UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

In re

Case No. 6:03-bk-00299-KSJ
Chapter 11
ADVANCED TELECOMMUNICATION NETWORK, INC.,

Debtor.
_____/

ADVANCED TELECOMMUNICATION NETWORK, INC.,

Plaintiff,

vs.

Adversary No. 6:03-ap-122

DANIEL W. ALLEN,
DAVID D. ALLEN,

Defendants.
_____/

SUPPLEMENTAL
MEMORANDUM OPINION

Advanced Telecommunication Network, Inc. ("ATN"), the debtor in this Chapter 11 case and plaintiff in this adversary proceeding, seeks to avoid transfers of $6,250,000 made to Daniel and David Allen, the defendants and former owners of the debtor (Doc. No. 163). After a multi-day trial, this Court entered a judgment in favor of the defendants finding that no avoidable transfer occurred and the District Court affirmed this decision[1] (Doc. Nos. 257, 258, and 318). On further appeal, the United States Court of Appeals for the Eleventh Circuit (the "Appellate Court") reversed in part and remanded in part requiring this Court to reconsider whether ATN was solvent at the time of the transfers (Doc. No. 330).

The parties each submitted a motion to frame the remanded issues. The Allens filed a Motion for Clarification asking this Court to make additional factual findings supporting the prior conclusion that ATN was solvent when the transfers occurred and to reenter a judgment in their favor finding that the transfers are not avoidable (Doc. No. 333). ATN filed a Motion for Entry of Judgment on Remand in which ATN argues that it is entitled to a judgment in its favor on only two counts, Counts 2 and 6, which assert fraudulent transfer claims under Sections 25:2-27(a) and 25:2-25(b) of the New Jersey Statutes (Doc. No. 348). Neither party wanted to reopen the evidence.

Count 6 – New Jersey Statute 25:2-25(b)(2)

In Count 6, ATN seeks to avoid the $6,250,000 transfers to the Allens under Section 25:2-25(b)(2) of the New Jersey Statutes, which provides that a transfer is fraudulent "if the debtor made the transfer… *without receiving a reasonably equivalent value* in exchange for the transfer… and the debtor… [i]ntended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they become due." (Emphasis added.) On appeal, the Appellate Court held, contrary to the prior ruling of this Court, that ATN did not receive reasonably equivalent value in exchange for the transfers to the Allens.[2] As such, in order

[1] All definitions used in this Court's earlier Findings of Fact and Conclusions of Law (Doc. No. 258) shall have the same meaning in this Memorandum Opinion.

[2] The Appellate Court explicitly stated, "It is clear from the record that ATN received nothing in return at the actual time of the transfer, other than the (arguable) value of the cessation of Allen and Carpenter's litigation." (Doc. No. 330, p. 21). Further, as to the possible value of Carpenter's promissory notes, the Appellate Court stated, "[T]hey do not present a 'reasonably equivalent

to successfully avoid the transfers under this statute, ATN must only demonstrate that, at the time of the transfers, it was not paying its bills as they became due.

Both this Court and the Appellate Court concluded that, when ATN made the transfers to the Allens, it was not paying its debts as they became due. From the date ATN signed the settlement agreement with the Allens, December 23, 1998, through the date ATN paid the Allens $6 million, June 1, 1999,[3] the company purposefully hoarded cash to pay the Allens. ATN was not paying its regular bills on a timely basis. ATN had to gather over $7.8 million to pay everyone under the settlement agreement. As Phil Kreiger, ATN's Chief Financial Officer, noted in an e-mail to several ATN employees on May 20, 1999: "We will need a substantial portion if not all of the funds that ATN currently has in order to meet the 6/1 payment. We hopefully will have a line of credit in place by that time, but it will not cover the full 6 million." (Plaintiff's Ex. No. 25). ATN had only $453 in its checking account on the final transfer date of June 1, 1999. ATN used substantial prepaid deposits made by other customers and was not paying its regular bills in order to pay the Allens. As the Appellate Court acknowledged, "ATN's landlord and insurance carrier were threatening to terminate their agreements with the company, and other vendors were threatening to withhold services." (Doc. No. 330, pp. 12-13). Without question, at the time of the transfers to the Allens, ATN incurred debts beyond its ability to pay as they became due.

