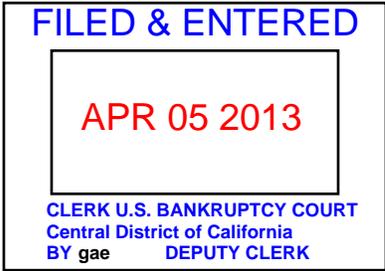


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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

In re:
GSM WIRELESS, INC.,
a California corporation,
Debtor.
GSM WIRELESS, INC.,
Plaintiff,
vs.
MOHAMMAD HONARKAR,
Defendant.
GSM WIRELESS, INC.,
Plaintiff,
vs.
JOSEPH FERNANDEZ DE CASTRO, an
individual, and DOES 1 THROUGH 10
Defendants.
MOHAMMAD HONARKAR,
Cross-Complainant,
vs.

Case No. 2:12-bk-16456 RK
Chapter 11
Adv. No. 2:12-ap-01350 RK

MEMORANDUM DECISION ON
TRUSTEE'S ADVERSARY COMPLAINTS
AGAINST DEFENDANTS MOHAMMAD
HONARKAR AND JOSEPH FERNANDEZ
DE CASTRO AND ON DEFENDANTS'
CROSS-CLAIMS FOR INDEMNITY AND
CONTRIBUTION

1 JOSEPH FERNANDEZ DE CASTRO, an
2 individual, and DOES 1 through 20,
3
4 Cross-Defendants.

5 **PROCEDURAL HISTORY**

6 On October 21, 2005, the Official Committee of Creditors Holding Unsecured
7 Claims of GSM Wireless, Inc. ("the Committee") commenced Adversary Proceeding No.
8 8:05-ap-01530 JR by filing a complaint against Defendant Mohammad Honarkar
9 ("Honarkar"). Later, GSM Wireless, Inc. ("GSM"), the Debtor, as successor-in-interest to
10 the Committee, became the lead plaintiff in the adversary proceeding, and Steven Speier,
11 the appointed Chapter 11 trustee is the representative of the GSM bankruptcy estate.

12 On February 22, 2008, GSM Wireless, Inc. ("GSM") by the Chapter 11 Trustee
13 commenced Adversary Proceeding No. 8:08-ap-01042-RK by filing a complaint against
14 Defendant Joseph Fernandez de Castro ("Fernandez de Castro"). Although the captions
15 of the adversary proceedings list GSM as the plaintiff, the adversary proceedings are
16 being prosecuted by the Chapter 11 Trustee ("Trustee") on behalf of the GSM bankruptcy
17 estate. To avoid any confusion between prepetition and postpetition activities in this
18 memorandum decision, the court refers to GSM as the prepetition debtor and to Trustee
19 as the party litigating the adversary proceedings on behalf of the bankruptcy estate.

20 On June 17, 2010, the court issued an order which consolidated for trial purposes
21 *GSM Wireless, Inc. v. Joseph Fernandez de Castro*, Adversary Proceeding Case No:
22 8:08-ap-01042 with *The Official Committee Of Creditors et al v. Honarkar*, Adversary
23 Proceeding Case No: 8:05-ap-01530-RK, such that the earlier-filed action, 8:05-ap-
24 01530-RK became the lead case.¹ The court will note because of the multiple case
25 numbers, the pleadings and orders as well as transcripts relevant to this memorandum

26
27 ¹ The case was subsequently reassigned Case No. 2:12-ap-01350-RK when the underlying bankruptcy
28 case and the consolidated adversary proceedings were transferred to the Los Angeles Division on or
about February 17, 2012.

1 decision are not filed under one case number, but may be filed under different case
2 numbers depending on how the document was submitted to, and processed by, the
3 court.

4 The operative pleading in this consolidated adversary action against defendant
5 Honarker is the First Amended Complaint: (1) For Unjust Enrichment; (2) For An
6 Accounting; (3) For Conversion; (4) For Breach of The Duty of Loyalty; (5) For
7 Rescission Pursuant to California Corporations Code § 310; (6) For Rescission Of Loan
8 Pursuant to California Corporations Code § 315; (7) For Breach Of Fiduciary Duty
9 Pursuant to California Corporations Code §§ 309 and 316; (8) For Breach Of Common
10 Law Fiduciary Duty; (9) For Aiding and Abetting Breach of Fiduciary Duty; (10) For
11 Fraudulent Transfer under Cal. Civ. Code § 3439.04(a)(1) and 11 U.S.C. §§ 544 and 550
12 (11) For Fraudulent Transfer under Cal. Civ. Code § 3439.04(a)(2) and 11 U.S.C. §§ 544
13 and 550; (12) To Avoid Preferential Transfers; (13) To Recover Post-Petition Transfers;
14 (14) to Recover Avoided Transfers for the Benefit of the Estate pursuant to 11 U.S.C. §
15 551; (15) For Turnover Of Property Of The Estate; (16) For Common Counts; (17) For
16 Declaratory Relief; (18) For Objections to Claims (“First Amended Complaint against
17 Honarker”). GSM’s Notice of Motion and Motion for Leave to File First Amended
18 Complaint. Etc., filed on February 6, 2009; Order re: GSM’s Motion for Leave to File First
19 Amended Complaint, entered on May 8, 2009. Honarker filed and served an answer to
20 GSM’s first amended complaint on March 31, 2009 and a third-party complaint for
21 indemnity against Fernandez de Castro.

22 The operative pleading in this consolidated adversary action against defendant
23 Fernandez de Castro is the Second Amended Complaint : (1) For Unjust Enrichment; (2)
24 For an Accounting; (3) For Conversion; (4) For Breach of the Legal Duty of Loyalty; (5)
25 To Avoid and Recover Intentional Fraudulent Transfers Pursuant to 11 U.S.C. § 544,
26 California Civil Code § 3439 *et seq.*, and 11 U.S.C. § 550; (6) To Avoid and Recover
27 Constructive Fraudulent Transfers Pursuant to 11 U.S.C. § 544, California Civil Code §
28 3439 *et seq.*, and 11 U.S.C. § 550; (7) To Preserve Avoidable Transfers for the Benefit of

1 the Estate pursuant to 11 U.S.C. § 551; (8) For Breach of Fiduciary Duty; (9) For
2 Rescission Pursuant to California Corporations Code § 310 and/or Common Law; (10)
3 For Aiding and Abetting Breach of Fiduciary Duty; and (11) For Common Counts
4 (“Second Amended Complaint against Fernandez de Castro”). GSM’s Motion for Leave
5 to File Second Amended Complaint, etc., filed on October 30, 2008, as modified by
6 GSM’s Notice of Refiling Second Amended Complaint, filed on May 7, 2010; Notice of
7 Ruling, filed on November 6, 2008. On February 25, 2009, Fernandez de Castro filed
8 and served an answer to the second amended complaint as well as a counterclaim and
9 cross-claim against GSM and a third-party complaint against Honarkar.

10 The claims in the complaints against Honarkar and Fernandez de Castro are
11 substantially similar, if not identical.

12 The trial in this consolidated adversary proceeding was conducted before the
13 undersigned United States Bankruptcy Judge on April 22, 2010, April 28, 2010, April 29,
14 2010, June 28, 2010, and August 2, 2010.

15 John C. O’Malley and Lisa A. Wegner, of the law firm of Eagan O’Malley &
16 Avenatti, LLP, appeared as special litigation counsel for the GSM bankruptcy estate and
17 Trustee. H. Daniel Fuller and Gabriel K. Coy of the law firm of Cadden & Fuller, LLP,
18 appeared for Defendant Honarkar. Stephen Abraham, of the Law Offices of Stephen
19 Abraham, appeared for Defendant Fernandez de Castro.

20 On August 2, 2010, after closing arguments, the court took this matter under
21 submission. Having considered the testimony of the witnesses and the other evidence
22 admitted at trial and the oral and written arguments of the parties, the court hereby issues
23 this memorandum decision setting forth its findings of fact and conclusions of law.

24 **FACTS**

25 The parties were not able to agree on most of the facts in this consolidated
26 adversary proceeding as reflected in the joint pretrial order, which necessitated the trial of
27 this matter. The few facts, three in number, that the parties were able to agree upon in
28 the joint pretrial order were: (1) GSM was formed in or about 1998 by Defendants

1 Honarkar and Fernandez de Castro, *Joint Pretrial Order*, filed on June 9, 2010, Fact No.
2 1; (2) Honarkar and Fernandez de Castro each owned 50% of the 100,000 issued shares
3 of stock in GSM, *Joint Pretrial Order*, Fact No. 2; and (3) Fernandez de Castro was
4 GSM's President prior to his departure. *Joint Pretrial Order*, Fact No. 3. The remaining
5 list of 114 factual allegations and of 100 disputed legal conclusions submitted by the
6 parties to be resolved at trial were set out in the Joint Pretrial Order. *Joint Pretrial Order*,
7 Facts Not Admitted by One or More Parties and Are Subject to Proof, Nos. 4-102, and
8 Disputed Issues of Fact, Nos. 103-117, and Conclusions of Law (Claims and Defenses)
9 Remaining to be Litigated, Nos. 118-217.

10 Based on the evidence received at trial, the court makes the following findings of
11 fact.

12 GSM was initially an authorized agent of Pacific Bell Wireless selling wireless
13 services, mobile phones and accessories on behalf of Pacific Bell. *Direct Examination*
14 *Testimony of Defendant Mohammad Honarkar Submitted Pursuant to Declaration by*
15 *Defendant Mohammad Honarkar ("Honarkar Direct Examination Declaration")*, filed on
16 April 2, 2010, at 2:8-11, 17. Honarkar and Fernandez de Castro started GSM in 1998
17 with two stores, one of which was run from the back of Honarkar's retail clothing business
18 at the time. *Id.* at 2:8-10; *Joint Pretrial Order*, Fact No. 1. GSM was incorporated as a
19 California corporation on March 11, 1998. *Trial Exhibit B, Articles of Incorporation of*
20 *GSM Wireless, Inc.*; see also, *Trial Exhibit D, By-Laws and Related Corporate*
21 *Documents of GSM Wireless, Inc.*² After a series of mergers and deals in the wireless
22 telephone industry, GSM eventually became an exclusive authorized agent of Cingular
23 Wireless II, LLC ("Cingular"). *Honarkar Direct Examination Declaration* at 2:17-19. By
24 2002, GSM (with its Spanish language subsidiary, Enlace Wireless) had rapidly grown to
25 be one of Cingular's top agents with more than 150 locations (stores and kiosks) in the
26 following markets: San Diego, Las Vegas, Arizona, Los Angeles, Orange County, the

27 _____
28 ² Defendants' trial exhibits are identified by letters. Plaintiff's trial exhibits are identified by numbers.

