (1) under principles of equitable subordination, subordinate for purposes of  
16 distribution all or part of an allowed claim to all or part of another allowed  
17 claim or all or part of an allowed interest to all or part of another allowed  
interest...

18 Equitable subordination requires the court to make three findings: “(1) that the claimant  
19 engaged in some type of inequitable conduct, (2) that the misconduct injured creditors or  
20 conferred unfair advantage on the claimant, and (3) that subordination would not be  
21 inconsistent with the Bankruptcy Code.” *In re First Alliance Mortg. Co.*, 471 F.3d 977,  
22 1006 (9th Cir. 2006). The second element of the test requires the proponent of equitable  
23 subordination to demonstrate that the misconduct caused injury to the debtor or its  
24 creditors or resulted in an unfair advantage to the claimant. *In re 80 Nassau Associates*,  
25 169 B.R. 832, 840 (S.D.N.Y. 1994). “Bankruptcy Courts must take care not to subordinate  
26 claims where doing so will operate only to penalize the claimant.” *In re Westgate-*  
27 *California Corp.*, 642 F.2d 1174, 1178 (9th Cir. 1981). Courts should not subordinate a  
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1 claim where the value of the claim greatly exceeds the amount of damage inflicted by the  
2 claimant's inequitable conduct. *Id.*

3 Equitable subordination is a "dramatic remedy" that is "rarely granted." *In re GTI*  
4 *Capital Holdings, LLC*, 2007 WL 2493671 at 14 (Bankr. D. Ariz. Aug. 30, 2007).  
5 However, "[w]here the trustee seeks to subordinate 'a claim arising from the dealings  
6 between a debtor and an insider,' the court will give the insider's actions rigorous  
7 scrutiny." *Stoumbos v. Kilimnik*, 988 F.2d 949, 959 (9th Cir. 1993) (citing *In re*  
8 *Fabricators, Inc.*, 926 F.2d 1458 (5th Cir. 1991)).

## 9 10 **V. FINDINGS AND CONCLUSIONS<sup>27</sup>**

### 11 12 **A. The Selznick Obligation**

13 Count I of Plaintiff's Amended Complaint demands payment to the Trustee of what  
14 he claims is a fully matured debt in the amount of \$835,268.65 ("Selznick Obligation")  
15 due and owing to the Debtor by Selznick at the Petition Date. This amount presumably  
16 consists of the principal balance of \$804,307.17 plus interest at the 4% annual rate  
17 reflected in the note<sup>28</sup> signed by Selznick on August 28, 2015. However, the Court  
18 calculates the Petition Date balance on the Selznick obligation at \$814,317 plus any fees  
19 and costs owed to the Debtor.<sup>29</sup> Other than Exhibit 22, no evidence was introduced  
20 reflecting the present balance owed on the Selznick Obligation so this Court will use its  
21 own calculations indicated in the footnote below.

22 Through the introduction of Exhibit 22 and the testimony of the Trustee, Plaintiff  
23 has shown prima facie evidence of Selznick's debt to the Roomstores. Defendants have  
24 not challenged the fact of Roomstores' transfers to Selznick totaling \$804,307.17 except  
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26 <sup>27</sup> This Order constitutes this Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Rules of  
27 Bankruptcy Procedure.

<sup>28</sup> See Ex. 22

28 <sup>29</sup>  $\$804,307.17 \times 4\% = \$32,172.29/\text{year}/360 \text{ days} = \$89.37/\text{day}$ . 112 days lapsed between the note date (August 28,  
2015) and the Petition Date (December 18, 2015).  $112 \times \$89.37/\text{day} = \$10,009 + \$804,307.17 = \$814,317$  owed on  
the Petition Date.

1 to contend that amount reflects capital distributions to Selznick and not a debt owed by  
2 Selznick to the Debtor.

3 In view of the Plaintiff's prima facie showing of the validity of the Selznick  
4 Obligation, Defendants bear the burden of proof on their contention that the Selznick  
5 Obligation must be recharacterized as a capital distribution to Selznick. Defendants point  
6 to a January 15, 2015 email from Selznick to Alan and Phil Levitz, his relatives and fellow  
7 owners of the Roomstores. In that email, Selznick stated "[t]he operating agreement [of  
8 the Roomstores] ... prohibits any distributions when the assets of the company are or will  
9 be lower than its liabilities, which is the case at this time. Were the loans from the  
10 company to the members to be properly characterized as capital distributions, the negative  
11 equity increases by another \$3,500,000."<sup>30</sup> The fact that Selznick signed his note to the  
12 Roomstores over eight months after this email not only undercuts Defendants' claim that  
13 the Selznick Obligation must be recharacterized as an equity distribution, it obliterates this  
14 argument.<sup>31</sup> Defendants provided no additional evidence supporting their contention.