With the Appellate Court's finding that ATN received no reasonably equivalent value in exchange for the transfers to the Allens, combined with the universal conclusion that ATN had incurred debts beyond its ability to pay on a timely basis, this Court is required, under Section 25:2-25(b) of the New Jersey Statutes, to conclude that the transfers totaling $6,250,000 paid to the Allens on January 12 and June 1, 1999, were avoidable fraudulent transfers. As such, an Amended Final Judgment shall be entered in favor of the plaintiff and against the defendants on Count 6 of the Amended Complaint.

Count 2 – New Jersey Statute 25:2-27(a)

In Count 2, ATN seeks to avoid the transfers to the Allens under Section 25:2-27(a) of the New Jersey Statutes, which provides that a transfer is fraudulent "if the debtor made the transfer…without receiving a reasonably equivalent value in exchange for the transfer…and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer."

Because of the Appellate Court's conclusion that ATN failed to receive reasonably equivalent value for its payment of $6,250,000 to the Allens, the remaining issue then is whether ATN was legally (balance sheet) insolvent at the time of the transfers. Under applicable New Jersey law, a debtor is insolvent if "the sum of the debtor's debts is greater than all of the assets, at fair valuation." N.J. Stat. Ann. § 25:2-23(a). Further, the New Jersey statute provides that a debtor is presumptively insolvent if the debtor "is generally not paying his debts as they become due." N.J. Stat. Ann. § 25:2-23(b). At the time the questionable transfers occurred, ATN clearly was not paying its debts as they became due. Therefore, ATN was presumptively insolvent unless the Allens can demonstrate that the company's assets were greater than its outstanding debts.

Previously, this Court held that ATN remained solvent using a balance sheet analysis, even though ATN clearly was not paying its debts as they became due at the time of the questionable transfers. The Appellate Court remanded the insolvency issue instructing this Court to make additional factual findings in connection with this Court's previous valuation of: (1) ATN's loans of $4.5 million made to Gary Carpenter, previously valued at $4.5 million, (2) ATN's Customer Lists, previously valued at a range of between $5.2 million and $7.4 million, and (3) ATN's contingent liability involved in the WATS litigation, previously valued at zero. Each of these three items was an adjustment to ATN's audited financial statements, which both parties stipulated were accurate and which reflected a slight negative net worth of ($216,144).

First, the Appellate Court directed this Court to reassess the value of the shareholder loans[4] made by ATN to Gary Carpenter, and, in this reassessment, to ignore the value of ATN's stock in determining the ability of Mr. Carpenter to repay the loans.[5] The Appellate Court focused on four factors: (1) the notes were not readily

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value' to the $6 million transfer to the Allens." (Doc. No. 330, p. 22). As such, this Court must conclude ATN did not receive reasonably equivalent value in exchange for the payment to the Allens.

[3] ATN also had paid the Allens $250,000 under the settlement agreement on January 12, 1999.

[4] Carpenter's loans from ATN totaled approximately $4.5 million on December 31, 1998, and later, on June 30, 1999, increased to approximately $10.7 million as a result of the payments made under the settlement agreement with the Allens. The later "loans" enabled Carpenter to "purchase" the Allens' stock in ATN.

[5] The Appellate Court actually held that the "upward adjustment [for Carpenter's shareholder loans] was erroneous as a matter of law." (Doc. No. 330, p. 13).

susceptible to liquidation; (2) the notes were not due for ten years, a distant horizon in the telecommunications field; (3) Carpenter's precarious financial situation at the time he obtained the loans and his probable negative net worth (assuming the value of ATN stock is not included); and (4) Carpenter's lack of any independent source of income or assets to repay the notes.

