

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

AVN CORPORATION,

Case No. 98-20098-L

Debtor.

Chapter 11

**MEMORANDUM OPINION AND ORDER
ON MOTION FOR APPOINTMENT OF TRUSTEE**

Before the Court is Sentinel Trust Company's Motion for Appointment of Chapter 11 Trustee filed April 16, 1998. The Debtor filed a response in opposition to the motion, and the Court conducted a hearing to consider this contested matter on May 18, 1998. For the reasons set forth below, the Court grants the motion for appointment of a Chapter 11 Trustee. The Court has jurisdiction over the motion for appointment of a Chapter 11 trustee pursuant to 28 U.S.C. § 1334(b), and it is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). The following constitutes the Court's findings of fact and conclusions of law in accordance with FED. R. BANKR. P. 7052.

I. FACTS

AVN Corporation ("AVN" or the "Debtor") filed a petition for relief under Chapter 11 of the United States Bankruptcy Code on January 6, 1998. The petition was signed by David Namer as president of AVN. The only creditor listed in the Debtor's schedules was Sentinel Trust Company ("Sentinel"), an indenture trustee for holders of notes issued by the Debtor. Sentinel has filed two proofs of claim against the Debtor. The first is a claim in the amount of \$326,428.35 which is secured by the real and personal property of the Debtor. The second claim, in an amount "in excess of \$6,000,000," is unsecured. The Debtor has objected to both proofs of claim.

The assets of the Debtor consist of an office building located at 1080 West Rex Road and a vacant lot located on 5603 St. Joseph's Fairway, both in Memphis, Shelby County, Tennessee; a bank account in the amount of \$800.00; and "rent performance bonds from Westchester Fire Insurance Company for tenant in default" valued at \$19,000.00.

The only shareholder of the Debtor is the Alexandra Vivian Namer Trust, a trust established by Nissim Russo, the former president of AVN, now deceased. Alexandra Vivian Namer is the nine- year old daughter of David Namer. Mr. Russo was the husband of Grace Russo, the mother of David Namer.

Following an evidentiary hearing on March 13, 1998, the Court granted Sentinel relief from the automatic stay permitting Sentinel to foreclose upon its deed of trust. The Debtor timely filed a notice of appeal on March 23, 1998, however, and the Court granted the Debtor a stay of the order terminating the automatic stay after the Debtor posted a bond in the amount of \$20,000.00.

As grounds for the appointment of a Chapter 11 trustee, Sentinel alleged the following (as numbered in Sentinel's motion):

4. The Debtor, on its Statements and Schedules, failed to list substantial accounts receivable owed to it by Network Mortgage Services and Offshore Insurance Services. Both of these entities are parties related to the Debtor, and share common officers and interests.
5. The only business of the Debtor presently being conducted is the operation of an office building at 1080 West Rex Road. However, the only tenants in that building at present are

entities, owned, controlled or related to David Namer, the President of the Debtor. According to the terms of the Leases entered into between AVN and these tenants, the rent payments became due on April 1, 1998. Absent the appointment of a trustee, these rents will never be collected, or if collected, may be dissipated by the Debtor.

6. Additionally, within the six years prior to the filing of the Bankruptcy Petition, the Debtor has made substantial transfers of assets to insiders, affiliates, and related parties, for little or no consideration in return. For example, upon information and belief, the Debtor has paid in excess of \$100,000.00 for improvements made to the principal residence of David Namer located at 5600 St. Joseph's Fairway, Memphis, Tennessee. This property is in the name of Grace Russo, the mother of David Namer.
7. The present executive officer of the Debtor, David Namer, is unable to carry out the fiduciary obligations required of a Debtor-in-possession due to actual conflicts of interest.
8. Cause exists under 11 U.S.C. § [1]104(a)(1) for the appointment of a Trustee.
9. The appointment of a Trustee is in the interest of creditors, inasmuch as all creditors to this case have joined into the motion for the appointment of a Trustee.

Motion for Appointment of Chapter 11 Trustee, April 16, 1998, pp. 1-2.

