



IT IS ORDERED as set forth below:

Date: August 6, 2013

Mary Grace Diehl

**Mary Grace Diehl
U.S. Bankruptcy Court Judge**

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION**

In Re:	:	Case No. 09-68613-MGD
	:	
DIPLOMAT CONSTRUCTION, INC.,	:	Chapter 7
	:	
Debtor.	:	Judge Mary Grace Diehl
	:	
PAUL H. ANDERSON, Chapter 7	:	
Trustee for the Estate of Diplomat	:	
Construction, Inc.,	:	
	:	
Plaintiff,	:	Adversary Proceeding
	:	
v.	:	
	:	No. 11-5611
JAGDEEP PATEL AKA RICK PATEL,	:	
	:	
Defendant.	:	
	:	

MEMORANDUM OPINION

A trial was held on March 18, 2013 in the above-styled adversary proceeding. The Chapter 7 Trustee seeks to avoid and recover alleged fraudulent transfers from Debtor to Defendant in the two years preceding bankruptcy pursuant to 11 U.S.C. §§ 548(a)(1)(b) and 550 and within the four

years prior to bankruptcy under §§ 544, 550 and O.C.G.A. § 18-2-75. Alternatively, Trustee seeks avoidance and recovery of purported preferential transfers to Defendant in the 1-year period preceding the Debtor's bankruptcy filing. §§ 547 & 550. The timeframe for which Trustee seeks to avoid these transfers is based upon his allegations that Defendant was a non-statutory insider of the Debtor. The Court has jurisdiction pursuant to 28 U.S.C. § 1334, and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(F) and (H).

James Schulz of Merritt Watson, LLP represented Trustee and Frank Wilensky of Macy, Wilensky, Kessler and Hennings, LLC represented Defendant. The Court heard testimony from Defendant, Trustee, Rajesh C. Patel,¹ Mukesh C. Patel,² Paul Jones, forensic accountant, Paul Anderson, Chapter 7 Trustee, and former employees of Debtor or related entities: Betty Moore, Terry Zwirn, and Harry Priddle. Plaintiffs Exhibits 1 through 20 and Defendants' Exhibits 1 through 6 were admitted into evidence without objection. At the close of Trustee's case in chief and again at the close of all evidence, Mr. Wilensky moved to dismiss the action for failure to state a claim. The motion was taken under advisement as to the preference claim and denied as to the fraudulent transfer claims. This ruling resolves Defendant's motion and all claims in the action.

This order constitutes findings of fact and conclusions of law pursuant to Rule 52(a)(1) of the Federal Rules of Civil Procedure, made applicable to this proceeding by Rule 7052 of the Federal Rules of Bankruptcy Procedure.

¹ Rajesh C. Patel was the principal of the Debtor and a shareholder at all relevant times. Rajesh C. Patel is also a defendant in a similar action by Trustee, Adversary Proceeding Number 11-5610. This trial was held jointly with the 11-5610 action and Adversary Proceeding Number 11-5609, *Anderson v. Mukesh Patel*.

² Mukesh C. Patel was a minority shareholder of Debtor until 2009 and is a defendant in a similar action by Trustee.

Trustee alleges that undisputed payments made by Debtor to Defendant constitute constructive fraudulent transfers because there is no evidence of an underlying debt to support such payments. Trustee asserts that such payments to Defendant were not in exchange for reasonably equivalent value. Defendant contends payments made to him were in exchange for services and work performed for Debtor's benefit and that payments were of reasonably equivalent value to Defendant's services. Alternatively, Trustee seeks to avoid payments in the 1-year period preceding the bankruptcy filing as preferential transfers. Defendant exclusively defends this theory on the basis that he is not a creditor of Debtor.

Findings of Fact

Debtor filed a chapter 11 voluntary petition on April 3, 2009. Debtor owned and operated a 192-room hotel known as the Red Roof Inn-Atlanta Airport (the "Hotel") located near Hartsfield-Jackson Atlanta International Airport. Debtor acquired the Hotel in 1998 in a tax free exchange under I.R.C. § 1031. Debtor's principals were Rajesh and Mukesh Patel. Defendant's position and scope of work with Debtor was undefined, yet fellow employees reported he worked typical hours for a hotel manager and had similar responsibilities. Defendant was first employed by a separate entity owned by Rajesh and Mukesh Patel. Defendant never had an employment contract with Debtor nor any other Debtor-related entity. Debtor's general ledger shows monthly payments from Debtor to Defendant have remained constant at \$3,666.06 since, at least, 2002. Testimony established that Defendant received twice monthly checks for equal payments of approximately \$1,833.03. Rajesh and Mukesh Patel operated a number of hotels through different, but related, entities. This structure created ambiguity regarding Defendant's position with Debtor and these other entities.