15 Section 542 contains an exception to the requirement that a debt owed to a debtor  
16 be paid over to the trustee; namely, when the obligor has a § 553 right of offset. If a setoff  
17 is effectuated, the Selznick Obligation on the Petition Date (\$814,317) would be reduced  
18 by the Selznick Claim (\$101,316)<sup>32</sup> leaving a balance of \$713,001 owed to the Trustee.  
19 On the other hand, if Selznick must pay the Selznick Obligation in full and await the  
20 arrival of distributions to unsecured creditors under the Debtor's confirmed Plan, Selznick  
21 would receive approximately \$9,118 to \$10,132.<sup>33</sup> The net effect to Selznick would be an  
22 obligation owed to Roomstores in an amount between \$804,155 and \$805,199.<sup>34</sup> This  
23 produces a variance of \$91,930 to \$90,916<sup>35</sup> depending on whether a setoff is appropriate  
24 or not. Selznick has presented no evidence to support a right of setoff nor does Plaintiff's

25 <sup>30</sup> Ex. 87, paragraph 2.

26 <sup>31</sup> Selznick, of course, could not explain this jarring conflict at trial because he passed away December 9, 2016.

27 <sup>32</sup> This assumes the Selznick Claim is allowed in full and not recharacterized as equity or subordinated under § 510(c).  
See the discussion below in Section V(B).

28 <sup>33</sup> According to Defendants' counsel, the allowed claims of unsecured creditors will receive 9 to 10 cents on the  
dollar. Trial Transcript at DE 64, page 111, lines 6 – 8.

<sup>34</sup> \$814,317 - \$10,132 = ~~\$804,185~~; \$814,317 - \$9,118 = ~~\$805,199~~.

<sup>35</sup> \$805,199 - \$713,269 = ~~\$91,930~~; \$804,185 - \$713,269 = ~~\$90,916~~.

1 closing brief argue that the Selznick Claim must be setoff against the Selznick Obligation.  
2 The Court will not order a setoff *sua sponte*.

3 The Court finds that Plaintiff sustained his burden of proving, under § 542, that the  
4 Selznick Obligation is matured and has been due and owing to the Roomstores since its  
5 December 31, 2016 maturity date. The principal amount of the Selznick Obligation is  
6 \$804,307.17. Interest has been accruing on that principal amount at 4% from August 28,  
7 2015. The Court also finds the Selznick Claim may not be offset against the Selznick  
8 Obligation under § 553. The Court further finds that the Defendants have failed to sustain  
9 their burden of proving that the Selznick Obligation should be recharacterized as a capital  
10 distribution to Selznick.

11 Since the note signed by Selznick contains a provision calling for his payment of  
12 attorneys' fees should Selznick not pay this debt when due, Plaintiff may file his  
13 application for fees and costs no later than January 24, 2020. Defendants' response, if  
14 any, shall be filed no later than February 7, 2020. Plaintiff's reply, if any, shall be filed  
15 by February 14, 2020. After reviewing these pleadings, the Court shall set a hearing on  
16 such application only if a hearing would be deemed by the Court to be useful.

17  
18 **B. The Selznick Claim**

19 **(1) Recharacterization of the Selznick Claim**

20 Count III of Plaintiff's Amended Complaint seeks to reclassify the Selznick Claim  
21 as an equity investment in the Roomstores by Selznick, Count V seeks disallowance of  
22 that claim. Reclassification of a claim as equity is determined by application of state law.  
23 Since the Selznick Claim arose in Arizona, the Court must apply Arizona law to this issue.  
24 As noted above in Section IV(B), the parties have not directed the Court to controlling  
25 Arizona law on this question nor has the Court found an Arizona case which has decided  
26 the standards to use in making a determination of whether it is appropriate to  
27 recharacterize a claim as equity. A recent decision from the Central District of  
28 California's esteemed Judge Kwan notes that even California's state courts have not

1 definitively supplied an answer as to how trial courts are to analyze the recharacterization  
2 issue.<sup>36</sup> Like Judge Kwan, this Court must predict what the highest state court would  
3 likely decide in view of this surprising legal vacuum.