During January through June 1, 1999, Carpenter's entire net worth was completely subsumed in the value of ATN. Gary Carpenter worked for years to build up ATN and increase its value. If the company had succeeded, he could repay the loans by selling his stock. If the company failed, as it later did, he could not. By excluding consideration of the value of Carpenter's ownership interest in ATN, as directed by the Appellate Court, he lacked any other way to pay the notes. Carpenter's promissory notes to ATN, therefore, are valued at zero.

Second, the Appellate Court directed this Court to make a more precise determination of the value of ATN's customer list. Both parties' experts opined that an upward adjustment for ATN's customer list was merited, although they disagreed on the amount of the required adjustment. ATN's expert valued the customer list at as low as $4,655,000 and as high as $7,430,000. (Plaintiff's Exh. No. 41). ATN's expert opined that a midpoint value of $5.2 million was appropriate. The Allens' expert testified that the value of the customer list could reach a value as high as $10,827,967. (Defendants' Exh. No. 17). After rejecting the testimony of the Allens' expert as to the valuation of the customer list, the Court accepts the opinion of ATN's expert. Upon remand, the Court would find that, if a more precise number is needed, the best number is the mid-point used by Cuthill, ATN's expert, of $5.2 million.

Third, the Appellate Court instructed this Court to reassess the value of ATN's potential debt to WATS under a lawsuit WATS filed against ATN in October, 1995, almost four years before ATN made the transfers in question to the Allens in January ($250,000) and June ($6,000,000), 1999. The law suit ultimately was settled when two consent judgments totaling $10.5 million were entered against ATN on October 19, 2000, five years after the lawsuit was filed and almost two years after ATN's settlement with the Allens.

Both ATN and the Allens assert good reasons why, as of June 1999, this Court should value ATN's contingent liability to WATS either at $10.5 million (according to ATN), or at zero (according to the Allens). ATN highlights the fact that WATS sought $39 million in damages and that, on September 30, 1999, approximately three months after the $6 million transfer to the Allens, the court presiding over the WATS' litigation partially denied[6] ATN's motion for summary judgment finding that material factual disputes existed and that a reasonable fact finder could find fraudulent conduct by ATN. (Defendants' Trial Exh. Nos. 33 (p.32); 47, and 230 (p.107)). The plaintiff also points to the $10.5 million consent judgments entered in October 2000.

Conversely, the Allens argue that the Court should value ATN's contingent liability to WATS at zero, for purposes of determining solvency in June 1999. The Allens correctly note that, although ATN listed other contingent liabilities[7] arising from lawsuits in its audited financial statements for the years ending December 31, 1997 and 1998, ATN failed to list the WATS litigation as a potential contingent liability. (Defendants' Exh. No. 73). ATN's accountants, in a letter dated December 16, 1999, opined that the financial statements were "free of material misstatement" and accurately presented the current financial condition of ATN "in all material respects…in conformity with generally accepted accounting principles." (Defendants' Exh. No. 73). In determining whether to list a contingent liability, the Statement of Financial Accounting Standard No. 5 requires an auditor to disclose a contingent liability, such as threatened or pending litigation, "when there is at least a reasonable possibility[8] that a loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." FAS5-3(4)(e). Therefore, in 1997 and 1998, years after the WATS litigation was filed, ATN's professional certified public accountants, applying generally accepted accounting principles, determined that the WATS lawsuit did not merit mention in ATN's financial statements for 1997 and 1998, even though other contingent claims were noted. As such, in 1997 and 1998, professional auditors concluded that ATN's liability, if any, to WATS was remote and unlikely.

At worst, the Allens contend that, as of June 1999, ATN's contingent liability to WATS cannot exceed $2 million. In January 1998, WATS offered to settle the pending litigation for $2 million. ATN's attorneys, in

[6] Significantly, the same court also granted the majority of ATN's motion for summary judgment in connection with other counts WATS alleged against ATN.

[7] For example, in Note 16 of ATN's audited financial statements, ATN's auditors disclosed a claim held by GE Capital Communication Services Corporation against ATN.