In 1998, Defendant worked with Debtor initially to oversee construction on the project to complete the Hotel and to oversee the start-up operations of the Hotel. Defendant performed services at Hotel on a regular basis and was described as Hotel's manager. Testimony from both Defendant and Hotel employees established that Defendant was presumed to be an employee and not an owner of the business. Two employees testified that they shared an office with Defendant and that Defendant acted as the Hotel's general manager. Harry Priddle, former Director of Operations for Diplomat Companies, testified that Defendant reported to him and he considered Defendant as part of the Hotel's management team. Mr. Priddle, however, did not review, recommend, or oversee Defendant's compensation.

At least beginning in 2002, Defendant received total monthly transfers from Debtor in the amount of \$3,666.06, amounting to an approximate annual receipt of \$43,000. Defendant and Rajesh Patel testified that these payments constituted payroll payments. The general ledger coded these payments as a "payroll journal" under the sub-category of "desk clerk," beginning in December of 2003. Alleged transfers to owners and officers of Debtor, Rajesh and Mukesh Patel, were also coded as "desk clerk" in the general ledger.

Defendant described these amounts as "basically my salary." Debtor's general ledger initially documented these amounts as 1099 Interest until early 2003. Thereafter, the general ledger showed these payments as a payroll journal entries. Former co-workers testified that Defendant performed work for Debtor that equaled or exceeded the annual compensation Defendant received of approximately \$43,000.

Defendant, however, was not treated by Debtor as a traditional employee. Debtor did not issue W-2 tax forms to Defendant. Instead, payments to Defendant were reported as independent

contractor interest income or miscellaneous income and Debtor issued Form 1099s to Defendant. Mr. Jones testified that treating Defendant as a contractor given the scope of his duties and responsibilities was unusual. Defendant's joint tax returns reported the payments from Debtor as Form 1099 Miscellaneous income for the years 2005-2007. His 2008 joint tax return classified the payments as 1099 Interest income. A W-2 was issued to Defendant from Debtor in 2009 in the amount of \$4,333.

Trustee asserts that Defendant had an ownership interest in Debtor during the relevant look back periods. Debtor's Schedule K-1 for 2005 showed Defendant with a 20% ownership stake. Defendant reported 20% ownership in Debtor on his 2005 tax return. Defendant testified that he did not know whether he was a shareholder and that he deferred to his accountant for all tax-related questions. Defendant did not think he owned any stock of Debtor at anytime. Debtor's 2009 Schedule K-1 indicated that Defendant had no ownership in Debtor. Testimony from Rajesh and Mukesh Patel stated that Defendant did not own any shares of Debtor during the relevant time periods. All testimony indicates that Defendant reported to Rajesh and Mukesh Patel and could not make decisions on behalf of Debtor beyond those of a general or night manager for a hotel.

Mr. Jones testified that in his thorough review of Debtor's available financial records he found accounting entries referencing a \$420,545.21 loan from Defendant to Debtor. This loan appeared on Debtor's 2005 year end balance sheet. Defendant and Rajesh Patel testified that Defendant made no loan was made to Debtor. The only loan amounts testified by the witnesses related to Defendant's \$200,000 contribution in 1994 (financed through his father), which was paid back at the sale of a Ramada hotel in 1997. It is unclear whether Debtor owned the Ramada or whether it was owned by a separate entity owned by Rajesh and Mukesh Patel.

There was testimony that the Trustee assumed that Defendant was related to Rajesh and Mukesh Patel. Mr. Jones and Mr. Anderson, in addition to all other witnesses, testified that this assumption was erroneous. Rajesh and Mukesh are brothers, and the testimony revealed that Defendant and Mukesh Patel had been high school friends in London, England before Mukesh Patel invited Defendant to work with him at an Atlanta-based hotel that predated Debtor's acquisition of Hotel.