4 At least one state court (Texas)<sup>37</sup> has developed a 16-factor test which is based  
5 upon criterion developed by federal tax courts. The 6th Circuit<sup>38</sup> has developed a test  
6 which also finds its genesis in federal tax law. While the Texas and 6th Circuit tests are  
7 not exactly the same, both cover essentially the same territory. Delaware's 7 factor test  
8 differs a bit from both of these tests in that it explicitly incorporates a requirement that the  
9 court discern the parties' intent.<sup>39</sup> Because the *AutoStyle* case is more widely cited and  
10 adopted by other courts, this Court predicts that the Arizona Supreme Court would likely  
11 find all or most of the *AutoStyle* factors applicable to recharacterization cases in Arizona.

12 In *AutoStyle*, the 6th Circuit identified 11 factors which trial courts are to review  
13 when analyzing whether a debt claim should be recharacterized as an equity contribution:

14 1. "[T]he names given to the instruments, if any, evidencing the indebtedness."

15 Roomstores' Operating Agreement permits its members to loan money to the  
16 LLC.<sup>40</sup> Selznick's Claim #306-1<sup>41</sup> reflects an April 24, 2015 promissory note<sup>42</sup> payable  
17 to Selznick in the amount of \$50,000 signed for Roomstores by Al Levitz. Also attached  
18 to that proof of claim is an unsigned Roomstores note<sup>43</sup> to Selznick in the amount of  
19 \$43,334.<sup>44</sup> Roomstores' books and tax filings also reflect the Debtors' debt obligation to  
20 members of the LLC but do not specifically single out the amount of debts owed to  
21 Selznick.<sup>45</sup> However, the Trustee points to the Trade Vendor Letters which indicate

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22 <sup>36</sup> *L. Scott Apparel* at 57.

23 <sup>37</sup> *Arch Petroleum, Inc. v. Sharp*, 958 S.W.2d 475, 477 n. 3 (Tex. Ct. App. 1997).

24 <sup>38</sup> *AutoStyle* at 749-50.

25 <sup>39</sup> *In re Color Tile* at 4.

26 <sup>40</sup> Ex. 29, ¶ 6.7.

27 <sup>41</sup> Ex. 1.

28 <sup>42</sup> Exs. 1 and 21.

<sup>43</sup> Ex. 1.

<sup>44</sup> These note amounts plus the accrued interest reflected in Selznick's proof of claim are not challenged by the Trustee. However, the Court noticed that the Selznick Claim of \$101,316 is a bit less than reflected in the Trustee's Ex. 45.

<sup>45</sup> See Ex. 38, especially Note 4 to the 2011-2012 financial statements. See also Schedule L to Exs. 39-43, the 2011 through 2015 tax returns of Roomstores.

1 Roomstores' members injected \$3.5 million into this LLC between August 2008 and  
2 August 2010, "in the form of long term subordinated debt."<sup>46</sup> Included with those letters  
3 was a balance sheet reflecting subordinated debt of over \$3.4 million. The Trade Vendor  
4 Letters do not indicate whose debt is subordinated or to whom those loans are  
5 subordinated. The Trustee reads the Trade Vendor Letters as indicating the members'  
6 cash infusions as being subordinated to all creditors, especially the claims of Roomstores'  
7 trade vendors. No subordination agreements were produced at trial. In fact, the only  
8 mention of written subordination agreements pertained to the members' agreements to  
9 subordinate their claims to the claims held by Northern Trust Bank. Footnote 4 to the  
10 2011 and 2012 balance sheets of Roomstores reflects three amounts totaling \$3,415,000  
11 as "unsecured notes payable to a member . . . subordinated to Northern Trust Bank."<sup>47</sup>

12 Factor 1 weighs in favor of Selznick's position that the Selznick Claim were loans  
13 to Roomstores, not capital contributions.

14  
15 2. "[T]he presence or absence of a fixed maturity date and schedule of payments."

16 The signed note referenced in the preceding paragraph has a maturity date of  
17 December 31, 2015. The unsigned note has a December 31, 2016 maturity date. Neither  
18 note contains a reference to interim payments.

19 Factor 2 weighs in favor of Selznick's position.

20  
21 3. "[T]he presence or absence of a fixed rate of interest and interest payments."