The Debtor responded to the allegations of Sentinel denying that cause exists for the appointment of a Chapter 11 trustee. With respect to the first allegation, the Debtor admitted that accounts receivable from Network Mortgage Services and Offshore Insurance Services were omitted from its Schedules and Statement of Financial Affairs, because they were deemed to be uncollectible

and because “[n]either company, if it had assets, could make payments as a result of an injunction brought by acts of Sentinel Trust Company and an asset freeze by the Security Exchange Commission.” Debtor’s Response to Motion for Appointment of Chapter 11 Trustee, May 11, 1998, p. 1.

With respect to the second allegation, the Debtor denied that the only tenants in the Debtor’s office building are “owned, controlled or related to David Namer” and denied that rent payments would be dissipated by the Debtor. The Debtor admitted that payments under the tenant leases were not due until April 1, 1998, and affirmatively stated that April rent had been paid. Mr. Namer testified that AVN has four tenants. AVN collected \$1,000.00 in April from James Kephart as rent for the months of March and April. AVN collected \$1,500.00 from National Mortgage Acceptance Corporation. AVN did not collect any rent from its other tenants. Mr. Namer testified that AVN does not have a debtor in possession account. AVN instructed Mr. Kephart and National Mortgage to send their payments directly to the Hartford Insurance Company for payment of insurance on the building.

Mr. Namer did not know whether lease payments had been made for May by any tenant. Mr. Namer testified that he believed that payments had been made by Mr. Kephart and National Mortgage based upon conversations with these tenants, but Mr. Namer admitted that he had not been in the office of AVN for the prior eight days. AVN has no employees. In connection with questions raised by the Court, Mr. Namer indicated that he uses the office dedicated to AVN at the Debtor’s

office building to conduct a financial consulting business on his own behalf. The Court is not aware of any lease between the Debtor and Mr. Namer.

Sentinel's third ground for the appointment of a Chapter 11 trustee is that AVN made substantial transfers to insiders, affiliates and related parties for little or no consideration in the six years preceding the filing of the Debtor's petition. Specifically, Sentinel alleges that AVN paid for substantial improvements upon a residence occupied by Mr. Namer and owned by his mother, Grace Russo. In response, the Debtor avers that payments other than to Sentinel are irrelevant; that payments made to or for the benefit of Grace Russo were in the form of repayment of loans to the corporation; and that none of the payments were made within one year prior to the filing of the Debtor's petition.

Sentinel presented the testimony of Glen Austin, owner of Austin's Heating and Air Conditioning; Laurie Hansom, head bookkeeper of Graham's Lighting Fixtures; and Sandra Bishop, bookkeeper for Bishop Construction. Each of these companies provided goods or services for an extensive remodeling project at Mr. Namer's residence. Each was paid by checks drawn on "AVN Corp." dated in 1996. Sentinel also introduced documentary evidence of other payments made by AVN for remodeling Mr. Namer's residence. Based upon the exhibits received, more than \$180,000.00 was spent by AVN for goods and services related to Mr. Namer's residence.

Mr. Namer maintains that AVN's only source of income from its inception was rent received from its tenants and that all rent payments were made directly to Sentinel. Mr. Namer testified that

from time to time AVN would issue checks for various purposes and call upon Mr. Russo to make deposits to cover those checks. Thus, Mr. Namer maintains that the checks written by AVN to pay for improvements to his residence do not represent AVN funds.

Sentinel introduced as Exhibit 1 a copy of a computer-generated check register for AVN covering the period July 7, 1994, through March 3, 1997. Mr. Namer admitted that the register had been found among the records of AVN, but that he did not know whether the document was accurate because all supporting documentation is in the possession of the Federal Bureau of Investigation. Exhibit 1 reflects deposits and transfers to AVN for “rent” in the aggregate amount of \$89,400.00 for the covered period. Of this amount, \$51,900.00 appears to have come from “NMS,” or Network Mortgage Services. Another \$26,000.00 came from “OIS” or Offshore Insurance Services. Mr. Namer testified that AVN entered into only one lease upon the acquisition of the property at 1080 West Rex Road, that being with Network Mortgage Services. Mr. Namer testified that that lease called for Network Mortgage Services to pay the expenses of repair and maintenance of the property and make payments to Sentinel Trust pursuant to the Trust Indenture. Other deposits reflected on the register are insignificant. The register appears to have been printed on January 23, 1998, but Mr. Namer claimed not to know who had printed the document from the computer records of AVN. Mr. Namer testified that from time to time AVN received funds from its shareholder, but he could not identify the amount of funds received, other than that he believed the funds were in excess of \$50,000.00. Exhibit 1 reflects no deposits from the Alexandra Vivian Namer Trust. Mr. Namer did

not know whether the funds he believes were received by AVN from the Trust were intended to be a loan to the corporation. The Debtor offered no other evidence of loans made to AVN.