Mr. Jones testified that Debtor was insolvent during all relevant periods to this action. Defendant did not contest the insolvency analysis. The parties stipulated that there was at least one creditor holding an allowed unsecured claim in the case when each transfer was made. Mr. Anderson became the Chapter 7 Trustee in May 2010 after the case was converted following the denial of Debtor's Chapter 11 plan confirmation.

Conclusions of Law

Trustee asserts two legal theories to avoid undisputed transfers made to Defendant by Debtor for the periods preceding Debtor's bankruptcy filing. Trustee seeks to extend the avoidance period for the alleged preferential transfers under a theory that Defendant was a non-statutory insider of Debtor.

Non-Statutory Insider Status

Under the relevant portions of 11 U.S.C. § 101(31)(B), an individual is an insider of a debtor corporation if that individual is a "relative of a... person in control of the debtor...." Section 101(45) defines relative as an "individual related by affinity or consanguinity...." Trustee concedes that Defendant is not a relative of a person in control of Debtor. Trustee does not rely on the statutory definition to assert Defendant's insider status. Instead, Trustee asserts that Defendant had insider-

like control over Debtor and the same extended reach back period for avoidance actions should apply to Defendant as they would to a statutory insider. Courts have extended insider status to other individuals who fall within the definition but outside of the enumerated categories. *Schubert v. Lucent Techs., Inc. (In re Winstar Commc'ns, Inc.)*, 554 F.3d 382, 395 (3d Cir. 2009) (explaining that Congress's use of the term “includes” in § 101(31) expands the reach of the definition).

The Third Circuit has held “it is not necessary that a non-statutory insider have actual control; rather, the question “is whether there is a close relationship [between debtor and creditor] and ... anything other than closeness to suggest that any transactions were not conducted at arm's length.” *Id.* at 396-97. The bankruptcy court elaborated on whether a person or entity should be considered a non-statutory insider in *In re Foothills Texas, Inc.*, 408 B.R. 573 (Bankr. D. Del.2009). That court explained: “The Third Circuit's focus of inquiry is in accord with the plain meaning of insider—a person who is within some society, organization, etc.; a person who is a party to a secret, *esp. so as to gain an unfair advantage.*” *Id.* at 579 (emphasis in original, citation omitted).

The evidence does not establish that Defendant had any control over Debtor or that there was any concern of non-arm’s length transactions. In fact, the evidence indicated that Defendant worked and reported to Rajesh and Mukesh Patel and did not have executive authority. Fellow employees noted that Defendant’s authority to make financial decisions was limited to hotel operations and consistent with a hotel manager. The evidence did reveal that Defendant was compensated unconventionally. Defendant did not receive W-2s to reflect his compensation for his work and, instead, 1099s were issued.³ The tax records reflecting Defendant’s 20% ownership interest in

³ The Court makes no determination as to the legality of this treatment under the Internal Revenue Code and applicable regulations.

Debtor for the period 2005-2008 could have been an indicator of insider-like status, yet, if anything, the testimony revealed that Defendant had nothing but a passive interest, if any, in Debtor.

The effect of payment transfers from Debtor to Defendant will be discussed in more detail below, yet the evidence established that Defendant did provide valuable work for Debtor (in addition to other related entities) in the opening of the Hotel and in service as Hotel's manager. The amount of payment to Defendant, the form of payment, and the frequency of payment provided no indication that Defendant's connection to Debtor provided any unfair advantage. The evidence revealed that the payment transfers were commensurate with the services performed by Defendant for Debtor. The financial practices and the record keeping of Debtor is not a model of clarity or transparency, yet Trustee failed to meet his burden in establishing that Defendant exhibited traits, benefits, or any unfair advantage that would classify him as a non-statutory insider. As such, the preference analysis below will be limited to the statutory timeframes of 90-days preceding the bankruptcy filing.

Fraudulent Transfers Claims

Trustee seeks avoidance of undisputed transfers from Debtor to Defendant as provided in Plaintiff's Exhibit 3 as constructive fraudulent transfers under § 548(a)(1)(B), in the total amount of approximately \$88,000.00. Section 548(a)(1)(B) provides that the trustee may avoid a transfer made within two years of the petition-date if the debtor voluntarily or involuntarily

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts

that would be beyond the debtor's ability to pay as such debts matured; or. . . .