22 The signed and unsigned notes from Roomstores to Selznick reflect an interest rate  
23 of 7% per annum. Roomstores' 2011 and 2012 financial statements at Note 4 reflect these  
24 same rates for two of the three member loans but reflect a 12% rate on the \$50,000 note.<sup>48</sup>

25 Factor 3 weighs in Selznick's favor.

26 \_\_\_\_\_  
27 <sup>46</sup> Exs. 57-66.

28 <sup>47</sup> Ex. 38, page 11 of 15.

<sup>48</sup> None of the three loan balances reflected in Note 4 (i.e. \$2,743,334, \$621,666 or \$50,000) indicate to which Roomstores member these debts are owed. The fact that the interest rates vary from the 4% rate Roomstores agreed to accept on the Selznick Obligation troubles this Court. This is discussed at the end of Section V(B).

1 4. “[T]he source of repayments.”

2 As to this factor 4, the *AutoStyle* court stated:

3 If the expectation of repayment depends solely on the success  
4 of the borrower’s business, the transaction has the appearance  
5 of a capital contribution.

6 The signed and unsigned notes payable from Roomstores to Selznick simply indicate  
7 Roomstores as the obligor. No third party is reflected as a guarantor or as a likely source  
8 for repayment of these loans. More importantly, payment was not dependent on  
9 Roomstores’ profitability.

10 Selznick wins factor 4.

11  
12 5. “[T]he adequacy or inadequacy of capitalization.”

13 The Court in *AutoStyle* held:

14 Thin or inadequate capitalization is strong evidence that the  
15 advances are capital contributions rather than loans.

16 Roomstores’ 2011 and 2012 financial statements and the 2011 through 2015 tax returns  
17 reveal significant “[d]eficit in members’ capital”<sup>49</sup> or negative “[p]artners capital  
18 accounts.”<sup>50</sup> Whether Roomstores was adequately capitalized *ab initio* or somewhere  
19 after its formation is unknown to the Court as no evidence was introduced to this effect.  
20 The Court does note that ¶ 2.1 of Roomstores’ Operating Agreement claims the members  
21 “have previously made Capital Contributions to [Roomstores].”<sup>51</sup>

22 Factor 5 is unknown but since Trustee failed to sustain his burden of proof on this  
23 issue, factor 5 weighs in favor of Selznick.

24  
25 6. “[T]he identity of interest between the creditor and the stockholder.”

26 As to this factor, *AutoStyle* tells us that where

27  
28 <sup>49</sup> Ex. 38.

<sup>50</sup> Exs. 39-43.

<sup>51</sup> Ex. 29, page 4.

1 stockholders make advances in proportion to their respective  
2 stock ownership, an equity contribution is indicated. *Ibid.* On  
3 the other hand, a sharply disproportionate ratio between a  
4 stockholder's percentage interest in stock and debt is  
5 indicative of bona fide debt.<sup>52</sup>

6 Trustee's people prepared Ex. 46 which reflects "2015 Subordinated Debt" owed by  
7 Roomstore to Phil Levitz in the amount of \$3,445,134 and to Selznick in the amount of  
8 \$101,693. No debt is reflected as owing to Al Levitz. Non-member MasterMind is  
9 reflected as being owed \$1,285,600. Since membership interests are held in nearly equal  
10 proportion by Phil Levitz (33.5%), Al Levitz (33.5%) and Selznick (33%), it is clear that  
11 member advances to Roomstores were not in proportion to members' ownership interests.

12 Factor 6 favors Selznick.

13 7. "[T]he security, if any, for the advances."

14 According to the *AutoStyle* court,

15 [t]he absence of a security for an advance is a strong indication  
16 that the advances were capital contributions rather than  
17 loans.<sup>53</sup>

18 None of the member advances were secured by any of Roomstores' assets.

19 Factor 7 favors Trustee.

20  
21 8. "[T]he corporation's ability to obtain financing from outside lending  
22 institutions."

23 When discussing factor 8, *AutoStyle*, stated

24 [w]hen there is no evidence of other outside financing, the fact  
25 that no reasonable creditor would have acted in the same  
26 manner is strong evidence that the advances were capital  
27 contributions rather than loans.<sup>54</sup>

28 <sup>52</sup> *AutoStyle* at 751.

<sup>53</sup> *Id.* at 752.

