

IT IS ORDERED as set forth below:

Date: July 8, 2013



A handwritten signature in black ink, reading "James R. Sacca".

James R. Sacca
U.S. Bankruptcy Court Judge

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION**

IN RE:	}	
	}	CASE NO. 09-86091-JRS
ATLANTA RUG GALLERY, INC.,	}	
	}	CHAPTER 7
Debtor.	}	

PAUL H. ANDERSON, JR., as Trustee,	}	
	}	ADVERSARY PROCEEDING
Plaintiff,	}	
	}	NO. 12-05076-JRS
v.	}	
	}	
SAEID KHEIRI,	}	
	}	
Defendant.	}	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter came on for trial on May 7, 2013 on the Complaint filed by the Chapter 7 Trustee seeking to avoid and recover—under 11 U.S.C. § 548 and 550—transfers of cash from the Debtor to Saeid Kheiri totaling \$472,806.00. After considering all of the evidence, including

testimony and documents, and all other matters of record, the Court makes the following findings of fact and conclusions of law.

Background

The Debtor was a retail seller of premium quality Persian rugs, antique carpets, and other rugs and related accessories at a store it owned in Atlanta, Georgia. Mohamad Gavahi was the Debtor's sole officer, director, and shareholder.

According to Gavahi's testimony at trial, Defendant Kheiri had no relationship to the Debtor as an insider or otherwise. Kheiri never participated in the Debtor's operations nor provided any goods or services to the Debtor. Despite the fact that the Debtor never received any goods or services from Kheiri, the Debtor nevertheless issued seven checks to Kheiri between March and May 2009, which totaled \$472,806.00 (the "Transfers").¹

About four and a half months after the Debtor issued the last of these checks, it filed a voluntary petition commencing this case under Chapter 11 of the Bankruptcy Code on October 4, 2009 (Case No. 09-86091-JRS). This case was converted to one under Chapter 7 on November 19, 2010, and Plaintiff Paul H. Anderson, Jr. was appointed as the Chapter 7 Trustee (the "Trustee"). The Trustee then commenced this adversary proceeding seeking to avoid and recover the total of the Transfers—\$472,806.00—from Kheiri.

In response, Kheiri has essentially argued that this money was his all along—that in fact the Debtor simply aided him in transferring his money from Iran to the United States. Kheiri

¹ The dates and amounts of the checks were as follows:

March 4, 2009: \$ 7,000.00;
March 24, 2009: \$ 6,306.00;
April 24, 2009: \$ 60,000.00;
April 30, 2009: \$150,000.00;
May 11, 2009: \$ 20,000.00;
May 11, 2009: \$ 20,000.00;
May 21, 2009: \$209,500.00.

explained at trial that Iran has no banking relationship with the United States; therefore he was forced to go through an exchange company known as Espadana in order to get his money into this country. Gavahi testified that he regularly dealt with Espadana in order to pay for rugs and other products that it imported from Iran and other countries. Gavahi further testified that he agreed to help bring Kheiri's money into this country as a favor to a friend who worked for Espadana. He testified that he had never met Kheiri before he agreed to provide this assistance.

But aside from the testimony of Gavahi and Kheiri, the record contains no evidence that Kheiri ever transferred any money to the Debtor through an exchange company or otherwise. The Trustee's forensic accountant testified that he searched for such evidence in Debtor's books and records and found none. Although the entries in the Debtor's general ledger reflect transfers from Espadana to the Debtor, nothing in the Debtor's books and records indicate that any of those transfers consisted of money belonging to Kheiri. In fact, the only mentions of Kheiri in the Debtor's books and records are in reference to the seven checks that the Debtor issued to Kheiri. And aside from his own testimony, Kheiri offered no evidence that he ever transferred any money to Espadana.

Discussion

The Trustee seeks to avoid and recover the value of the Transfers from Kheiri, arguing that they were recoverable fraudulent transfers under 11 U.S.C. §§ 548 and 550. The Trustee primarily argued that the Transfers were avoidable fraudulent transfers under § 548(a)(1)(B) because they were transfers "of an interest of the debtor in property" made "within 2 years before the filing date of the petition," for which the Debtor "received less than a reasonably equivalent value in exchange," and the Debtor "was insolvent on the date that such transfer was made . . . or became insolvent as a result of such transfer." 11 U.S.C. § 548(a)(1)(B). The Transfers (made between

March 4 and May 21, 2009) were made within two years of the petition date (October 4, 2009). Thus three issues remain: (1) whether the Transfers were transfers of the Debtor's property, (2) whether the Debtor received reasonably equivalent value in exchange for the Transfers, and (3) whether the Debtor was insolvent either at the time of the Transfers or on account of the Transfers.