11 U.S.C. § 548(a)(1)(B). Trustee bears the burden of proof of establishing each element of this claim. *In re Rowanoak Corp.*, 344 F.3d 126, 131 (1st Cir. 2003); *see also In re Chase & Sanborn Corp.*, 904 F.2d 588 (11th Cir.1990). Defendant's defense is limited to the reasonably equivalent value element. Defendant does not dispute any of the transfers. Defendant does not dispute Debtor's insolvency at the time of the transfers. Instead, Defendant asserts that he provided reasonably equivalent value to Debtor through his work for Debtor.

Trustee's legal theory relies on the transfers being denominated as loan repayments from Debtor to Defendant, although no such loan actually existed. In essence, the Trustee contends that repayment of a non-existent loan is a fraudulent transfer. The Trustee did show that no promissory note or other writing existed between Debtor and Defendant. The testimony from Defendant and Mukesh and Rajesh Partel also showed no loan to Debtor beyond the \$200,000 loan that had been repaid in full. Defendant contends the payments were in exchange for his personal services.

The Court finds that Defendant's work for Debtor constituted reasonably equivalent value in exchange for the transfers; therefore, the transfers are not avoidable under § 548(a)(1)(B) and § 544 and O.C.G.A. § 18-2-74(a)(2)(B) and § 18-2-75. Assessing reasonably equivalent value in the context of fraudulent transfers involves a two-part test: (1) did Debtor receive any value whatsoever, whether in the form of an indirect or direct benefit; and (2) was the value reasonably equivalent to the Property? *Pension Transfer Corp. v. Beneficiaries (In re Fuehauf Trailer Corp.)*, 444 F.3d 203, 212-14 (3d Cir. 2006). In the context of § 548, value means

“property, or satisfaction or securing of a present or antecedent debt of the debtor.” 11 U.S.C. § 548(d)(2)(A).

The second part of the “reasonably equivalent value” test involves comparing the value given by the Debtor to the value of whatever the Debtor received in exchange. *Fuehauf Trailer Corp.*, 444 F.3d at 212-13. This comparison is a factual analysis. If the values appear close, courts “look to the totality of the circumstances, including (1) the fair market value of the benefit received as a result of the transfer, (2) the existence of an arms-length relationship between the debtor and the transferee, and (3) the transferee’s good faith.” *Id.* at 213 (quoting *Mellon Bank v. Official Comm. Of Unsecured Creditors of R.M.L. (In re R.M.L.)*, 92 F.3d 139, 148-49, 153 (3d Cir. 1996)). A precise calculation of the exchanged values is unnecessary, however, if there is sufficient evidence to conclude the values are plainly not equivalent. *Id.* at 213-14.

Trustee failed to prove that Debtor received less than reasonably equivalent value from Defendant in exchange for the transfers. The evidence presented at trial established that Defendant worked in a managerial position for Debtor for the relevant period. The evidence also establishes that Defendant’s approximately \$43,000 in payments from Debtor was sufficiently equivalent (or likely less than) the cost of hiring a hotel manager for substantially similar services performed by Defendant. Debtor received a direct benefit from Defendant’s work and services performed for the benefit of Debtor. Here, although the totality of the circumstances reveal that the tax reporting of Defendant’s income and Debtor’s payments to Defendant were unusual, Trustee failed to prove that the transfers to Defendant resulted from not an arm’s length transaction. The testimony did reveal a long-term friendship between Mukesh Patel and

Defendant, but no monetary benefit and special influence was testified to or presented in the exhibits.

Trustee presented no evidence that created any inference that Defendant had not exhibited good faith in his interactions with Debtor. Trustee asserts that the form and issuance of tax documents prepared by Debtor – 1099s instead of W-2 - and Defendant's adoption of the form of these on Defendant's personal income tax returns evidences unusual practices. Yet, these facts considered in light of all the evidence presented does not prove that Debtor received less than reasonably equivalent value for the transfers made to Defendant.