1 Inland Empire, Bakersfield, Northern California, and the Pacific Northwest. *Id.* at 2:19-23.
2 During this period of expansion of GSM, Fernandez de Castro and Honarkar split the
3 various management duties. *Id.* at 2:24-26; *Transcript of Deposition of Joseph*
4 *Fernandez de Castro (Fernandez de Castro Deposition)*, October 20, 2005, at 24:8-11.
5 Honarkar was GSM's Chief Executive Officer ("CEO") and Secretary. *Id.* Fernandez de
6 Castro was the President of GSM. *Joint Pretrial Order*, Fact No. 3; *Honarkar Direct*
7 *Examination Declaration* at 2:24-26; *Fernandez de Castro Deposition* at 15:17-25.
8 Honarkar and Fernandez de Castro were GSM's only two directors. *Id.* According to
9 Honarkar, he focused on negotiations with Cingular, and Fernandez de Castro focused
10 on the sales side of the business. *Id.* at 2:26-3:1; *Fernandez de Castro Deposition* at
11 15:8-16, 24:18-26:2.

12 The relationship between GSM and Cingular was governed by the Exclusive
13 Agency Agreements ("Agency Agreements"), which were executed by and between GSM
14 and Cingular for each market in which GSM operated. *Honarkar Direct Examination*
15 *Declaration* at 3:3-16; *see also, Trial Exhibit E, Amended and Restated Authorized*
16 *Agency Agreement between Cingular Wireless and GSM Wireless, Effective February*
17 *22, 2002 ("Amended Agency Agreement, February 22, 2002"); Trial Exhibit L, Exclusive*
18 *Authorized Agency Agreement between Southwestern Bell Mobile Systems, LLC, d/b/a*
19 *Cingular Wireless and GSM Wireless, Effective March 1, 2003 (Amended Agency*
20 *Agreement, March 1, 2003)*. Generally, the Agency Agreements, though individualized
21 for particular markets, were uniform in their contents. *Id.*; *see also, Honarkar Direct*
22 *Examination Declaration* at 3:17-18. From time to time, GSM and Cingular also entered
23 into various side agreements concerning specific promotions, incentives, payments,
24 funds for stores, etc. *Honarkar Direct Examination Testimony* at 3:18-20.

25 Pursuant to the Agency Agreements, GSM received five basic types of
26 compensation that were detailed in "Exhibit C Compensation Exclusive Agent" to the
27 Agency Agreements. *Honarkar Direct Examination Declaration* at 3:21-25; *Exhibit C*
28 *Compensation Exclusive Agent attached to Trial Exhibit E, Amended Agency Agreement,*

1 *February 22, 2002; Exhibit C Compensation Exclusive Agent attached to Trial Exhibit L,*
2 *Amended Agency Agreement, March 1, 2003.* Specifically, GSM received (1) post-paid
3 activation commissions; (2) upgrade commissions; (3) optional features commissions; (4)
4 cooperative advertising reimbursement compensation (“Co-op Reimbursement”); and (5)
5 residual payments in the form of activation and upgrade residuals. *Id.*; *see also,*
6 *Honarkar Direct Examination Declaration* at 3:22-25. In addition, GSM could also be
7 compensated for store build-out costs through Market Development Funds (“MDF”) and
8 through specific incentives and programs detailed in side letters that were generally
9 known as SPIFFs. *Id.*; *see also, Honarkar Direct Examination Declaration* at 3:25-27;
10 *Honarkar Trial Testimony*, April 28, 2010, at 10:54-10:56 a.m.

11 The post-paid activation commissions were one time commissions paid by
12 Cingular to GSM for subscribers who activated cellular phone service with Cingular in a
13 given month through GSM, but were payable only for subscribers who continued service
14 with Cingular for a 180-day consecutive period. *Honarkar Direct Examination Declaration*
15 at 4:1-6; *see also, Trial Exhibit E, Amended Agency Agreement, February 22, 2002* at 9-
16 12, § 8 (Prices and Compensation) and *Exhibit C Compensation Exclusive Agent*
17 *attached thereto; Trial Exhibit L, Amended Agency Agreement, March 1, 2003, § 8*
18 (Compensation) and *Exhibit C Compensation Exclusive Agent attached thereto.* Cingular
19 could “charge-back” GSM for commissions paid to GSM if a subscriber discontinued
20 service within this 180-day period. *Honarkar Direct Examination Declaration* at 4:6-8.
21 These chargebacks became a point of serious contention between GSM and Cingular
22 according to Honarkar. *Id.* at 4:9-10.

23 Cingular, pursuant to vendor agreements with GSM, paid GSM monthly
24 Subscriber Management Fees (“SMF”, and also referred to as “Residuals”), which
25 essentially were paid in connection with customers GSM had signed up for Cingular
26 cellular products and services. *Honarkar Direct Examination Declaration* at 4:26-5:5; *see*
27 *also, Trial Exhibit E, Amended Agency Agreement, February 22, 2002* at 9-12, § 8
28 (Prices and Compensation) and *Exhibit C Compensation Exclusive Agent attached*

1 *thereto; Trial Exhibit L, Amended Agency Agreement, March 1, 2003, § 8*
2 *(Compensation) and Exhibit C Compensation Exclusive Agent attached thereto.*
3 Residuals were calculated as a monthly percentage (generally 5% for GSM) of the
4 average subscriber monthly usage based on billing collected by Cingular of all activated
5 subscribers that were originally enrolled by GSM. *Id.* Some aspects of the payment of
6 Residuals were conditional. *Id.; see also, Honarkar Direct Examination Declaration at*
7 *5:2-3.* GSM had to maintain a minimum increase in activation during a given month and
8 subscribers had to incur minimal charges. *Id.; see also, Honarkar Direct Examination*
9 *Declaration at 5:2-5.* Residuals were generally payable within 45 days of the close of a
10 monthly cycle. *Id.* Cash flow from the Residuals was a key source of income for GSM.
11 *Fernandez de Castro Deposition at 64:21-65:12, 78:18-20.* Honarkar and Fernandez de
12 Castro testified that the Residuals from Cingular to GSM were approximately \$450,000 to
13 \$500,000 per month at the time of the transaction in March 2003. *Honarkar Direct*
14 *Examination Declaration at 7:9 -11; Fernandez de Castro Deposition at 78:18-20.*

15 While GSM was compensated by Cingular, it was also financed by Cingular; GSM
16 was reliant on Cingular for inventory and credit. *Honarkar Direct Examination Declaration*
17 *at 5:6-12.* GSM was required to purchase most of its inventory from Cingular. *Id.* In
18 order to compete with other cellular agents and in order to participate in various Cingular-
19 run incentive programs, GSM had to sell its inventory at a substantial loss, often actually
20 giving away the mobile phone handset with the activation of a new subscriber. *Id.; see*
21 *also Honarkar Trial Testimony, April 28, 2010, at 10:47-10:52 a.m.* Accordingly, the cost
22 of handsets was not recovered through the retail sales of the handsets, but rather was
23 offset against the amount of commissions owed to GSM in a given month by Cingular.
24 *Id.* Because it often had to sell its inventory at a loss in order to generate commissions, it
25 was difficult for GSM to procure outside financing for that inventory. *Honarkar Direct*
26 *Examination Declaration at 5:13-14.*

27 At the outset, GSM established an inventory line of credit with Cingular, as did all
28 other Cingular agents. *Honarkar Direct Examination Declaration at 5:15-24.* Cingular

1 would extend to GSM a buying account or inventory line of credit, which fluctuated, but at
2 its peak was more than \$5,000,000 a month in order to purchase inventory (handsets) for
3 sale. *Id.* GSM would purchase inventory from Cingular through the line of credit, which
4 was payable in 45 days (temporarily adjusted during 2003-2004 to 55 days). *Id.* In
5 practice, Cingular would offset GSM's commissions payable (which were paid every 40
6 days) for the month against the amount due under the line of credit. *Id.* Commissions
7 usually exceeded the amount due under the line of credit, but if they were inadequate,
8 Cingular had the right to offset against Residuals or any other amounts due and owing
9 from Cingular to GSM. *Id.* Cingular reserved the right to terminate the equipment
10 financing agreement and the line of credit with 10 days written notice. *Id.*

11 GSM was run by Honarkar and Fernandez de Castro from its formation until
12 Fernandez de Castro left GSM in 2003. *Fernandez de Castro Deposition* at 24:8-11.
13 Honarkar and Fernandez de Castro were each a director of GSM and, until March 6,
14 2003, they were the only two directors of the company. *Honarkar Direct Examination*
15 *Declaration* at 2:26. Honarkar became President after Fernandez de Castro left GSM on
16 March 6, 2003. *Honarkar Deposition* at 30:1-9.

17 According to GSM's federal income tax return for 2002, GSM had gross income of
18 \$42,335,881, cost of goods sold of \$19,923,765, deductions of \$22,655,861 and ordinary
19 income of \$756,255. *Trial Exhibit 4, GSM's December 31, 2002, IRS Form 1120S, U.S.*
20 *Income Tax Return for an S Corporation.* The balance sheet for GSM in this tax return
21 reflected that as of December 31, 2002, GSM had assets of \$8,791,592, liabilities of
22 \$8,714,086 and shareholders' equity of \$77,506 (capital stock of \$40,000 and retained
23 earnings of \$37,506). *Id.* The tax return indicated that it was prepared by GSM's outside
24 independent accountants, Boudreau, Rickmeyer & Chang LLP. *Id.*

25 In or about October or November of 2002, Honarkar and Fernandez de Castro
26 decided to part ways. *Honarkar Direct Examination Declaration* at 5:27. According to
27 Fernandez de Castro, he and Honarkar "could no longer work together," and Honarkar
28 wanted to continue to expand the business and Fernandez de Castro did not approve of

1 Honarker's "personal morals." *Fernandez de Castro Deposition* at 32:3-16. Honarker
2 and Fernandez de Castro attempted to divide the company evenly and devised a plan to
3 do so, but it required approval from Cingular, which refused to approve the split up.
4 *Honarkar Direct Examination Declaration* at 6:5-17, 21-25; *Fernandez de Castro*
5 *Deposition* at 60:24-64:20. Honarker and Fernandez de Castro requested that Cingular
6 purchase GSM, but Cingular refused. *Honarkar Direct Examination Declaration* at 6:26-
7 7:3; *Fernandez de Castro Deposition* at 60:24-64:20. Honarker and Fernandez de
8 Castro eventually decided that GSM would redeem Fernandez de Castro's stock and
9 essentially buy him out for \$3,000,000 financed by a loan from GSM to Honarker funded
10 from its future residual income. *Honarkar Direct Examination Declaration* at 7:4-15, 8:1-
11 10, 10:21-11:10; *Trial Exhibits 7-19, Transaction Documents; Trial Exhibit 31, Promissory*
12 *Note; Fernandez de Castro Deposition* at 61:25-63:9. This transaction for Honarker to
13 buy out Fernandez de Castro's stock based on GSM's loan to Honarker, who became
14 GSM's sole shareholder, is referred to herein as the "Transaction." *Id.*