Did the Transfers Consist of the Debtor's Property?

First, the Court finds that the Transfers did consist of funds that belonged to the Debtor, not Kheiri. The Transfers consisted of cash held in the Debtor's operating account, where it was commingled with other funds which were used by the Debtor to fund its operations. Gavahi admitted that the Debtor had no agreement with Kheiri to hold any money in trust for him. And aside from the testimony of Kheiri and Gavahi, the Court has seen no evidence that this money was earmarked for Kheiri. None of the amounts listed in the Debtor's general ledger as transferred from Espadana match up with the amounts the Debtor transferred to Kheiri. If Kheiri was the rightful owner of funds that were commingled with other funds transferred from Espadana to the Debtor, one would expect that there would be some evidence that a certain amount of those funds were earmarked for Kheiri. But no such evidence has been presented to the Court. Therefore, the Court finds that the Transfers were transfers of the Debtor's property.

Did the Debtor Receive Reasonably Equivalent Value for the Transfers?

As explained above, Kheiri did not participate in the operations of the Debtor and provided no goods or services to the Debtor. The only value Kheiri asserts he gave to the Debtor was cash equal to the amount of the Transfers. But the Debtor's books and records contain no indication that Kheiri transferred any money into the company. These records show that the Debtor transferred cash *to* Kheiri, but they do not show that it ever received any funds *from*

Kheiri. These records do show that the Debtor received money from Espadana, but there is no indication of *why* Espadana transferred funds to the Debtor. Gavahi testified that he received funds from Espadana for various reasons, including loans from one of that company's principals, Hamid Hariri.

Kheiri could have produced records to show that he gave money to Espadana which then went from Espadana to the Debtor, but he did not. He could have produced his own banking records or subpoenaed Espadana's banking records. He did not. He could have deposed a principal of Espadana such as Hariri—who was a defendant in another adversary proceeding in this bankruptcy case—and used that testimony at trial or had Hariri voluntarily appear at trial. He did not. Other than his own testimony and that of Gavahi, Kheiri produced no evidence to prove that he transferred any cash or anything else of value to the Debtor. Based on this lack of evidence, why should the Court believe Kheiri's story that he was using the Debtor to transfer his assets from Iran any more than a story that Gavahi was using Kheiri to transfer money out of the Debtor as it was heading toward bankruptcy? Documents or third party testimony should have existed and been readily accessible to Kheiri if his testimony was true, but because no such evidence was introduced, the Court finds that his story is not true.

The Trustee introduced testimony from his forensic accountant, who testified that he searched the Debtor's books and records for evidence of any transfers of cash or other property from Kheiri to the Debtor and found none. Accordingly, the Court finds that the Trustee has carried his burden of proving that Kheiri gave no reasonably equivalent value for the Transfers.

Was the Debtor Insolvent at the Time of the Transfers?

The next element under § 548(a)(1)(B) concerns Debtor's financial condition at the time of the Transfers. Under § 548(a)(1)(B)(ii), this element is met if, at the time of the Transfers: (1)

the Debtor was insolvent or the Transfers rendered the Debtor insolvent, or (2) the Transfers left the Debtor with unreasonably small capital, or (3) the Debtor believed or knew it was incurring debts it would be unable to repay, or (4) the Debtor made the Transfers to an insider under an employment contract and not in the ordinary course of business. 11 U.S.C. § 548(a)(1)(B)(ii). Proving any of these elements will satisfy § 548(a)(1)(B)(ii). The Trustee has argued that the Debtor was insolvent at the time of the Transfers or that these transfers at least rendered the Debtor insolvent.

Determining whether a business is insolvent under § 548(a)(1)(B)(ii) a question of fact. *Join-In Int'l (U.S.A.) Ltd. v. Wholesale Distribs. Corp. (In re Join-In Int'l (U.S.A.) Ltd.)*, 56 B.R. 555, 560 (Bankr. S.D.N.Y. 1986) (citation omitted). A business is insolvent if “the sum of [its] debts is greater than all of [its] property, at a fair valuation.” 11 U.S.C. § 101(32)(A)(I). This determination has been called the “balance sheet test,” and involves tallying a debtor’s assets and liabilities. *Mellon Bank, N.A. v. Metro Commc’ns, Inc. (In re Metro Commc’ns, Inc.)*, 945 F.2d 635, 648 (3d Cir. 1991). The balance sheet test is applied at the time of the transfer. *Mellon Bank, N.A. v. Official Committee of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*, 92 F.3d 139, 154 (3d Cir. 1996) (citation omitted).