Mr. Namer claimed not to know how the checks drawn on the account of AVN were prepared, whether typed or generated by computer, although he admitted signing a number of the checks that were introduced into evidence. Mr. Namer testified that Jody Reaves was in charge of the bookkeeping for AVN during 1996. Mr. Namer claimed that he did not necessarily ascertain whether there was a corporate purpose for the checks he signed on behalf of AVN. Mr. Namer was not certain whether he was president of AVN in 1996. Mr. Namer could not confirm or deny that there were a number of transfers to AVN from Network Mortgage Services during 1996, claiming that he could only rely on the documents in the possession of the FBI to answer. Mr. Namer could not identify the banking records of AVN. Mr. Namer testified that Mr. Russo died in May 1996, leaving written instructions for AVN. Mr. Namer could not explain whether transfers made to AVN from Network Mortgage Services after the death of Mr. Russo were made pursuant to Mr. Russo's instructions or pursuant to his own instructions. In response to questions by Sentinel's counsel, Mr. Namer claimed that he did not believe that AVN borrowed \$250,000.00 in 1996, but that he would "not particularly" know whether AVN received \$250,000.00 in 1996.

Sentinel's fourth ground for the appointment of a trustee is that Mr. Namer cannot carry out the fiduciary responsibilities of the debtor in possession because of conflicts of interest. In addition to conflicts of interest arising from Mr. Namer's operation of a financial consulting business from

the office of the Debtor, and Mr. Namer's occupation of the residence that was substantially improved by payments drawn on the account of AVN, a conflict of interest also arises from Mr. Namer's relationship to the prior tenants of AVN. Mr. Namer refused to answer questions concerning his relationship to Network Mortgage Services on the basis of his privilege against self-incrimination.¹ Mr. Namer did testify that Mr. Russo, his mother's late husband, was the owner and president of NMS before his death. Network Mortgage Services was admittedly the lessee under the only lease that AVN entered into immediately after acquiring the property at 1080 West Rex Road. Network Mortgage Services admittedly defaulted in payment of rent. Pursuant to the Trust Indenture, AVN was required to obtain certain "Performance of Lease Bonds" to secure the performance of AVN's tenants. The Debtor and Mr. Namer maintain that Sentinel is the only party that has the right, duty and obligation to make a claim against the bond for the default of Network Mortgage Services. Neither the Debtor nor Sentinel has made a claim. The Debtor lists the value of the potential claim as \$19,000.00.

Sentinel's fifth ground for the appointment of a trustee is that the appointment of a trustee is in the best interest of creditors as all creditors have joined in the motion. There has been one additional proof of claim filed in this case on behalf of the City of Memphis for personal property taxes in the amount of \$43.19. Otherwise, Sentinel's statement is substantially correct. Sentinel is

¹ According to the Supreme Court, the Fifth Amendment "does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them." *Baxter v. Palmigiano*, 425 U.S. 308, 318, 96 S. Ct. 1551, 1558 (1976).

in effect the only creditor of the Debtor, and Sentinel has agreed to provide initial funds for the compensation of a trustee if appointed. Sentinel seeks the appointment of a trustee rather than the dismissal of this case because it wishes to preserve certain causes of action that are available only to a trustee or debtor in possession.