<sup>54</sup> *Id.* at 752.

1 Selznick was indisputedly an insider of Roomstores. That said, the Court is a bit puzzled  
2 by this factor. If an equity interest holder advances funds to an entity partially owned by  
3 them, they may be doing so for reasons other than simply protecting or boosting their  
4 equity position. Advances can be made to protect their guarantee of the entity's debts to  
5 arms-length third party creditors. Equity holders may wish to cover an entity's cash  
6 shortages so payroll can be timely paid, so raw materials or inventory can be purchased  
7 or to enable the entity to take advantage of favorable credit terms from vendors. Equity  
8 holders may want to make sure the difficulties experienced by their entity does not impact  
9 their long-time faithful employees. On the other hand, equity holders may also advance  
10 money to their entity because they may have never adequately capitalized the entity. But,  
11 of course, if that is the case factor 5 has been met and factor 8 would be superfluous. The  
12 reasons for Selznick's loans to Roomstores were not explicitly revealed at trial.

13 Whether factor 8 should be included in the list of 11 or not, this factor weighs in  
14 favor of Trustee.

15  
16 9. “[T]he extent to which the advances were subordinated to the claims of outside  
17 creditors.”

18 *AutoStyle* held that “[s]ubordination of advances to claims of all other creditors  
19 indicates that the advances were capital contributions and not loans.”<sup>55</sup> Here, the Trustee  
20 argues that the language of the Trade Vendor Letters evidences a subordination of member  
21 loans to all Roomstores' creditors. This contention is, however, undercut by the fact that  
22 Roomstores' 2011 and 2012 financial statements identify subordination of member loans  
23 only to Northern Trust Bank.<sup>56</sup> Those financial statements were “Reviewed” by Dennis,  
24 Schmich & Co Ltd., an independent third party certified public accountant. The Court  
25 finds Selznick knowingly and voluntarily subordinated the Selznick Claim to only  
26 Northern Trust Bank and not to the trade vendors or other creditors of Roomstores.

27 Factor 9 weighs in favor of Selznick.

28 

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<sup>55</sup> *Id.* at 752.

<sup>56</sup> Ex. 38, Note 4.



1           10. “[T]he extent to which the advances were used to acquire capital assets.”

2           Accordingly, to the *AutoStyle* court, advances for the entity to acquire capital  
3 assets, rather than for daily operating expenditures, signals a capital contribution.<sup>57</sup> Here,  
4 the Court received no explanation of how Selznick’s advances were employed by  
5 Roomstores nor was any evidence submitted reflecting any capital purchases by  
6 Roomstores.

7           The Trustee has not sustained his burden of proof on factor 10. Selznick wins the  
8 10th round.

9  
10           11. “[T]he presence or absence of a sinking fund to provide repayments.”

11           To the 6th Circuit, the absence of a sinking fund suggests an advance could be a  
12 capital contribution.<sup>58</sup> There was no evidence submitted by the parties suggesting the  
13 establishment of a sinking fund in this case. If the creation of sinking funds were ever the  
14 norm in arm’s length, third party unsecured loan transactions, this Court can only note  
15 that they are rarely, if ever, seen by this Court in modern day non-governmental  
16 commercial lending transactions of this size.

17           This Court views factor 11 to be of very little importance but, to the extent it is of  
18 any use, it weighs in favor of Plaintiff.

19           In summary, 8 of the 11 *AutoStyle* factors weigh in favor of a finding that the  
20 Selznick Claim is a debt of Roomstores and not an equity contribution by Selznick to  
21 Roomstores. Moreover, the two factors favoring the Trustee’s position (factors 8 and 11)  
22 are seen by this Court to be of very little significance. Factor 7 is, however, clearly a mark  
23 in Plaintiff’s favor. Importantly, inequitable conduct is not one of the factors to be  
24 reviewed in a case of debt recharacterization.<sup>59</sup> As will be seen below, this is one of the  
25 primary differences between recharacterization and equitable subordination.

26  
27 \_\_\_\_\_  
<sup>57</sup> *AutoStyle* at 752.

<sup>58</sup> *Id.* at 753.

28 <sup>59</sup> *Debt Recharacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending*, 71 Ohio St. L.J. 187, 198 (2010).