15 During the negotiation of the Transaction, on or about November 2002, Babak
16 Samini ("Samini"), an attorney hired to represent GSM, informed Honarker and
17 Fernandez de Castro that he could not represent either of them in the Transaction
18 because as GSM's counsel, he had to represent its best interests. *Honarkar Direct*
19 *Examination Declaration* at 8:9-11. Samini then advised Honarker and Fernandez de
20 Castro to each retain their own counsel. *Honarkar Direct Examination Declaration* at
21 8:26; *Trial Testimony of Babak Samini*, April 28, 2010 at 1:39-1:40 p.m.; *Fernandez de*
22 *Castro Trial Testimony*, April 28, 2010 at 3:05-3:06 p.m. Thereafter, Honarker retained
23 Hatley & Hampton to represent him during the negotiations of the Transaction. *Honarkar*
24 *Direct Examination Declaration* at 8:13-16; *Trial Exhibit 70 (also Trial Exhibit FF),*
25 *Engagement Letter from Hateley & Hampton to Mohammad Honarkar, dated December*
26 *2, 2002; Trial Exhibit 71 (also Trial Exhibit GG), Invoice from Hateley & Hampton to*
27 *Mohammad Honarkar, Samini Trial Testimony*, April 29, 2010 at 1:39-1:40 p.m. Initially,
28 Fernandez de Castro retained Steven Silverstein to represent him during the negotiations

1 of the Transaction. *Honarkar Direct Examination Declaration* at 8:17-18; *Fernandez de*
2 *Castro Trial Testimony*, April 28, 2010 at 2:53-2:54 p.m.; *Samini Trial Testimony*, April 29,
3 2010 at 1:39-1:40 p.m. In his capacity as counsel for GSM, Samini drafted the
4 agreements for the Transaction between Honarkar, Fernandez de Castro and GSM.
5 *Samini Trial Testimony*, April 29, 2010, at 1:41 p.m.

6 Cingular's in-house counsel, Al Jimenez, also became involved in the negotiation
7 of the agreements for the Transaction. *Honarkar Direct Examination Declaration* at 10:1-
8 2; *Fernandez de Castro Deposition* at 82:23-83:2. Cingular was copied on emails and
9 facsimiles containing drafts of the agreements, and Jimenez was involved throughout the
10 course of the negotiations of the Transaction on behalf of Cingular. *Honarkar Direct*
11 *Examination Declaration*, at 9:24-10:3; *Samini Trial Testimony*, April 29, 2010, at 1:46-
12 1:51 p.m. Cingular's in-house counsel even inserted some of its own terms in the
13 agreements, including a revision of the technical language regarding wireless services
14 and a non-compete clause and agreement. *Samini Trial Testimony*, at 4:18-4:26 p.m.

15 GSM's Chief Financial Officer, Peter Elson, was also involved in reviewing and
16 commenting on the agreements for the Transaction on behalf of GSM. *Honarkar Direct*
17 *Examination Declaration*, at 9:24-10:3,10:6-10:7. A draft of the agreements was
18 submitted to GSM's outside independent accountant, Tony Chang, of the accountancy
19 firm of Boudreau, Rickmeyer and Chang LLP, who suggested that the Transaction be
20 structured as a stock purchase rather than redemption. *Honarkar Direct Examination*
21 *Declaration* at 10:8-12. The structure of the Transaction was altered accordingly.
22 *Honarkar Direct Examination Declaration* at 10:8-18; *Honarkar Trial Testimony*, April 28,
23 2010 at 11:24 a.m.

24 Subsequent negotiations occurred over the next few months between Honarkar,
25 Fernandez de Castro, Samini on behalf of GSM, and Cingular regarding the structuring of
26 the Transaction to buy out Fernandez de Castro's stock. *Honarkar Direct Examination*
27 *Declaration* at 9:1-16. During the negotiations in late December 2002 and early 2003,
28 Honarkar ceased to employ Hately & Hampton as his counsel in the discussions and

1 represented himself in the continued negotiations. *Id.* at 9:19-21. Fernandez de Castro
2 ceased to employ Silverstein as his counsel and hired Thomas Pinstone as his attorney.
3 *Id.* at 9:17-23; *Samini Trial Testimony* April 29, 2010 at 1:34-1:39 p.m.; *Fernandez de*
4 *Castro Trial Testimony* April 28, 2010 at 2:53-2:54 p.m.

5 The parties, Honarkar, Fernandez de Castro and GSM, eventually agreed to the
6 basic terms of the Transaction under which Fernandez de Castro would transfer his
7 interest in GSM to Honarkar in return for \$3,000,000 (the "Transfer"). *Honarkar Direct*
8 *Examination Declaration* at 10:21-23; *Fernandez de Castro Deposition* at 60:24-64:20.
9 The Transfer would include not only Fernandez de Castro's interest in GSM, but also his
10 interests in related companies, Brookline Aliso Viejo, LLC, a holding company that owned
11 the building in which GSM's headquarters was housed, and Global Mobile, a company
12 that technically owned Enlace Wireless. *Honarkar Direct Examination Declaration* at
13 10:23-27. The \$3,000,000 would be paid to Fernandez de Castro by GSM on behalf of
14 Honarkar in 12 monthly installments of \$250,000 each, which represented roughly half of
15 the Residuals that GSM was receiving at the time for one year. *Id.* at 10:21-11:10. At
16 Fernandez de Castro's request, Cingular agreed to pay him directly each month from the
17 Residuals due to GSM. *Id.* at 10:22-11:4; *Fernandez de Castro Trial Testimony*, April 28,
18 2010, at 3:04 p.m.

19 On or about February 28, 2003, Honarkar, Fernandez de Castro, GSM and
20 Cingular executed a series of agreements that comprised the Transaction. *Honarkar*
21 *Direct Examination Declaration* at 12:3-6; *Samini Trial Testimony*, April 29, 2010 at 1:45-
22 1:46 p.m.

23 The following documents memorialized the Transaction:

- 24 (a) Stock Purchase Agreement dated February 28, 2003. This
25 agreement was executed by Honarkar and Fernandez de Castro.
26 GSM was not a party to or signatory of this agreement. Section 1.2
27 of the Stock Purchase Agreement sets forth a purchase price of
28 \$1,000,000 for Fernandez de Castro's 50,000 shares in GSM

1 Wireless, Inc. Sections 5.1 and 5.2 of the Stock Purchase
2 Agreement contain mutual releases between Honarkar and
3 Fernandez de Castro of all liability for any claims, demands,
4 judgments, liabilities, obligations and causes of action existing as of
5 February 28, 2003. Section 6.2 sets forth that the delivery, by
6 Cingular, of a fully executed Notice of Irrevocable Assignment and
7 Acceptance was a condition to the closing of the Transaction. *Trial*
8 *Exhibit 7.*

9 (b) Copy of Stock Assignment Separate from Certificate, executed by
10 Fernandez de Castro as of February 28, 2003. *Trial Exhibit 8.*

11 (c) Purchase Agreement – Limited Liability Company Interest (Global
12 Mobile – LLC / Honarkar) executed February 28, 2003, by and
13 between Honarkar and Fernandez de Castro. This agreement
14 encompasses the purchase and sale of Enlace Wireless. The
15 purchase price of Fernandez de Castro’s 49% interest in Global
16 Mobile pursuant to Section 2.1 of this agreement is \$2,000,000.
17 Sections 7.1 and 7.2 of the agreement contain mutual releases
18 between Honarkar and Fernandez de Castro of all liability for any
19 and all claims, demands, judgments, liabilities, obligations, and
20 causes of action existing as of February 28, 2003. Section 4.2 sets
21 forth that the delivery, by Cingular, of a fully executed Notice of
22 Irrevocable Assignment and Acceptance was a condition to closing
23 of the Transaction. *Trial Exhibit 9.*

24 (d) Purchase Agreement – Limited Liability Company Interest (Global 2
25 – LLC / GSM Wireless, Inc.) executed as of February 28, 2003 by
26 and between GSM and Fernandez de Castro whereby Fernandez de
27 Castro transferred one percent of his fifty percent interest in Global
28 Mobile to GSM for \$20,000. *Trial Exhibit 10.*

- 1 (e) First Amendment to Operating Agreement of Global Mobile, LLC, a
2 Purchase Agreement – Limited Liability Company Interest (Global
3 Mobile LLC/Honarkar) executed on February 28, 2003 by and
4 between Honarkar, Fernandez de Castro and GSM. *Trial Exhibit 11.*
- 5 (f) Purchase Agreement – Limited Liability Company Interest (Brookline
6 Aliso Viejo, LLC / Honarkar) executed on February 28, 2003, by and
7 between Honarkar and Fernandez de Castro. This agreement
8 concerned the company that owned the building in which GSM's
9 headquarters was located. The purchase price of Fernandez de
10 Castro's 49% interest in Brookline Aliso Viejo pursuant to Section 2.1
11 of this agreement was \$49,500. *Trial Exhibit 12.*
- 12 (g) Purchased Agreement – Limited Liability Company Interest
13 (Brookline Aliso Viejo, LLC / GSM Wireless, Inc.) executed on
14 February 28, 2003, by and between Fernandez de Castro and
15 GSM. This agreement concerned the company that owned the
16 building in which GSM's headquarters was located. The purchase
17 price of Fernandez de Castro's 1% interest in Brookline Aliso Viejo
18 pursuant to Section 2.1 of this agreement was \$500. *Trial Exhibit 13.*
- 19 (h) First Amendment to Operating Agreement of Brookline Aliso Viejo,
20 LLC, executed as of February 28, 2003, by and between Honarkar,
21 Fernandez de Castro, and GSM. *Trial Exhibit 14.*
- 22 (i) Noncompetition and Nondisclosure Agreement, executed as of
23 February 28, 2003, by and between Fernandez de Castro on the one
24 hand and GSM, Global Mobile, LLC, Enlace Wireless, LLC,
25 Brookline Aliso Viejo, LLC and Honarkar on the other hand. *Trial*
26 *Exhibit 15.*
- 27 (j) Resignation Letter of Joseph Fernandez de Castro, addressed to
28 Honarkar of GSM and executed on March 6, 2003, by Fernandez de

1 Castro. In it Fernandez de Castro resigned all employment including
2 any position as an officer, director, shareholder, manager, member,
3 employee or otherwise with GSM. *Trial Exhibit 16.*

4 (k) Notice of Irrevocable Assignment and Acceptance. This Agreement
5 was entered into as of March 1, 2003, by and among GSM,
6 Fernandez de Castro, Honarkar, Pouran Honarkar (Honarkar's wife)
7 and Cingular. The Notice of Irrevocable Assignment and
8 Acceptance contains the following provisions, among others:
9 It states in Recital A that "As a condition to this Agreement, GSM and
10 Cingular are entering into five new, exclusive agency agreements
11 (the 'New Agency Agreements') which shall supercede [sic] the
12 respective Existing Agency Agreements."