II. DISCUSSION

Bankruptcy Code Section 1104 controls the appointment of a trustee in a Chapter 11 case. It provides:

(a) At any time after the commencement of a case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee—

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a). For purposes of the Bankruptcy Code, the term “including” is not limiting, 11 U.S.C. § 102(3), thus the factors listed in subsection (a)(1) are not exhaustive, but merely illustrative. Appointment of a trustee in a Chapter 11 case should be the exception. *See In re Sharon Steel Corp.*, 871 F.2d 1217, 1225 (3rd Cir. 1989) (citing, among other sources, H.R. Rep. No. 595, 95th Cong., 1st Sess. 233 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787,

5963, 6192, which states: “[V]ery often the creditors will be benefitted by continuation of the debtor-in-possession, both because the expense of a trustee will not be required, and the debtor, who is familiar with his business, will be better able to operate it during the reorganization case.”). The movant must prove the need of a trustee by clear and convincing evidence. *See Sharon Steel*, 871 F.2d at 1226.

The Debtor maintains that Sentinel has failed to demonstrate cause for the appointment of a trustee. The Debtor admits that checks drawn on the account of AVN were used for the personal benefit of Mr. Namer, but asserts that this fact does not constitute cause for the appointment of a trustee because (1) the transfers occurred more than one year prior to the filing of the Debtor’s petition; (2) Sentinel has failed to demonstrate that the funds used were AVN funds; and (3) the transfers caused no harm to AVN, but rather benefitted the Debtor’s shareholder, a trust established for the benefit of Alexandra Vivian Namer who lived in the residence improved by the transfers.

The fact that the subject transfers occurred more than one year prior to the filing of the Debtor’s petition is irrelevant to the Court’s determination. Pursuant to section 544(b):

[T]he trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of [title 11] or that is not allowable only under section 502(e) of [title 11].

11 U.S.C. § 544(b). One of the causes of action available to a bankruptcy trustee pursuant to this section is to recover fraudulent conveyances. A trustee is not limited to the federal bankruptcy law

with respect to fraudulent conveyances made within one year of the filing of a petition.² *See, e.g.,*

² See 11 U.S.C. § 548(a) which provides:

The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

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

(B)(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; or

(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.

Belfance v. Bushey (In re Bushey), 210 B.R. 95, 99 (6th Cir. BAP 1997) (Concerning a trustee's action under 11 U.S.C. § 544(b) to avoid the transfer of property as a fraudulent conveyance under Ohio law).

Pursuant to Tennessee law, certain conveyances made without fair consideration are deemed to be fraudulent without regard to the intent of the transferor. *See* TENN. CODE ANN. §§ 66-3-305, 66-3-306 and 66-3-307. A creditor of the transferor may have the conveyance set aside, or disregard the conveyance and attach or levy execution on the property in the hands of the transferee, so long as the transferee is not a purchaser for fair consideration without knowledge of the fraud. *See* TENN. CODE ANN. § 66-3-310. An action to recover personal property fraudulently transferred must be commenced within three years. *See* TENN. CODE ANN. § 28-3-105; 13 TENN. JURIS. *Fraudulent and Voluntary Conveyances* § 47, n.9 (1997). An action to recover the value of personal property fraudulently conveyed, but not the property itself, must be brought within six years. *See* TENN. CODE ANN. § 28-3-109; 13 TENN. JURIS. *Fraudulent and Voluntary Conveyances* § 47, n.10 (1997). The limitation begins to run when the creditor has a right of action to test the validity of the conveyance. *See* TENN. CODE ANN. § 29-12-106. The Debtor's argument that the Court should

11 U.S.C. § 548(a).

disregard the remodeling of Mr. Namer's residence because payments for that purpose were made more than one year prior to the filing of the Debtor's petition must fail.

The Debtor next argues that the Court should disregard payments made by AVN for the benefit of Mr. Namer and his family because Sentinel failed to prove that the payments were made from AVN funds. The Debtor asserts, through the testimony of Mr. Namer, that Mr. Russo made deposits to AVN's checking account to cover the checks written to suppliers of goods and services for Mr. Namer's residence. The only deposits reflected on AVN's check register are deposits or transfers for "rent," primarily from Network Mortgage Services. There are no deposits reflected coming directly from Mr. or Mrs. Russo or from the Alexandra Vivian Namer Trust. Mr. Namer testified that the AVN check register could not be relied upon, but offered no rebuttal proof in the form of bank or any other records. Even if Mr. Namer had been able to demonstrate that Mr. Russo's funds were deposited to the AVN account, the Debtor's argument would probably fail. Once funds were deposited to the account of AVN, AVN exercised control over those funds. The Court presumes that funds over which AVN exercised control were property of AVN. The burden is upon AVN to prove otherwise.