1           The *AutoStyle* 11 factor test is not a mathematical matter where the party with the  
2 greatest number of factors in their favor wins.<sup>60</sup> Some of the 11 factors are more important  
3 than others, at least in the context of this case. A fixed maturity date and fixed interest  
4 rate are hallmarks of debt whereas no interest rate and no date certain for repayment<sup>61</sup> are  
5 more indicative of equity. Whether the distressed borrower could not obtain outside third  
6 party financing or whether the insider lender obtained collateral for this loan are much less  
7 compelling factors in this Court’s analysis of recharacterization. One commentator<sup>62</sup>  
8 suggests these factors should be ignored because insiders are the very people who best  
9 understand a borrower’s potential and have the desire that the borrower reach that  
10 potential.<sup>63</sup> Moreover, this commentator suggests (correctly) that a collateralized insider  
11 loan should not be a sign of true debt because doing so would dilute assets available to  
12 pay non-insider creditors.<sup>64</sup> As a matter of public policy, the Court does not view this as  
13 a motivation courts should encourage.

14           The adequacy of capitalization (factor 5) is an interesting matter. If anything, this  
15 factor should review whether the borrower was initially adequately capitalized to engage  
16 in the type of business it set out to conduct. If so, subsequent negative capital positions  
17 should not necessarily count against the now troubled borrower. Here, the Court received  
18 no evidence of whether Roomstores was or was not adequately capitalized at its inception.  
19 It is true, however, that by 2010, Roomstores’ members found themselves in a state of  
20 woefully negative capitalization.<sup>65</sup> From a balance sheet perspective the members’  
21 ownership interests were worthless by 2010 and remained underwater through the Petition  
22 Date. Why would a member advance new money as equity contributions when  
23 Roomstores’ capital deficit exceeded \$3 million throughout this time period? This  
24 question was not answered by the parties. Ms. Selznick, however, testified that her father

25 \_\_\_\_\_  
26 <sup>60</sup> *In re Autobacs Strauss, Inc.*, 473 B.R. 525, 572 (Bankr. D. Del. 2012).

27 <sup>61</sup> Calling for repayment when the borrower returned to profitability was found by the 4th Circuit in *Dornier Aviation*,  
453 F.3d 225 (4th Cir. 2006), to be an important factor in the court recharacterizing the “loan” as equity.

28 <sup>62</sup> *Id.*

<sup>63</sup> *Id.* at 221.

<sup>64</sup> *Id.* at 219.

<sup>65</sup> See Ex. 44.

1 and his pension plan advanced money to Roomstores expecting to be timely repaid with  
2 interest. Payment was not contingent upon Roomstores' future profitability or any other  
3 future event.<sup>66</sup> Payment was due on a specified maturity date, per the promissory notes  
4 signed by Roomstores.

5 The Court finds Selznick and MasterMind intended that their advances to  
6 Roomstores be repaid when due and that these advances be treated and accounted for by  
7 Roomstores as debt, not equity. Roomstores likewise intended that these advances be  
8 treated and accounted for as debt. Roomstores' tax returns<sup>67</sup> and its 2010 and 2011  
9 financial statements reflect this intention.

10 This, however, does not fully resolve all concerns involving the Selznick Claim.  
11 The Selznick Obligation was incurred by Selznick after the Selznick Claim was  
12 established. Roomstores agreed to pay Selznick at the rate of 7% per annum while only  
13 charging him 4% per annum for the Roomstores' loan to him. All other terms of the  
14 Selznick Claim were reasonable, but the Court finds this interest rate disparity  
15 commercially unreasonable under the circumstances of this case. The Selznick Claim is  
16 to accrue interest at the same rate Selznick was being charged by Roomstores, i.e. 4% per  
17 annum.

18 Based on the intent of the Roomstores and the Defendants and that this Court finds  
19 the most important *AutoStyle* factors weigh in favor of Selznick, the Court finds the  
20 Trustee has not sustained his burden of demonstrating Selznick's advances to Roomstores  
21 were capital contributions. That portion of Plaintiff's Amended Complaint (Counts III  
22 and V, as they pertain to Selznick) are rejected. The principal amount of the Selznick  
23 Claim is allowed in the amount of \$93,334 plus interest at 4% per annum.

24  
25  
26  
27  
28 <sup>66</sup> The 4th Circuit found that, where a borrower's obligations to its insider was not due until the borrower became profitable, it was appropriate to recharacterize debt as equity. *Dornier Aviation* @ 235.