13 It further states in Recital A, "As a condition subsequent to this
14 Agreement Mohammad and Pouran [Honarkar] shall execute not
15 later than March 7, 2003: (i) a Personal Guarantee in favor of
16 Cingular guarantying the performance of GSM under the New
17 Agency Agreement ('Honarkar/Cingular Personal Guarantee'), (ii) a
18 Security and Pledge Agreement securing Mohammad and Pouran's
19 obligations under the Honarkar/Cingular Personal Guarantee (the
20 'Security and Pledge Agreement'), and in the sole and absolute
21 discretion of Cingular, Mohammad and/or Pouran will execute from
22 time to time promptly upon request of Cingular, deeds of trust with
23 assignments of rents and/or mortgages pursuant to which
24 Mohammad and/or Pouran will grant liens on certain real property in
25 favor of Cingular to further secure Mohammad and Pouran's
26 obligations under the Honarkar/Cingular Personal Guaranty. As an
27 additional condition subsequent to this Agreement, Mohammad and
28 Pouran will execute or cause to be executed such additional

1 agreements and documents as Cingular shall deem necessary or
2 advisable to perfect its security interest in all collateral securing
3 Mohammad's and Pouran's obligations under the Honarkar/Cingular
4 Personal Guaranty."

5 It further states in Recital B, "Joseph and Mohammad are the
6 sole shareholders of GSM and related entities. Concurrently
7 herewith Joseph and Mohammad are entering into certain stock
8 purchase agreements, dated even herewith (the 'Stock Purchase
9 Agreements') pursuant to which Mohammad is purchasing all of the
10 shares of GSM stock owned by Joseph, thereby leaving Mohammad
11 as the sole shareholder of GSM for an amount in excess of three
12 million dollars (\$3,000,000)('Aggregate Purchase Price')."

13 It states in Recital C, "Under the New Agency Agreements,
14 Cingular will pay GSM certain monthly Subscriber Management Fees
15 ('Residuals'). Pursuant to the Stock Purchase Agreements, the
16 Aggregate Purchase Price is to be paid in installments and it is
17 contemplated that GSM will instruct Cingular for itself and on behalf
18 of Mohammad to pay a portion of the Residuals to Joseph, which
19 payments will be applied to the Aggregate Purchase Price."

20 It states in Section 1, "GSM and Mohammad hereby give Cingular
21 notice that on behalf of GSM they have assigned to Joseph two
22 hundred and fifty thousand dollars (\$250,000) of the monthly
23 Residuals to be applied to the Aggregate Purchase Price (hereinafter
24 the 'Residual Assignment') and hereby irrevocably authorize and
25 instruct Cingular to honor the Residual Assignment and to pay
26 [Fernandez de Castro] of the monthly Residuals due and payable to
27 GSM the first two hundred and fifty thousand dollars (\$250,000) of
28 such monthly Residuals pursuant to the new Agency Agreements

1 until such time as the amount of the Residuals paid to Joseph by
2 Cingular pursuant thereto equals Three Million Dollars (\$3,000,000).
3 For the avoidance of doubt, nothing in this Agreement shall be
4 construed to mean that Cingular is obligated to pay to Joseph the full
5 two hundred and fifty thousand dollars (\$250,000) for any particular
6 month, if the amount of Residuals otherwise due and payable that
7 month would be less than two hundred and fifty thousand dollars
8 (\$250,000).”

9 It further contains additional extensive non-competition
10 requirements for Fernandez de Castro to follow in consideration of
11 the benefits he received under the Stock Purchase Agreements and
12 the Notice of Irrevocable Assignment and Acceptance.

13 It further states in Section 10, “This Agreement constitutes the
14 entire agreement and understanding among the parties hereto with
15 respect to the subject matter hereof and supercedes [sic] any prior
16 agreement or understanding among the parties hereto with respect
17 to the subject matter hereof, all of which are merged herein.”

18 It further contains provisions in Section 11 that in the event of a
19 dispute arising from this Agreement, “Each party shall bear its own
20 attorneys fees and costs of suit and arbitration.” *Trial Exhibit 17*.

21 (l) Security and Pledge Agreement, executed as of March 6, 2003, by
22 and between Honarkar and his wife Pouran Honarkar, on the one
23 hand, and Cingular on the other hand. *Trial Exhibit 18*; and
24 (m) Unconditional Guarantee of Mohammad Honarkar and Pouran
25 Honarkar, executed as of March 6, 2003, by Honarkar and Pouran
26 Honarkar in favor of Cingular under which Honarkar and Pouran
27 Honarkar jointly and severally, absolutely and unconditionally,
28 guaranteed prompt payment and performance when due of any and

1 all existing and future obligations, covenants and liabilities of GSM to
2 Cingular under the New Agency Agreements and as relates to the
3 Obligations to Fernandez de Castro that is the subject of the New
4 Agency Agreements. *Trial Exhibit 19.*

5 *Trial Exhibits 7-19; Honarkar Trial Testimony, April 22, 2010 at 121:5-122:1; Fernandez*
6 *de Castro Deposition at 124:2-131:25; Trial Exhibit 75, Honarkar's Answer to First*
7 *Amended Complaint and Third Party Cross-Complaint, ¶¶ 17-18.*

8 At some time after the closing of the Transaction, Honarkar executed a Promissory
9 Note dated March 1, 2003 by Honarkar in favor of GSM in the principal amount of
10 \$3,000,000 to bear interest at 5.0% per annum, which "shall be due and payable by the
11 undersigned as and when the undersigned receives any dividends paid by GSM in
12 connection with the common stock of GSM owned by the undersigned." *Honarkar Direct*
13 *Examination Declaration at 16:12-15; Trial Exhibit 31 (also Trial Exhibit KK), Promissory*
14 *Note, dated March 1, 2003.*

15 At or about this time Honarkar also executed five new exclusive agency
16 agreements with Cingular on behalf of GSM. *Honarkar Direct Examination Declaration at*
17 *16:16-18; Trial Exhibit L, Amended Agency Agreement, March 1, 2003.* According to
18 Honarkar, these new agency agreements made GSM more marketable because they
19 solidified GSM's relationship with Cingular for several more years. *Id.; see also,*
20 *Honarkar Direct Examination Declaration at 16:28-17:2; Honarkar Trial Testimony, April*
21 *28, 2010 at 11:16-11:17 a.m.*

22 The Transaction was separated into several individual transactions involving
23 various entities, Honarkar, Fernandez de Castro, GSM, and Cingular, a structure that
24 came to be as the result of advice of accountants and attorneys. *Honarkar Trial*
25 *Testimony, April 22, 2010 at 4:26 p.m. and April 28, 2010 at 10:45-10:46 a.m.; Fernandez*
26 *de Castro Deposition at 124:2-131:25.*

27 GSM filed a short-year federal income tax return for the period ending March 31,
28 2003. *Trial Exhibit 5, GSM's March 31, 2003, IRS Form 1120S, U.S. Income Tax Return*

1 *for an S Corporation.* According to GSM's federal income tax return for the short year
2 ending March 31, 2003, GSM had gross income of \$15,130,831, cost of goods sold of
3 \$8,883,241, deductions of \$6,780,122 and ordinary income of -\$532,377. *Id.* The
4 balance sheet for GSM in this tax return reflected that as of March 31, 2003, GSM had
5 assets of \$8,242,768, liabilities of \$6,137,418 and shareholders' equity of \$2,105,350
6 (capital stock of \$40,000 and retained earnings of \$2,065,350). *Id.* The tax return also
7 contained a section which reconciled income (loss) per books with income (loss) per
8 return, Schedule M-1, which reflected deferred revenue of \$2,825,107. *Id.* The tax return
9 also contained another section for analysis of accumulated adjustments account,
10 Schedule M-2, which reflected a balance of -\$729,775 at the end of the short tax year.
11 *Id.* The tax return indicated that it was prepared by GSM's outside independent
12 accountants, Boudreau & Chang LLP. *Id.*

13 As of March 31, 2003, approximately one month after the close of the Transaction,
14 the sum of GSM's assets exceeded its liabilities. *Direct Examination Testimony of*
15 *Rebuttal Expert Philip Lieberman Submitted Pursuant to Declaration at 5:10-14 and*
16 *Rebuttal to Expert Report of John P. Schafer, Exhibit 1 attached thereto; Defendant's*
17 *Trial Exhibit A, Defendant Mohammad Honarkar's Disclosure of Rebuttal Expert Witness*
18 *Information; see also, Fernandez de Castro Deposition at 64:21-65:15, 99:10-15. GSM*
19 *had a positive book value of \$2,105,350 and the fair market value of its tangible assets*
20 *exceeded its liabilities by \$972,920. Id.*

21 Fernandez de Castro began receiving his buyout payments from GSM's residuals
22 in April 2003. *Honarkar Direct Examination Declaration at 16:20-22; Fernandez de*
23 *Castro Deposition at 71:10-12, 72:2-10. GSM paid the monthly buyout payments from its*
24 *residuals to Fernandez de Castro until the last of the twelve monthly payments was made*
25 *in April 2004. Fernandez de Castro Deposition at 71:2-7, 109:10-23, 124:18-19; Trial*
26 *Exhibits 7-19; Fernandez de Castro Trial Testimony, April 28, 2010 at 2:09-2:16 p.m.;*
27 *Honarkar Direct Examination Declaration at 16:20-17:10.*

28 GSM began experiencing problems with its Spanish language market subsidiary,

1 Enlace Wireless. *Honarkar Direct Examination Declaration* at 17:17-18:20. In the
2 summer of 2003, although the stores consistently lost money, Cingular refused to allow
3 GSM to close ten poorly performing Enlace Stores. *Id.* at 17:20-27. This caused GSM to
4 lose substantial cash flow. *Id.* Cingular also unilaterally changed the credit evaluation
5 policy and deposit requirement for Enlace customers. *Id.* Thus, because a number of
6 customers of Enlace stores were opening their wireless accounts with little or no credit, a
7 number of those accounts would close for nonpayment soon after being opened. *Id.* As
8 GSM generally supplied the customer with a telephone handset for little or no cost to
9 these customers, the customers often kept the handset even though he or she failed to
10 pay for the service afterwards. *Id.* To stop the loss of inventory, Cingular began
11 requiring that all Enlace customers pay a prohibitively large deposit of \$500 to \$750 (up
12 from \$75) before Cingular would activate service. *Id.* Often, Cingular would revise its
13 estimate of the customer's creditworthiness after the account had been opened. *Id.* at
14 19:17-27. In that event, Cingular would collect a customer deposit by deducting the
15 amount after the fact from the commission payable to the agent. *Id.* Cingular also failed
16 to provide reports documenting and breaking out the basis for Cingular's unilateral
17 deductions from the commissions that it paid to its agents. *Id.* at 19:27-20:2.