At trial, the Trustee presented the report and testimony of his forensic accountant, Paul A. Jones, CPA, CFF, who was qualified as an expert witness. In preparation for trial, Jones examined the books and records of the Debtor, the financial representations made by the Debtor to this Court in the filings in the main bankruptcy case, and the proofs of claim filed by creditors in the main bankruptcy case.² Rather than accept the Debtor’s balance sheet on its face as a fair representation of the value of its assets and amount of its liabilities, Jones made adjustments and

² The Court took judicial notice of the proofs of claim and pleadings filed in the bankruptcy case, some of which were also admitted into evidence without objection at trial.

prepared a report reflecting what he thought was a more accurate representation of the fair value of Debtor's actual assets and liabilities at the time of the Transfers.

Debtor's balance sheet showed it was solvent on April 30, 2008, roughly a year before the Transfers.³ The 2008 balance sheet showed assets of \$16,491,400 and liabilities of \$9,111,350, for a net worth of almost \$7,400,000.⁴ But according to Jones' expert report, the Debtor's assets actually were worth no more than \$10,048,252 at a fair valuation, and its liabilities were at least \$12,636,850, so the Debtor's net worth was actually *negative* (\$2,588,598). Jones concluded that the Debtor became insolvent no later than April 30, 2008 and that it remained insolvent continuously thereafter through the filing of its bankruptcy petition, including the period during which the Transfers were made.

The Court finds Jones' report and testimony persuasive because most of the adjustments Jones made were reasonable. For example, he adjusted Accounts Receivable downward from \$581,231 to \$406,862. In reality, this downward adjustment should have been much greater, since nearly this entire balance was eventually written off as uncollectible. Also, Jones' downward adjustment to Depreciable Assets from \$1,930,740 to \$1,214,520 was reasonable because this category consisted primarily of the Debtor's land and building, and real estate values had fallen at that time. In addition, Jones' adjustments removing loans receivable in the

³ Debtor's fiscal year ended on April 30 of each year, and Debtor apparently did not keep its books on a monthly basis, but rather only generated sufficient accounting information to have tax returns prepared. In addition to the fact that Debtor did not keep monthly business records, Jones did not find the Debtor's books to be reliable in at least other several areas: (1) the balance sheet showed almost \$12,300,000 of Debtor's \$13,400,000 of inventory, or about 90%, was consigned outside of the state of Georgia, but there were no records to show where that inventory was, (2) the proofs of claims filed by creditors were not the same amounts as in the Debtor's records, and (3) Debtor did not maintain vendor invoices, only lump sum amounts due to vendors.

⁴ Despite its balance sheet showing it had a net worth of almost \$7,400,00 and supposedly being solvent at this time, about 18 months later, the Debtor was in bankruptcy and the only return unsecured creditors will get will be from recoveries on avoidance actions and even the secured creditors did not realize a full recovery from their collateral. In this Court's experience, it is not uncommon for a Debtor's balance sheet to show solvency or at least substantial value for unsecured creditors at the time a bankruptcy petition is filed, but like this Debtor, the fair value of the assets is lower and the amount of liabilities is higher, such that there is little or no value or return to the unsecured creditors from the assets.

amounts of \$8,363 and \$140,000 from the asset total were reasonable because no evidence seems to exist indicating these were anything more than valueless loans.

Jones' largest asset adjustment—reducing Consigned Inventory Outside Georgia from \$12,286,879 to \$6,608,796—was also reasonable. Jones adjusted this account for three reasons: (1) a physical inventory in February 2010 revealed that the Debtor's inventory was about \$400,000 lower at cost than what its books reflected at that time; (2) the Debtor reported a loss of \$3,654,667 after its inventory was eventually sold on foreclosure, and Jones estimated that at least half this amount—\$1,827,334—was missing, obsolete, or overvalued as of April 2008; and (3) a distribution of rugs from the Debtor to Gavahi reduced the Debtor's inventory by \$3,450,750.