<sup>67</sup> Exs. 39 through 43.

1           (2) § 510(c) Subordination of the Selznick Claim

2           Before a claim against a debtor can be subordinated under § 510(c), the Ninth  
3 Circuit<sup>68</sup> requires the party seeking subordination to carry its burden of proof on three  
4 points. These points are described and discussed as follows:

5           The claimant (here, Selznick) must have engaged in some type of inequitable  
6 conduct. The Trustee contends that Selznick's Trade Vendor Letters constitute  
7 inequitable conduct if Roomstores' members had not actually subordinated their claims to  
8 all other creditors of Roomstores. Since Selznick is an insider of Roomstores, his actions  
9 must be "rigorously scrutinized."<sup>69</sup> Even if the Court adopts the Trustee's position on this  
10 point<sup>70</sup> and on the third point<sup>71</sup> required by the Ninth Circuit, the Court finds the Trustee  
11 has not carried his burden of persuasion on the second point. This second element requires  
12 proof that Selznick's misconduct caused (1) injury to creditors or (2) conferred an unfair  
13 advantage to Selznick. Trustee would have this Court find that dilution of the distribution  
14 to unsecured creditors is the creditor injury which satisfies this second element. However,  
15 Selznick's Trade Vendor Letters did not cause dilution of creditor claims. It is possible  
16 those letters may have caused trade vendors to advance credit to Roomstores or induce  
17 existing creditors to forebear from taking action against Roomstores. Such vendor action  
18 or inaction, however, was not proven at trial. No evidence from any creditor was  
19 produced. The Court will not presume the Trade Vendor Letters caused any vendor to act  
20 or refrain from acting. Selznick's conduct (if such conduct was found to be inequitable)  
21 was not proven by Trustee to cause injury to any creditor of Roomstores. Moreover, the  
22 Trade Vendor Letters were not sent to all Roomstores' creditors.<sup>72</sup> Significant claims  
23 against the Debtor's estate are held by Debtor's landlords who admittedly were not

24 \_\_\_\_\_  
25 <sup>68</sup> *In re First Alliance Mtg. Co.* at 1006.

26 <sup>69</sup> *Stoumbos v. Kilimnik* at 959.

27 <sup>70</sup> For the record, the Court is not finding in Trustee's favor on this first element. Among other things, the Trade  
Vendor Letters do not clearly announce which members advances are subordinated or whether they are subordinated  
to all creditor claims or just the claims of Northern Trust Bank.

28 <sup>71</sup> Point 3 requires a finding that "[s]ubordination is not inconsistent with the Bankruptcy Code." *In re First Alliance  
Mortg. Co.*, 471 F.3d at 1006. The Court agrees the Trustee has carried his burden of proof on this third point.

<sup>72</sup> As noted above in Section III(A), Exhibits 57 – 66 were letters addressed to vendors. See Trial Transcript at DE  
64, page 48, lines 14 – 15.

1 recipients of the Trade Vendor Letters.<sup>73</sup> Subordinating Selznick’s Claim to all of  
2 Roomstores’ creditors would unfairly penalize Selznick. Furthermore, it is not clear to  
3 this Court that Plaintiff could properly demonstrate to which creditor claims Selznick  
4 should be subordinated. This form of picking and choosing was the remedy ordered by  
5 the 9th Circuit in *Stoumbos v. Kilimnik*, 988 F.2d at 960-61.

6 The Court also finds that Selznick’s inequitable conduct, if any, did not confer  
7 unfair advantage on Selznick. When Selznick sent the Trade Vendor Letters he had  
8 already advanced significant funds to Roomstores and some of those amounts remain  
9 owed to this date. Trustee has not proven what unfair advantage was conferred upon  
10 Selznick by virtue of his sending the Trade Vendor Letters. The Court finds Plaintiff  
11 failed to prove Selznick’s causation of injury to creditors or causation of unfair advantage  
12 to Selznick.

13 Based on the foregoing, the Court denies Trustee’s Count III subordination claims  
14 against Selznick and also denies Trustee’s Count V demand for disallowance of the  
15 Selznick Claim based on subordination.

16  
17 C. The MasterMind Claim

18 1. Recharacterization of the MasterMind Claim.