18 Additionally, Enlace was primarily a kiosk-driven enterprise. *Honarkar Direct*
19 *Examination Declaration* at 18:1-5. It had very few, if any actual storefront locations. *Id.*
20 During 2003 and 2004, Cingular began opening competing company-owned stores
21 proximate to (sometimes across the street from) Enlace kiosks. *Id.* As a result, Enlace
22 began losing potential customers. *Id.* In December 2003, Honarker sent a letter to
23 Cingular detailing Enlace's business problems and requested an adjustment in the
24 commission rate for Enlace's customers to remedy these problems. *Id.* at 18:5-7; *Trial*
25 *Exhibit M, Letter from Mohammed Honarkar of Enlace/GSM to Jon Garcia of Cingular*
26 *regarding Enlace's business problems.* Enlace lost approximately \$1.2 million in revenue
27 between April 2003 and the summer of 2004. *Honarkar Direct Examination Declaration*
28 at 18:11. Eventually, Enlace was forced to close its doors in all locations by October 1,

1 2004. *Id.* at 17:16-18:20. The financial difficulties and eventual closing of Enlace had a
2 significant financial impact on GSM. *Id.* at 18:16-21.

3 Honarker testified at trial that throughout 2003 and 2004, GSM also began
4 experiencing substantial cash flow problems because Cingular began understating the
5 amount of the commissions for new activations and the residual commissions which it
6 owed GSM. *Honarkar Trial Testimony*, April 28, 2010 at 11:28-11:29 a.m. As Honarker
7 testified, for example, if a new customer to whom GSM had sold a cellular phone and a
8 plan elected to change his telephone number before the commission was paid to the
9 agent (because, for instance, the customer had moved to a new area and wanted a local
10 number or simply did not like the phone number which had been assigned to him),
11 Cingular's customer service department would give the account a new code. *Honarkar*
12 *Direct Examination Declaration* at 18:27-19:4. The change would result in the
13 commission either being paid to, and retained by Cingular, or charged back from GSM.
14 *Id.* at 18:27-19:5. Cingular withheld or charged back GSM's commissions when
15 customers made any number of changes to their service plans. *Id.* at 18:22-19:5.
16 Ultimately, as Honarker testified, Cingular's understating of GSM's commissions
17 contributed significantly to GSM's cash flow issues. *Id.* at 21:7-8.

18 Honarker further testified that Cingular unilaterally changed the terms of
19 compensation under the new Agency Agreements by amending the agreements to
20 include a new Exhibit "C," which governed compensation of GSM as agent. *Honarkar*
21 *Direct Examination Declaration* at 20:4-18. The new terms altered the conditions under
22 which GSM received residuals and tied continued payments of residual compensation to
23 the continued ownership of the store or kiosk from which the service originated. *Id.*
24 Originally, GSM continued to receive Residuals or Subscriber Management Fees ("SMF")
25 associated with a particular customer as long as that customer remained an active
26 Cingular customer regardless of whether the location in which he or she originated
27 service continued. *Id.* Under the new Exhibit C, however, if GSM transferred the location
28 to another agent or it was closed or taken over by Cingular, the SMF associated with the

1 location ceased to be paid to GSM. *Id.* This change caused GSM to lose substantial
2 income throughout 2004, particularly because GSM was forced to close several locations
3 including all of its Enlace locations in 2004. *Id.*

4 According to Honarkar, additionally, Cingular was understating GSM's
5 commissions for new activations and the residual commissions which it owed and paid to
6 its agents. *Honarkar Trial Testimony*, April 28, 2010 at 11:28-11:29 a.m. The
7 accumulated discrepancy amounts which accrued as a result of the understatements was
8 substantial. *Id.* In one instance, pursuant to a letter agreement from Cingular to
9 Honarkar dated March 30, 2004, Cingular paid \$400,000 to GSM to cover discrepancies
10 for the six-month period from July 2003 through January 2004. *Honarkar Direct*
11 *Examination Declaration* at 20:22-24. Thereafter, Honarkar testified that Cingular
12 complicated efforts by GSM to collect its commissions by failing to provide electronic
13 reports documenting the basis for Cingular's unilateral deductions from the commissions
14 that it paid to its agents and limiting access to the Teligent Activation System which had
15 made it easy for GSM to track errors in commissions or changed orders. *Id.* at 21:1-19.
16 According to Honarkar, GSM could no longer question the propriety of Cingular's
17 deductions without manually auditing each month's financial reports at a significant back-
18 office expense. *Id.* Honarkar further testified that compounding this problem, Cingular
19 insisted that GSM provide it with manual tabulations and discrepancy reports. *Id.* at 21:4-
20 6. Cingular could then take up to six months to respond to the discrepancy reports. *Id.*

21 Honarkar's testimony regarding the financial problems caused by Cingular's 2003
22 actions are corroborated by a January 2004 email from Peter Elson, GSM's CFO, to
23 Honarkar, in which Elson stated, "I am very concerned that you may lose all you have
24 built up over the past 5+ years, primarily as a result of what I see as Cingular's failure to
25 advertise / compete adequately in the market at this time, since they have been
26 distracted by their would-be acquisition of AT&T, which has prevented GSM from
27 achieving the level of activations and upgrades necessary to at least break even. The
28 position has also been significantly worsened by their reductions in commissions and

1 their margin on handsets that they have charged GSM.” *Trial Exhibit 23,*
2 *Correspondence from Peter Elson to Mohammad Honarkar.* Elson observed that
3 Cingular had reduced GSM’s commissions by approximately 20% in the fall of 2003.
4 *Honarkar Trial Testimony, April 28, 2010, at 11:28-11:29 a.m.* Also as Elson observed,
5 Cingular marked up the wholesale price of handsets, thereby making a profit on handsets
6 at GSM’s expense despite GSM selling handsets for a loss. *Id.* at 11:29-11:30 a.m.

7 Because of these problems, GSM’s cash flow issues were exacerbated and GSM
8 found itself short of cash on hand in November of 2003. *Honarkar Direct Examination*
9 *Declaration* at 21:7-8. At the same time, GSM stopped using ADP for its payroll services.
10 *Id.* at 21:8-9. ADP had always previously automatically accounted for amounts of payroll
11 taxes while processing GSM’s payroll. *Id.* at 21:9-10. Beginning in November 2003,
12 GSM suspended payment of its payroll taxes. *Id.* at 21:10-11. GSM continued to timely
13 file its tax returns and acknowledge its obligation to the IRS, however it failed to pay its
14 employment taxes from November 2003 through October 2004. *Honarkar Trial*
15 *Testimony, April 22, 2010, at 137:1-2; Transcript of Honarkar Deposition, December 2,*
16 *2008, at 24:15-25:20; Honarkar Direct Examination Declaration* at 21:11-13; *Trial Exhibit*
17 *91, ¶ 19, Cross-Complaint filed by Mohammad Honarkar in New Cingular Wireless PCS,*
18 *Inc. v. Honarkar, Superior Court of California, County of Orange, Case No. 06CC09538.*
19 In total, GSM became delinquent in its payroll tax obligations to the IRS in the amount of
20 approximately \$3,300,000 (including penalties and interest). *Honarkar Direct*
21 *Examination Declaration* at 21:13-15; *Trial Exhibit 3, Proof of Claim for Internal Revenue*
22 *Taxes.*

23 On the proof of claim for unpaid taxes, the IRS asserted claims for unpaid income
24 tax withholding (WT) and Federal Insurance Contributions Act (FICA) taxes for calendar
25 quarters ending September 30, 2003 through December 31, 2004 and for Federal
26 Unemployment Tax Act (FUTA) taxes for calendar years ending December 31, 2003
27 through December 31, 2005 in the total amount of \$7,114,51961, including principal
28 taxes, interest and penalties. *Id.* The first of these tax liabilities was for WT-FICA taxes

1 for the calendar quarter ending September 30, 2003 (covering the period of July 1 to
2 September 30, 2003) in the amounts of \$6,880.52 in tax, \$5,674.88 in penalties to
3 petition date and \$864.00 in interest to petition date. *Id.* However, these amounts were
4 relatively modest while in contrast, the IRS asserts large WT-FICA tax liabilities for the
5 calendar quarters ending December 31, 2003 (covering the period of October 1 to
6 December 31, 2003) in the amounts of \$1,159,755.72 in tax, \$338,220.16 in penalties to
7 petition date and \$74,297.58 in interest to petition date, for the calendar quarter ending
8 March 31, 2004 (covering the period of January 1 to March 31, 2004) in the amounts of
9 \$945,492.31 in tax, \$421,176.53 in penalties to petition date and \$49,805.62 in interest to
10 petition date, and for the calendar quarter ending June 30, 2004 (covering the period of
11 April 1 to June 30, 2004) in the amounts of \$908,688.13 in tax, \$213,563.86 in penalties
12 to petition date and \$36,720.99 in interest to petition date. *Id.*

13 In early 2004, GSM's CFO, Elson, urged Honarkar that GSM should immediately
14 request Cingular to stop paying Fernandez de Castro his \$250,000 per month under the
15 transaction, and this request was communicated to Cingular. *Honarkar Deposition,*
16 *December 2, 2008* at 196:20–197:17; *Trial Exhibit 23, Correspondence from Peter Elson*
17 *to Mohammad Honarkar.* Honarkar admitted that Cingular's payment of \$250,000 a
18 month of GSM's residuals directly to Fernandez de Castro instead of to GSM under the
19 Transaction, had a detrimental impact on GSM's cash flow. *Honarkar Trial Testimony,*
20 *April 28, 2010* at 10:59 a.m. In January 2004, the idea of filing bankruptcy was discussed
21 by Honarkar and GSM's CFO with respect to GSM. *Trial Exhibit 23, Correspondence*
22 *from Peter Elson to Mohammad Honarkar.*