Debtor's receipt of Defendant's services and typical employee contributions in management of the Hotel constitutes value. The evidence establishes that the amount of transfers corresponds to a reasonably comparable salary range for a hotel manager. An economic benefit was conferred upon Debtor by Defendant's work and services provided to Debtor. Without his work, Debtor would have needed an employee with a similar scope of work. Although Debtor decided to compensate Defendant in a non-traditional way and did not report payments to the I.R.S. as salary, the evidenced showed that both sides of the transaction - principal of Debtor, Rajesh Patel, and Defendant - had intentions and expectations that Defendant would act as Debtor's employee. Payments of compensation for services are presumed to be for fair consideration, and in order for a trustee to avoid them he must establish that the salary payments were in bad faith or the payments were excessive in light of the Defendants' employment responsibilities. *See e.g., Anderson & Assocs., Pa v. S. Textile Knitters De Hond. Sewing Inc. (In re S. Textile Knitters)*, 65 Fed.Appx. 426, 437 (4th Cir.2003); *Cilco Cement Corp. v. White*, 55 A.D.2d 668, 668, 390 N.Y.S.2d 178 (2d Dep't 1976) (holding that the salary paid to the president

of the company was not a fraudulent conveyance because there was “no evidence that his salary was either excessive or unreasonable, or that the corporation did not receive full value in return.”); *Mills v. Everest Reinsurance Co.*, 410 F.Supp.2d 243, 254 (S.D.N.Y.2006). Although no employment contract was in the record, Trustee has failed to prove that under the totality of circumstances that Defendant was anything more than a de facto employee of Debtor.

Section 544(b) of the Bankruptcy Code also allows Plaintiff to avoid a transfer under applicable Georgia law (O.C.G.A. § 18-2-74(a)(2)(B) and § 18-2-75). Section 18-2-74(a)(2)(B) provides that

(2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

. . . .

	(B) Intended to incur, or believed or reasonably should have
believed	that he or she would incur, debts beyond his or her ability
to pay as	they became due.

And § 18-2-75 provides that

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

Both § 18-2-74(a)(2)(B) and § 18-2-75 substantially mirror the constructive fraud claims under the Bankruptcy Code. Thus, the Court incorporates here its analysis from above on Trustee’s claim under § 548(a)(1)(B).

Debtor’s twice monthly \$1833 payments to Defendant in exchange for regular, hotel managerial services does not constitute avoidable fraudulent transfers under the Bankruptcy Code or applicable Georgia law.

Preference Claims

Trustee asserted an alternative avoidance and recovery theory of preferential transfers. The elements of a preference are set forth in § 547(b) which permits a trustee to avoid any pre-petition transfer of an interest of a debtor in property:

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made-
 - (A) on or within 90 days before the date of the filing of the petition; or
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if-
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). The burden of proving each of the above elements falls on Trustee. § 547(g).

Defendant moved at trial to dismiss Trustee's preference claim based on Trustee's failure to state a claim. Defendant's basis for the motion was based on the failure of the Trustee to make out the first required preference element – that the transfers were made to or for the benefit of a creditor. § 547(b)(1).

Defendant relies, in part, upon the testimony of Mr. Jones where he stated that he would not consider Defendant a creditor of the Debtor. However, the testimony established that employees were paid in arrears, and Defendant was compensated for his services on the same terms and in the same form over the course of his employment. Therefore, Defendant was a creditor under § 101(10)(A). Upon Debtor's filing on April 3, 2009, Defendant was providing services for Hotel and

had not yet been paid for his services in full. Defendant's last pre-petition paycheck was dated March 22, 2009 and cleared the bank March 24, 2009. The evidence established that Defendant was paid on Debtor's payroll cycle, which was twice a month and paid in arrears for services performed. *In re Bernard L. Madoff Inv. Securities LLC*, 458 B.R. 87, 118 (Bankr. S.D.N.Y. 2011) (explaining that payment for previously rendered services constituted payment made on account of antecedent debt to a creditor). Based on the payment of services in arrears, Defendant was a creditor upon filing the petition because he had a claim for services against Debtor. Payment to Defendant for his services was made on account of antecedent debt. Therefore, the first two requirements of a preference claim were satisfied.

The remaining preference claim requirements were not disputed. Trustee can avail itself of the presumption of insolvency during the 90-day period prior to filing pursuant to § 547(f). Defendant neither rebutted the presumption of insolvency nor contested the insolvency analysis presented in Plaintiff's Exhibit 19. Defendant admits the transfers were made within the 90-day period

For the reasons set forth, Trustee's claims for fraudulent transfer and insider preference recovery are hereby denied. Judgment in favor of the Trustee in the amount of \$10,998.18 for the preferential transfers for the 90-day period preceding the Debtor's bankruptcy filing will be awarded by separate entry.

The clerk is directed to serve a copy of the opinion on the parties listed below.

END OF DOCUMENT

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