Finally, the Debtor argues that the Court should disregard the payments made by AVN for the benefit of Mr. Namer because the payments actually benefitted the shareholder of AVN. The sole shareholder of AVN is a trust established for the benefit of Mr. Namer's minor daughter. Mr. Namer reasons that because his daughter lives in the residence owned by Mrs. Russo, the payments

by AVN were proper. In an action to recover a fraudulent conveyance under Tennessee law, the question is whether the transferor received “fair consideration,” not whether the transferor received the sort of intangible benefit described by Mr. Namer. “Fair consideration” is defined for purposes of the Tennessee fraudulent conveyance statutes as follows:

Fair consideration is given for property, or obligation:

- (1) When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied; or
- (2) When such property or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property or obligation obtained.

TENN. CODE ANN. § 66-3-303. The Debtor failed to demonstrate that AVN received fair consideration for transfers made to improve Mr. Namer’s residence.

The Court will not disregard the transfers by AVN for the benefit of Mr. Namer and his family in determining whether to appoint a trustee in this Chapter 11 case. Indeed, these transfers, and the attempts by Mr. Namer to shield them from scrutiny, demonstrate that Mr. Namer has an actual conflict of interest in performing the duties of the president of AVN as debtor in possession.

A debtor in possession enjoys substantially all the rights and powers and performs substantially all the duties of a trustee. 11 U.S.C. § 1107. The debtor in possession is a fiduciary for the creditors, and the primary job of the debtor in possession is to get the creditors paid. *See In re Grayson Robinson Stores, Inc. v. Securities and Exchange Commission*, 320 F.2d 940, 949 (2d Cir.

1963); *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990); *In re Pied Piper Casuals, Inc.*, 40 B.R. 723, 727 (Bankr. S.D.N.Y. 1984). When a debtor in possession is incapable of performing its fiduciary duties, a Chapter 11 trustee may be appointed. *Ionosphere Clubs*, 113 B.R. at 164 (citing *In re McCorhill Publishing, Inc.*, 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987)).

AVN is a closely held corporation, controlled, so far as this Court can determine, by Mr. Namer. Mr. Namer is incapable of objectively evaluating whether the debtor in possession should pursue causes of action against related parties such as Grace Russo, Network Mortgage Services, and Mr. Namer himself. Mr. Namer's testimony clearly demonstrated that his decisions are based upon only one factor, his own self interest. Prior to the filing of the Chapter 11 petition, Mr. Namer repeatedly disregarded the corporate separateness of AVN. Mr. Namer claims now to have little knowledge of the financial affairs of AVN. The Court found Mr. Namer's memory to be selective and his answers evasive. Sentinel understandably has no confidence in the current management of the Debtor. Further, the Court is aware that Sentinel is itself a fiduciary for the Debtor's noteholders, and Sentinel is pursuing all avenues of recovery on their behalf. Understanding the costs involved in having a trustee appointed, Sentinel has agreed to provide "seed money" in an as yet undetermined amount to permit a trustee to further investigate and pursue causes of action available to the estate.

This Court has already determined that cause exists for granting Sentinel relief from the automatic stay. AVN has chosen to appeal. While AVN pursues its appeal from the Court's prior

order, the interests of the Debtor's noteholders cannot be adequately protected so long as Mr. Namer remains in control of AVN.

IV. CONCLUSION

The Court concludes that Sentinel has carried its burden to demonstrate that cause exists for the appointment of a trustee and that such appointment is in the interest of AVN's creditor. The United States Trustee is ORDERED to appoint a qualified person to serve as trustee for AVN as quickly as possible. Upon request, the Court will conduct an additional hearing concerning the amount and terms of the contribution to be made by Sentinel for this purpose.

BY THE COURT

JENNIE D. LATTA
United States Bankruptcy Judge

Date: May 29, 1998

cc: AVN Corporation
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All Creditors and Interested Parties