19 Count III of the Amended Complaint seeks to recharacterize the MasterMind Claim  
20 as equity. The Court’s analysis of the Trustee’s efforts to recharacterize the Selznick  
21 Claim is equally applicable to the MasterMind Claim,<sup>74</sup> with one important addition.  
22 *AutoStyle’s* factor 6 requires the Court to examine the identity of interests between the  
23 creditor and equity holder. While Selznick owned a membership interest in the  
24 Roomstores and also “loaned” money to the Roomstores, MasterMind (although wholly

25  
26 <sup>73</sup> Trustee testified that “the two largest classifications [of general unsecured creditors] were rejected lessors and vendors.” See Trial Transcript at DE 64, page 46, lines 13 – 16. Also, the Joint Chapter 11 Plan of Reorganization at Administrative DE 549 provides for the treatment of all general unsecured creditors in Class 4 and does not distinguish between vendors and lessors.

27  
28 <sup>74</sup> The MasterMind Claim is an unsecured claim memorialized in a \$260,000 signed note dated April 24, 2015, which calls for interest at 7% and a maturity date of December 31, 2015, as well as an unsigned note in the principal amount of \$621,666 calling for a December 31, 2016 maturity date.

1 owned by Selznick) owned no membership interest in the Roomstores limited liability  
2 company. This fact makes the Trustee's recharacterization claim ever more tenuous.  
3 Importantly, the Court has been shown no evidence that MasterMind is one and the same  
4 as Selznick or was Selznick's alter ego or his instrumentality. The Court will not pierce  
5 the MasterMind pension plan to find it to be one and the same as Selznick. As with the  
6 Selznick Claim (and for the same reasons), the MasterMind principal balance of \$881,666  
7 shall accrue interest at 4% per annum, not the 7% rate set forth in the signed and unsigned  
8 notes.

9 For the reasons stated in this subsection, as well as the reasons stated in  
10 Section V(B) above, the Court rejects Plaintiff's claims to recharacterize the MasterMind  
11 Claim as equity.

12  
13 2. Subordination of the MasterMind Claim.

14 Count IV of Trustee's Amended Complaint seeks to subordinate the MasterMind  
15 Claim under § 510(c) while Count V seeks to disallow the MasterMind Claim for the same  
16 reasons. The Court's rationale for denying Trustee's claims to subordinate the Selznick  
17 Claim are equally applicable to the MasterMind Claim but with the additional facts that  
18 MasterMind held no equity interest in Roomstores. Moreover, Selznick, not MasterMind,  
19 engaged in the so-called inequitable conduct. These facts strengthen MasterMind's  
20 position on elements (1) and (2) of the Ninth Circuit's requirements in finding equitable  
21 subordination. Selznick, not MasterMind, sent the Trade Vendor Letters. Those letters  
22 did not refer to subordination of MasterMind's Claim because those letters refer only to  
23 cash infusions by "members" "in the form of long-term subordinated debt."

24 The Court finds Trustee failed to carry his burden of persuasion on his Count III  
25 subordination claims as to the MasterMind Claims and as to his Count V disallowance of  
26 the MasterMind Claim based on equitable subordination.

27  
28

1 **VI. CONCLUSION**

2 After considering the evidence at trial, hearing the arguments of counsel and  
3 reading the parties' briefs, the Court now rules that Selznick owed the Roomstores  
4 bankruptcy estate \$814,317 on the Petition Date plus interest thereafter on the principal  
5 balance at 4% per annum. If Plaintiff seeks an award of attorneys' fees in connection with  
6 the Selznick Obligation, he must apply to this Court as more fully discussed in Section  
7 V(A), above.

8 The Court finds that Plaintiff failed to carry his burden of proof on his claims for  
9 equitable subordination. The Court also finds Plaintiff (except as noted above) failed to  
10 sustain his burden of proof of his claims for state law recharacterization of debt as equity.  
11 Therefore, Selznick's Claim #306-1 is allowed in the principal amount of \$93,334 plus  
12 interest at 4% and MasterMind's Claim #307-1 is allowed in the principal amount of  
13 \$881,666 plus interest at 4%. Since Selznick failed to demonstrate that his liability to  
14 Roomstores is entitled to setoff against the debt Roomstores owes Selznick, Selznick must  
15 pay the full amount owed to Roomstores while the Selznick Claim against Roomstores is  
16 entitled to share pro rata in the 9% to 10% return expected to be paid to unsecured  
17 creditors.

18 Defendant shall lodge with this Court a judgment consistent with this order.  
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