23 According to GSM's federal income tax return for 2004, GSM had gross income of
24 \$67,347,170, cost of goods sold of \$31,691,849, deductions of \$34,803,327 and ordinary
25 income of \$1,102,751. *Trial Exhibit 6, GSM's December 31, 2004, IRS Form 1120S,*
26 *U.S. Income Tax Return for an S Corporation.* The balance sheet for GSM in this tax
27 return reflected that as of December 31, 2004, GSM had assets of \$11,980,593, liabilities
28 of \$13,098,467 and shareholders' equity of -\$1,117,874 (capital stock of \$40,000 and

1 retained earnings of -\$1,157,874). *Id.* The tax return indicated that it was prepared by
2 GSM's outside independent accountants, Boudreau & Chang LLP. *Id.*

3 On May 19, 2005, GSM commenced this bankruptcy case by filing a voluntary
4 petition for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. About this time,
5 Honarkar invested \$900,000 of his own money into GSM. *Honarkar Direct Examination*
6 *Declaration* at 32:27-28. According to Honarkar, a promissory note and a security
7 agreement were executed for the \$900,000 investment in or about late May 2005. *Id.* at
8 33:1-3. By stipulation and order entered on August 15, 2005, the court approved
9 Honarkar's investment as a post-petition secured loan with a reservation of rights by
10 GSM, the official unsecured creditors' committee and any Chapter 7 or 11 trustee.
11 *Stipulation re: Final Order on the Debtor's Emergency Motion for Order Authorizing Post-*
12 *Petition Secured Loan; Order thereon*, filed on August 15, 2005.

13 DISCUSSION

14 In the complaints against defendants, Trustee alleges a myriad of statutory and
15 common law claims against them with respect to the transfer of assets by the debtor,
16 GSM, to Fernandez de Castro as a result of what the court will refer to as the
17 Transaction, which took place in March 2003. *First Amended Complaint against*
18 *Honarkar; Second Amended Complaint against Fernandez de Castro*. As described in
19 this memorandum decision, Honarkar and Fernandez de Castro were partners in
20 business as the two 50% shareholders of the debtor, GSM. Honarkar and Fernandez de
21 Castro agreed that Honarkar would buy out Fernandez de Castro using assets of GSM,
22 which would become wholly owned by Honarkar after the Transaction. The claims raised
23 by Trustee present the question of whether Honarkar and Fernandez de Castro as the
24 only shareholders of GSM violated any duty or obligation to the creditors of GSM, and
25 that question in this court's view depends on whether the debtor was insolvent at the time
26 of the Transaction or rendered insolvent by the Transaction. Defendants argue that as
27 the sole owners of GSM, a closely held corporation, they had breached no duty or
28 obligation to creditors because GSM was solvent at the time of the Transaction and was

1 not rendered insolvent by the Transaction. See, e.g., *Defendant and Cross-Complainant*
2 *Mohammad Honarkar's Trial Brief*, filed on April 16, 2010, at 8-10. Trustee argues that
3 they breached various duties as shareholders and corporate insiders of the debtor
4 because the debtor was insolvent at the time of, or rendered insolvent by, the
5 Transaction. *Plaintiff's Proposed Findings of Fact and Conclusions of Law*, filed on May
6 28, 2010, at 29. Trustee asserts various claims against defendants, but the primary
7 claims are the fraudulent transfer claims which the court analyzes first. *First Amended*
8 *Complaint against Honarkar* at 13-17, ¶¶ 59-70 (specific allegations relating to fraudulent
9 transfer claims); *Second Amended Complaint against Fernandez de Castro* at 8-10, ¶¶
10 39-51 (same).

11 Trustee has alleged claims under the California Uniform Fraudulent Transfer Act
12 ("CUFTA") against defendants Honarkar and Fernandez de Castro. California Civil Code,
13 §§ 3439-3439.12. The authority of a bankruptcy trustee to assert a fraudulent transfer
14 claim under the CUFTA derives from Section 544(b) of the Bankruptcy Code, 11 U.S.C.
15 *Neilson v. Union Bank of California, N.A.*, 290 F. Supp. 2d 1101, 1144 (C.D. Cal. 2003)
16 (citation omitted). Section 544(b) states, in relevant part, the "trustee may avoid any
17 transfer of an interest of the debtor in property or any obligation incurred by the debtor
18 that is voidable under applicable law by a creditor holding an unsecured claim" 11
19 U.S.C. § 544(b). Where state law provides a similar avoiding power to a creditor, as in
20 California, Section 544(b) permits a trustee (or a debtor in possession) to stand in the
21 shoes of the creditor and to assert the same cause of action. *Kupetz v. Wolf*, 845 F.2d
22 842, 845 and n. 2 (9th Cir.1988). However, under Section 544(b), a trustee may avoid a
23 fraudulent transfer only if a creditor with a claim against the bankruptcy could have done
24 so actually exists.

25 Under California law, a creditor may avoid transfers of property that are either
26 actually or constructively fraudulent. California Civil Code, §§ 3439.04 and 3439.05. If it
27 is shown that a transfer of property is fraudulent as to the creditors, a bankruptcy trustee
28 may recover the transferred property, or the value of the property transferred, for the

1 benefit of the estate pursuant to California Civil Code § 3439.07 and 11 U.S.C. § 550.

2 In the amended complaints against defendants Honarkar and Fernandez de
3 Castro, Trustee alleges that the debtor, GSM, fraudulently transferred \$3 million to
4 Fernandez de Castro in violation of California Civil Code § 3439.04(a). *First Amended*
5 *Complaint against Honarkar* at 13-17, ¶¶ 59-70; *Second Amended Complaint against*
6 *Fernandez de Castro* at 8-10, ¶¶ 39-51. Based on these allegations, Trustee alleges
7 claims for actual and constructive fraudulent transfer under California Civil Code
8 § 3439.04 and § 3439.05 against defendants Honarkar and Fernandez de Castro. *Id.*

9 Specifically, Trustee argues that Defendants are liable on Trustee's fraudulent
10 transfer claims because: (1) the \$3 million paid to Fernandez de Castro through the
11 Transaction was done when GSM was insolvent or rendered GSM insolvent in 2003;
12 (2) GSM must be presumed to have been insolvent; (3) Honarkar and Fernandez de
13 Castro reasonably should have believed that an inability for GSM to meet its debts and
14 obligations would result; and (4) GSM could not meet its debts and obligations as they
15 became due. *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 29.³ In
16 support of these claims, Trustee makes specific factual arguments which are addressed
17 below.

18 **I. Constructive Fraudulent Conveyance Under California Civil Code Sections**
19 **3439.04(a)(2) and Section 3439.05.**

20 Because the court is of the view that the issue of whether the Transaction
21 prejudiced the debtor's financial condition is crucial, the court first analyzes Trustee's
22 claims of constructive fraudulent transfer against defendants. Trustee asserts claims

23 ³ Defendants object to Plaintiff's Proposed Findings of Fact and Conclusions of Law on grounds that it is a
24 post-trial legal brief rather than proposed findings of fact and conclusions of law pursuant to Fed. R. Civ. P.
25 52(a)(1). *Defendant and Cross-Complainant Mohammed Honarkar's Objections to the [Proposed] Findings*
26 *of Fact and Conclusions of Law Submitted by Plaintiff GSM Wireless, Inc.*, filed on June 11, 2010, at 2;
27 *Defendant Fernandez de Castro's Joinder in Part with Objections Submitted by Defendant Mohammad*
28 *Honarkar*, filed on June 13, 2010, at 2. The court notes these objections of defendants, but believes that
plaintiff's proposed findings of fact and conclusions of law, though not adopted by the court for the reasons
stated in this memorandum decision, are helpful to the court in framing the issues presented by these
adversary proceedings. In this regard, the court overrules defendants' objections on grounds that the
document accurately reflects Trustee's post-trial arguments.

1 against defendants Honarkar and Fernandez de Castro based on constructive fraudulent
2 transfer. Under the CUFTA, a transfer of property is constructively fraudulent as to a
3 creditor whose claim arose before the transfer if the debtor made the transfer without
4 receiving reasonably equivalent value in exchange for the transfer or obligation and the
5 debtor either (a) was engaged in a business for which the remaining assets of the debtor
6 were unreasonably small in relation to the business, (b) intended to incur, believed or
7 reasonably should have believed that he or she would incur debts beyond his or her
8 ability to pay as they became due or (c) the debtor was insolvent at the time or became
9 insolvent as a result of the transfer or obligation. California Civil Code, §§ 3439.04(a)(2)
10 and 3439.05. In other words, Trustee must prove that (1) the transfer was made without
11 reasonably equivalent value and (2) the financial condition of debtor, considering three
12 alternative situations: (a) insolvency at the time of the transaction or the debtor is
13 rendered insolvent by the transaction, (b) the debtor's inability to pay debts as they
14 became due, or (c) relatively small remaining assets of the debtor compared with the
15 alleged fraudulent transaction. *Id.* For the reasons discussed below, the court finds that
16 Trustee has not met his burden under any of these three alternative financial conditions.
17 The court then finds that the Trustee has similarly not met his burden with respect to an
18 alleged lack of reasonably equivalent value. The court also finds that Trustee has not
19 met his burden of proving that the transfer was constructively fraudulent as to a creditor
20 whose claim arose before the transfer.

21 **A. GSM Was Solvent at the Time of the Transaction and Was Not**
22 **Rendered Insolvent by the Transaction.**

23 Trustee argues that the preponderance of the evidence establishes that GSM was
24 insolvent at the time of the Transaction or rendered insolvent by the Transaction.
25 *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 37:14-41:20 (Proposed
26 Conclusions of Law, ¶¶ 24-25). The burden of proving insolvency is on the creditor
27 asserting a fraudulent transfer claim. *See, e.g., Neumeyer v. Crown Funding Corp.*, 56
28 Cal.App.3d 178, 186 (1976), *disapproved of on other grounds by Liodas v. Sahadi*, 19

1 Cal.3d 278, 287 n. 3 (1977); *Stearns v. Los Angeles City School District*, 244 Cal.App.2d
2 696, 737 (1966). Thus, in this case, the burden of proving insolvency is on Trustee as
3 the plaintiff asserting the fraudulent transfer claims. *Id.* In an action to establish a
4 fraudulent transfer, the plaintiff must establish each requisite element by a
5 preponderance of evidence. *Whitehouse v. Six Corp.*, 40 Cal.App.4th 527, 533-534
6 (1995).