[8] "Reasonably possible" is further defined as the circumstance where "[t]he chance of the future event or events occurring is more than remote but less than likely."

evaluating this settlement offer, admittedly indicated that ATN faced significant exposure in the litigation, which could include the assessment of punitive damages. ATN, however, regarded the risk at less and declined to accept the settlement with WATS. As such, ATN's officers clearly believed that they owed WATS less than $2 million in January 1998.

In evaluating these two contrary positions as to whether, in June 1999, ATN should have reflected a contingent liability to WATS at zero, $2 million, $10.5 million, $39 million, or some other amount, the Court notes that, under applicable New Jersey law, the operative issue is whether the debtor was insolvent *at the time of the transfer* or became insolvent *as a result of the transfer*. N.J. Stat. Ann. § 25:2-27(a). (Emphasis added.) ATN's knowledge at the transfer date, June 1999, is the key, and this Court must assess what ATN knew in June 1999, not two years later when Carpenter gave up the company and signed the $10.5 million consent judgments. As the Eleventh Circuit noted in endorsing the Seventh Circuit's approach to valuing contingent liabilities, articulated in In re Xonics Photochemical, 841 F.2d 198, 200 (7th Cir. 1988): "[A] contingent liability is not certain—and often is highly unlikely—ever to become an actual liability. To value the contingent liability it is necessary to discount it by the probability that the contingency will occur and the liability will become real."

After weighing all of the contrary arguments, the Court concludes that, in June 1999, at the time the $6 million was paid to the Allens, ATN knew WATS had asserted a claim for $39 million in 1995. ATN's accountants regarded the likelihood ATN would incur any actual liability as remote and failed to list the contingent liability in the company's 1997 or 1998 audited financial statements. The court administering the litigation had not yet rendered any decision on ATN's motion for summary judgment, so no judicial opinion was known at the time of ATN's settlement with the Allens.

ATN, however, did know that WATS agreed to settle its claim for $2 million a year earlier. ATN rejected WATS settlement offer after considering the advice of its attorney. Therefore, ATN clearly valued its exposure in the WATS litigation at less than $2 million in June 1999. The question is how much less? Is a 50 percent reduction appropriate? Is a greater discount merited? Were ATN's auditors correct in concluding that the likelihood of WATS' assertions materializing into a valid actual claim so remote as to be immaterial? After reviewing the evidence, the Court concludes that a 50 percent reduction from the settlement offer of $2 million is appropriate to discount the likelihood that the contingent liability would materialize into actual liability. Therefore, the Court values ATN's contingent exposure to liability arising from the WATS litigation at $1 million as of June 1999.

In the end, however, the Court queries whether any of these adjustments are relevant. Once the Appellate Court concluded that ATN received no reasonably equivalent value in exchange for the transfers to the Allens and directed the Court to ignore the value of ATN's stock in determining the value of the Carpenter notes, ATN clearly was insolvent or was made insolvent by the transfers to the Allens in June 1999 as follows:

Starting Point	($216,144.00)
Adjustment No. 1 – Carpenter Notes are Worthless	0.00
Adjustment No. 2 – Value of ATN's Customer List	5,200,000.00
Adjustment No. 3 – Contingent WATS Claim	(1,000,000.00)
Sub-Total	$3,983,856.00
Transfer to the Allens – June 1, 1999	(6,000,000.00)
ATN's Net Worth – June 1999	(2,016,144.00)

Under this revised analysis required by the Appellate Court's decision on remand, ATN was insolvent by at least $2 million on the date the Allens were paid in June 1999. Under Section 25:2-27(a) of the New Jersey Statutes, ATN made transfers of $6,250,000 to the Allens for no reasonably equivalent value and either already was insolvent or was rendered insolvent as a result of the transfers. The transfers to the Allens are avoidable as fraudulent transfers under Count 2 of the Amended Complaint. An Amended Final Judgment shall be entered in favor of the plaintiff and against the defendants on Count 2 of the Amended Complaint.

DONE AND ORDERED in Orlando, Florida, on July 10, 2009.

/s/ Karen S. Jennemann
KAREN S. JENNEMANN
United States Bankruptcy Judge

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