As for the first two components of this adjustment, the Court does not find either to be unreasonable. Although the cost valuation of inventory may be probative of its actual value, it is not necessarily conclusive of what the fair market value of that inventory would be at a later point in time, particularly when the inventory has been unsold for many years. Many factors can influence fair market value downward, some of which were present in this case. For example, basic economic law dictates that if demand for a product goes down while supply remains steady, its fair market value will go down. In other words, a product is only worth what people are willing to pay for it. If fewer people are willing to buy Persian rugs, sellers necessarily must reduce the price of those rugs in order to find more willing buyers. The rugs in the Debtor's inventory were likely overvalued at the time of the Transfers because willing buyers were increasingly scarce at that time. Demand for Persian rugs, like other high-dollar home furnishings, typically falls during a recession and tracks closely with home sales because many people buy those types of items in connection with moving into a home. In 2007, the American

“housing bubble” popped, triggering a recession which began in December 2007 and which continued into 2008 and which led to a massive slowdown in new home purchases. This slowdown no doubt led to a corollary drop in demand for Persian rugs, which suggests that the actual value of the Debtor’s inventory had declined. In addition, it was clear from Gavahi’s testimony that some of this inventory was many years old, which means the demand for it was not there, which would further indicate a lower actual value.

As for the third component of Jones’s downward inventory adjustment—for the amount of the rug distribution to Gavahi—the Court does not entirely agree with Jones’ analysis. Jones asserted that he made this adjustment because these rugs were improperly included as inventory and paid-in capital when initially contributed. But in order to accept this assertion, one must accept Gavahi’s position that the rugs should not have been included in inventory because they belonged to him all along. The Court has found that this position is untenable and that these rugs were property of the Debtor at the time they were distributed to Gavahi. Therefore, it is inappropriate to reduce the Debtor’s inventory by \$3,450,750 to account for this distribution prior to the time it was made. However, after this distribution, the Debtor’s inventory was obviously that much lower as a result. Therefore, although it was inappropriate to suggest that this amount should never have been included in inventory, it is appropriate to reduce the Debtor’s inventory by this amount at the moment this distribution occurred.

In addition to these downward asset adjustments, Jones made several upward adjustments to the Debtor’s liabilities which the Court finds were appropriate. Jones identified numerous loans in the Debtor’s name that were not on its books. Jones adjusted the Debtor’s liabilities upwards to reflect additional loans payable to John LaBarbera, Sherkat Nafis, LLC, Alidad Gavahi, and Gita Gavahi totaling \$3,525,500. Jones also identified other liabilities which should

have been carried on the Debtor's books, such as (1) a \$4,734,234 discrepancy between the amount shown on David Belke's proof of claim (and the promissory note attached thereto) and the amount owed to him according to the Debtor's books, and (2) a \$433,991 discrepancy between J. Thompson's proof of claim and the amount owed to him according to the Debtor's books.

In sum, the Court concludes that the Debtor was insolvent at the time of the Transfers. Other than generally arguing that Jones' conclusions were unreasonable, Kheiri offered no evidence to counter those conclusions. Therefore, the Trustee satisfied his burden in proving this element. And because the Trustee has proven all of the elements of 11 U.S.C. § 548(a)(1)(B), he is entitled to avoid the Transfers and recover them under 11 U.S.C. § 550.

Conclusion

For the reasons stated above, the Trustee may avoid the Transfers pursuant to 11 U.S.C. § 548 and recover the value of the Transfers pursuant to 11 U.S.C. § 550. Accordingly, it is hereby

ORDERED that judgment shall be entered in favor of the Trustee and against Kheiri for \$472,806.00 plus pre-judgment interest from the date of the filing of the Complaint to the date of judgment, plus post-judgment interest as provided by law.⁵

[END OF DOCUMENT]

⁵ The Court has statutory and constitutional authority to enter a final order in this core adversary proceeding. *See* 28 U.S.C. § 157(b)(2)(H) (designating "proceedings to determine, avoid, or recover fraudulent conveyances" as core proceedings); *see also Tyler v. Banks (In re Tyler)*, --- B.R. ---, 2013 WL 2477274 at *4-14 (N.D. Ga. June 6, 2013) (holding that bankruptcy court had constitutional authority to enter final order in fraudulent transfer action). The Court also has authority to enter a final order in this proceeding pursuant to 28 U.S.C. § 157(c)(2) because the parties have consented to the Court doing so. (*See* Compl. [Doc. 1] ¶2, Answer [Doc. 5] ¶2 and Consolidated Pre-Trial Order [Doc. 13] (admitting that this proceeding is core)). In the event that an appellate court were to conclude that this Court does not have the constitutional authority to enter a final judgment in this matter, the Court's findings of fact and conclusions of law should be treated as a Report and Recommendation to the District Court pursuant to Fed. R. Bankr. P. 9033.