7 CUFTA defines “insolvency” under California Civil Code § 3439.02(a) under two
8 different tests, the “balance sheet test” and the “equity” or “cash flow test.” Under the
9 “balance sheet” method, “a debtor is insolvent if, at fair valuations, the sum of the
10 debtor’s debts is greater than all of the debtor’s assets.” California Civil Code,
11 § 3439.02(a); *Bay Plastics, Inc. v. BT Commercial Corp, (In re Bay Plastics, Inc.)*, 187
12 B.R. 315, 328 n. 22 (Bankr. C.D. Cal.1995). In determining whether a debtor’s liabilities
13 exceed the assets, the court must evaluate the debtor’s assets and liabilities based upon
14 a practical assessment of their actual value—a “fair valuation”—rather than in
15 accordance with generally accepted accounting principles. *In re Bay Plastics, Inc.*, 187
16 B.R. at 330. Intangible balance sheet assets, such as goodwill, which may have no
17 market value (either on a liquidation or going concern basis) generally should be
18 excluded from the calculation. *Id.* at 330-331; *see also, Mellon Bank, N.A. v. Official*
19 *Committee of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*, 92 F.3d 139, 156
20 (3rd Cir. 1996). Under the alternative “equity” or “cash flow test,” California Civil Code §
21 3439.02(c) provides for a presumption of insolvency for “a debtor who is generally not
22 paying his or her debts as they become due is presumed to be insolvent.” *In re Bay*
23 *Plastics, Inc.*, 187 B.R. at 328 n. 22.

24 **1. Schafer’s Lack of a Balance Sheet Approach**

25 In support of Trustee’s argument that GSM was insolvent at the time of the
26 Transaction or rendered insolvent by the Transaction, Trustee offered the testimony and
27 report of an expert witness, John Schaffer, who is an attorney licensed in California,
28 founded a law firm specializing in “strategic business and transactional law” and has had

1 “more than a decade of professional experience providing strategic legal and
2 restructuring advisory services.” *Trial Declaration of John P. Schafer (“Schafer Trial
3 Declaration”)*, filed on March 30, 2010, at 2:4-12. In preparing his testimony, Schafer
4 stated that he reviewed the documents relating to the Transaction and the transcripts of
5 the depositions of Honarkar and Fernandez de Castro. *Id.* at 6-9. After reviewing these
6 documents, Schafer “formed an opinion about the Transaction based on over a decade of
7 experience as an insolvency attorney charged with analyzing the propriety of transactions
8 and more recently as strategic counsel to numerous privately held businesses, which of
9 significance in this case includes having worked full-time in-house for nine (9) months as
10 interim general counsel for a Fortune 100 private business that was in the ‘Zone of
11 Insolvency’ during the entire course of my employment, and my resulting knowledge and
12 involvement with financially distressed corporations.” *Id.* at 9:3-8. That is, Schafer
13 “formed an opinion about Fernandez and Honarkar’s conduct in this case and the
14 voidability of the Transaction by GSM.” *Id.* at 23:2-3. Schafer’s ultimate opinion was:

15 It is my opinion that there was no disinterested shareholder approval of
16 the Transaction, nor was there any disinterested director approval,
17 authorization or ratification of the Transaction. Moreover, the terms of the
18 Transaction were neither just nor reasonable to GSM, and the Court has
19 already found that GSM received little or no benefit from the Transaction.
20 Finally, it is my opinion that Fernandez and Honarkar breached their
21 fiduciary duties to GSM by consummating the Transaction to their benefit
22 and to the detriment of the company.

23 *Id.* at 23:3-9.

24 Schafer did not expressly opine on whether the Transaction constituted a
25 fraudulent transfer, but stated opinions regarding GSM’s solvency. For instance, Schafer
26 concluded that “GSM was basically insolvent before and after the Transaction—and
27 could not meet its debts as they came due during the period when the funds for the
28 Transaction were being paid” and that “GSM was insolvent at the time of the Transaction,
and therefore the use of GSM’s funds to purchase a shareholder’s equity interest is
prohibited, even if proper corporate governance practices had been observed.” *Id.* at

1 14:9-11, 16:10-12. In support of this conclusion, according to Schafer, GSM's insolvency
2 is based on undisputed facts:

3 Because it is undisputed from the facts of this case, namely, Honarkar's
4 admissions to Hateley, GSM's inability to meet its payroll taxes during the
5 time period that Fernandez was receiving monthly residuals from GSM,
6 and GSM's inability to secure a loan, among other things, that GSM was
7 insolvent both before and after the Transaction, the directors could not
8 have authorized a dividend, redemption or repurchase of any kind, and in
9 fact would have faced personal liability for any such improper payment
under California Corporations Code § 316 and pertinent case law. Of
course, this was not how the Transaction was structured—it was
structured as a use of corporate funds for personal purposes by Honarkar.
Nonetheless, even a different structure would have been improper.

10 *Id.* at 16:14-22 and n. 39, *citing Honarkar Deposition* at 25:1-20, 122:5-113:15 [sic];
11 *Declaration of Donald Hateley*, ¶¶ 2-6. Schafer listed the Hateley Declaration as one of
12 the documents he reviewed in forming his opinion. *Id.* at 5:21-26, *citing Declaration of*
13 *Donald P. Hateley in Connection with GSM Wireless, Inc.'s Application for Order to Show*
14 *Cause As To Why Preliminary Injunction Should Not Be Issued Freezing And/Or*
15 *Preventing Impairment, Transfer, Dissipation, Or Encumbrance Of Assets Of Joseph*
16 *Fernandez de Castro Pending Trial And Satisfaction Of Claims At Issue In This Litigation*
17 *("Hateley Declaration")*. The Hateley Declaration was identified as Trial Exhibit 33, but
18 never offered nor received into evidence at trial, apparently because Trustee was unable
19 to locate and subpoena Hateley as a trial witness. *Trial Statements of John C. O'Malley*,
20 April 28, 2010 at 4:00 p.m.

21 Schafer also concluded that Honarkar and Fernandez de Castro as directors and
22 officers of GSM "owed fiduciary duties" and committed "breaches of the duty of care and
23 duty to creditors while GSM operated in the Zone of Insolvency." *Id.* at 13:6-10, 14:14-
24 20. In his trial declaration, Schafer explained why the "zone of insolvency" analysis is
25 "more accurate" than a "pure" balance sheet approach:

26 Having successfully assisted with the management and
27 restructuring of several companies, both privately and publicly held, on the
28 fringe of insolvency, I know well that determining whether a company has
the ability to meet its financial obligations requires more than a simple

1 assessment of the company's book value for tax purposes. One of the
2 landmark cases discussing the "zone of insolvency," *Pereira v. Cogan*,
3 294 B.R. 449, 521 (S.D.N.Y. 2003), describes it as a state that may exist
4 when "the corporation cannot generate and/or obtain enough cash to pay
5 for its projected obligations and fund its business requirements for working
6 capital and capital expenditures with a reasonable cushion to cover the
7 variability of its business needs over time." The term "zone of insolvency"
8 is used widely in bankruptcy treatises and case law and necessitates a
9 more broad view of a company's financial condition than the straight
10 Bankruptcy Code definition of insolvency. Based on my experience, the
11 analysis of a company's global financial condition from a "zone of
12 insolvency" perspective results in a much more accurate assessment of
13 the company's ongoing viability and ability to restructure than a pure
14 "balance sheet" approach. Based on the documentation I have reviewed
15 in this matter, there were several red flags which led me to conclude that
16 Honarkar and/or Fernandez knew or had reason to know that the
17 company was in the "zone of insolvency" at the time of the Transaction
18 was entered into, and that the value of GSM at the time of the Transaction
19 could not be based solely on financial information prepared by
20 accountants, which appears to be what Lieberman relied on in preparing
21 his rebuttal report and testifying at deposition. (Lieberman Depo. 71:24-
22 72:4.)

23 *Schafer Trial Declaration* at 18:9-26 and n. 40. Schafer defined the "zone of insolvency"
24 in footnote 40 of this trial declaration: "Again, in accordance with *Pereira* and respected
25 bankruptcy treatises such as Collier's on Bankruptcy, I define 'zone of insolvency' to be at
26 any point when a reasonable director, based on the current financial condition of the
27 company, knows or has reason to believe with reasonable likelihood that the company
28 will be unlikely (a) in the near future to meet its short term financial obligations, if not
already unable to do so, as well as (b) meet its long-term financial obligations." *Id.* at 18-
19 n. 40.

29 In his trial declaration, Schafer was making opinion statements at trial on GSM's
30 solvency at the time of the Transaction, but such statements are problematic because
31 Schafer did not conduct any financial analysis of GSM as of the time of the Transaction
32 to determine whether GSM was actually insolvent at that time or prior to the Transaction
33 under a "balance sheet" analysis. *See generally, Schafer Trial Declaration.* As
34 acknowledged by Schafer in his trial declaration, he did not review any of GSM's balance
35 sheet

1 sheets or other financial statements. *Schafer Trial Declaration* at 4-5 (listing the
2 documents Schafer relied upon to prepare his declaration, none of which include any of
3 GSM's financial statements). In his trial declaration, Schafer opined that the "zone of
4 insolvency" test was a superior form of analysis for a company's financial condition.
5 *Schafer Trial Declaration* at 18. According to Trustee, "John Schafer's testimony,
6 determining whether a corporation is insolvent and/or operating in the 'zone of
7 insolvency' gives due consideration to the corporation's ability to pay debts as they
8 become due and/or the transaction itself may result in insolvency." *Plaintiff's Proposed*
9 *Findings of Fact and Conclusions of Law* at 42:23-26 (Proposed Conclusions of Law, ¶
10 30). According to Trustee, "[t]he term [zone of insolvency] is widely used in bankruptcy
11 treatises and case law and necessitates a more broad view of the company's financial
12 condition than a straight Bankruptcy Code definition of insolvency." *Id.* at 42:26-28
13 (Proposed Conclusions of Law, ¶ 30), *citing Schafer Trial Declaration* at 18:12-18.

14 Trustee's reliance on Schafer's "zone of insolvency" analysis is legally problematic
15 because it is not the test expressly adopted in the relevant statute for determining a
16 fraudulent transfer claim, California Civil Code, § 3439.02(a), which is the "balance sheet"
17 test. California Civil Code § 3439.02(a); *In re Bay Plastics, Inc.*, 187 B.R. at 328; see
18 *also, Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal.App.4th 1020, 1038-1048
19 (2009)(holding "there is no fiduciary duty prescribed under California law that is owed to
20 creditors by directors of a corporation solely by virtue of its operating in the 'zone' or
21 'vicinity of insolvency'"), *citing, North American Catholic Educational Programming*
22 *Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 101-103 (Del. 2007). Pursuant to California
23 Civil Code § 3439.02(a), a review of GSM's financial statements would have been
24 essential to a "balance sheet" analysis to determinate whether GSM's liabilities exceeded
25 its assets. Because Schafer did not review any of GSM's financial statements and did
26 not conduct a "balance sheet" analysis and heavily relies on a "zone of insolvency"
27 approach specifically rejected in California (and Delaware), Schafer's opinion testimony

28

1 on GSM's solvency or lack thereof is not very helpful to the court.⁴

2 **2. Schafer's Equity or Cash Flow Approach**

3 Trustee's reliance on Schafer's "zone of insolvency" analysis apparently attempts
4 to invoke the presumption of insolvency under California Civil Code § 3439.02(c), which
5 provides that "a debtor who is generally not paying his or her debts as they become due
6 is presumed to be insolvent" and is known as the "equity" or "cash flow" test. *In re Bay*
7 *Plastics, Inc.*, 187 B.R. at 328 n. 22; *see also, Plaintiff's Proposed Findings of Fact and*
8 *Conclusions of Law* at 32:7-10 (Proposed Conclusions of Law, ¶ 5) ("By definition, in
9 applying the *presumption* of insolvency, the proper test and analysis of this concept is
10 whether the company can meet its debts and obligations as the[y] mature. California
11 Civil Code, § 3439.02(c) (a company is presumed insolvent when it cannot meet its debts
12 and obligations as they mature.)). Thus, in this case, Trustee does not offer evidence of
13 a "balance sheet" analysis to ascertain GSM's solvency or insolvency, but has chosen to
14 base his case on its ability or inability to pay its debts, arguing that "the proper tests and
15 analyses for whether a company is rendered insolvent via a transfer under California Civil
16 Code Sections 3439.05, 3934.04, and/or under the rules applicable to transfers to
17 shareholders, are whether the debtor could meet its debts and obligations as they
18 matured or came due." *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at
19 32:11-15 (Proposed Conclusions of Law, ¶ 6), *citing, Kirkeby v. Sup. Ct. of Orange*
20 *County*, 33 Cal.4th 642, 648 (2004) and California Civil Code, §§ 3439.04 and
21 3439.04(a)(2)(B). Trustee argues that not only the Transaction should be evaluated as a

22 _____
23 ⁴ Additionally, Schafer's reliance upon the district court's opinion in *Pereira v. Cogan*, 294 B.R. 449, 521
24 (S.D.N.Y. 2003), as his primary authority for using the "zone of insolvency" test is suspect because the
25 Second Circuit vacated the judgment entered in *Pereira v. Cogan* and remanded the case for a jury trial.
26 *Pereira v. Farace*, 413 F.3d 330 (2nd Cir. 2005), *vacating and remanding, Pereira v. Cogan*, 294 B.R. 449
27 (S.D.N.Y. 2003). The court also notes that the district court in *Pereira v. Cogan* was interpreting Delaware
28 law when it set forth its "zone of insolvency" analysis, but the Delaware Supreme Court has rejected the
"zone of insolvency" test to allow creditors to sue corporate directors directly for breach of fiduciary duty
short of insolvency. *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930
A.2d at 98-103. The "zone of insolvency" test has been rejected in California. *Berg & Berg Enterprises,*
LLC v. Boyle, 178 Cal. App. 4th 1020, 1038-1048 (2009); *accord, Swimmer v. Moeller (In re Moeller)*, 466
B.R. 525, 532 (Bankr. S.D. Cal. 2012).

1 fraudulent transfer at the time it was made, but also, each payment pursuant to the
2 Transaction should be also evaluated as a fraudulent payment to a shareholder, such as
3 Fernandez de Castro, as such payment was made. *Plaintiff's Proposed Findings of Fact*
4 *and Conclusions of Law* at 32:15-23 (Proposed Conclusions of Law, ¶ 6), *citing Flynn v.*
5 *California Casket Co.*, 105 Cal.App.2d 196, 205 (1951) and California Corporations
6 Code, § 501.

7 The Ninth Circuit Bankruptcy Appellate Panel has observed that California courts
8 have not established what constitutes sufficient evidence for a creditor to prove that a
9 debtor was presumptively insolvent by generally not paying his debts as they became
10 due. *Ash v. Moldo (In re Thomas)*, 2006 WL 6811032 at *6 (9th Cir. BAP, unpublished
11 memorandum opinion filed on July 25, 2006). To determine what constitutes sufficient
12 evidence in showing that a debtor is not generally paying debts as they become due, it is
13 appropriate for a court to look to other states that have adopted the UFTA. California
14 Civil Code, § 3439.11 ("This chapter shall be applied and construed to effectuate its
15 general purpose to make uniform the law with respect to the subject of this chapter
16 among states enacting it."); *see also, Neumeyer v. Crown Funding Corp. of America*, 56
17 Cal.App.3d at 187. CUFTA itself refers to the test from Section 303(h)(1) of the
18 Bankruptcy Code. *See* California Civil Code, § 3439.02, Legislative Committee
19 Comment 3 (comparing subdivision (c) to § 303(h)(1)). The comment refers to case law
20 under this section and implies that an inquiry under §3439.02(c) would be analogous to
21 an inquiry under § 303(h)(1):

22 In determining whether a debtor is paying its debts generally as they
23 become due, the court should look at more than the amount and due dates
24 of the indebtedness. The court should also take into account such factors
25 as the number of the debtor's debts, the proportion of those debts not being
26 paid, the duration of the nonpayment, and the existence of bona fide
27 disputes or other special circumstances alleged to constitute an explanation
28 for the stoppage of payments. The court's determination may be affected by
a consideration of the debtor's payment practices prior to the period of
alleged nonpayment and the payment practices of the trade or industry in
which the debtor is engaged.

1 California Civil Code, § 3439.02, Legislative Committee Comment 3.⁵ The court applies
2 the “totality of the circumstances” test in deciding whether a debtor is paying his debts as
3 they became due, which has been adopted by the Ninth Circuit. *Liberty Tool &*
4 *Manufacturing v. Vortex Fishing Systems, Inc. (In re Vortex Fishing Systems, Inc.)*, 277
5 F.3d 1057, 1072 (9th Cir. 2002) (citations omitted). The court is to “compare the number
6 of debts unpaid each month to those paid, the amount of the delinquency, the materiality
7 of the non-payment, and the nature of the debtor’s conduct of its financial affairs.” *Id.* For
8 the reasons discussed above and *infra*, Section I.B, the court finds that the Trustee has
9 not shown by a preponderance of the evidence that GSM was not generally paying its
10 debts as they became due.

11 3. Problematic Expert Testimony

12 Aside from his legally incorrect “zone of insolvency” opinions, Schafer also based
13 his opinion that GSM was insolvent based on the Hateley Declaration, which is
14 problematic because the declaration was not received into evidence. Under Federal Rule
15 of Evidence 703, a witness qualified as an expert may base his or her opinion on “facts or
16 data in the case that the expert has been made aware of or personally observed. If
17 experts in the particular field would reasonably rely on those kinds of facts or data in
18 forming an opinion on the subject, they need not be admissible for the opinion to be
19 admitted.” While an expert witness may base his or her opinion on inadmissible
20 evidence, the court must consider whether the evidence *adequately supports* a finding

21
22 ⁵ This inquiry is in line with the case law that has developed under Section 303(h)(1) of the Bankruptcy
23 Code, relating to involuntary bankruptcy petitions. See *Liberty Tool, & Manufacturing v. Vortex Fishing*
24 *Systems, Inc., (In re Vortex Fishing Systems, Inc.)*, 277 F.3d 1057, 1072 (9th Cir. 2002); *General Trading*
25 *Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1504 n. 41 (11th Cir. 1997); *Federal Financial Co. v.*
26 *DeKaron Corp.*, 261 B.R. 61, 65 (S.D. Fla. 2001). In *Vortex Fishing Systems*, the Ninth Circuit stated that it
27 had adopted a “totality of the circumstances” test for determining whether a debtor is generally not paying
its debts under Section 303(h). In *re Vortex Fishing Systems, Inc.*, 277 F.3d at 1072, citing, *In re Bishop,*
Baldwin, Rewald, Dillingham & Wong, Inc., 779 F.2d 471, 475 (9th Cir. 1985). The Ninth Circuit concluded
in *Vortex Fishing Systems* that “[a] finding that a debtor is generally not paying its debts requires a more
general showing of the debtor’s financial condition and debts structure than merely establishing the
existence of a few unpaid debts.” *In re Vortex Fishing Systems, Inc.*, 277 F.3d at 1072 (internal quotation
marks omitted), quoting, *In re Dill*, 731 F.2d 629, 632 (9th Cir. 1984).

1 that GSM was insolvent at the time of the Transaction or was rendered insolvent by the
2 Transaction.⁶

3 In the Hateley Declaration, Hateley said that, during his time as Chief
4 Administrative Officer of GSM, he discussed the Transaction with Honarkar. *Hateley*
5 *Declaration* at 2, ¶ 5. He stated:

6 Honarkar admitted to [Hateley] that upon Cingular Wireless paying
7 \$250,000 a month of GSM's residuals directly to Mr. Fernandez instead of
8 to GSM, this had an immediate detrimental impact on GSM's cash
9 flow . . . without the \$250,000 a month . . . GSM was not able to meet its
10 operating expenses, including the timely payment of payroll taxes owed to
11 the IRS. . . . GSM stopped making payroll tax payments to the IRS and
12 used that money to run GSM's operations.

13 *Id.* at 2-3, ¶ 5. Hateley also said in his declaration that he learned that between 2002 and
14 2005, GSM did not pay the proper amount of taxes owed to the California State Board of
15 Equalization. *Id.* at 3, ¶ 6.

16 This evidence at best provides a general description of the GSM's finances over
17 the course of three meaningful years in the company's history, 2002 through 2005. But
18 this evidence is too general in time to carry the Trustee's burden of proof on insolvency at
19 the time of the Transaction. As discussed above, the Transaction occurred in March
20 2003. "Between 2002 and 2005" does not adequately demonstrate to this court that the
21 debtor was insolvent at the time of—or rendered insolvent by—the Transaction in 2003.

22 ⁶ Indeed, attacks on the soundness of an expert's opinion or its credibility affect the *weight* of the opinion,
23 rather than its admissibility. See Fed. R. Evid. 703; *Micrfofinancial, Inc. v. Premier Holidays Int'l, Inc.*, 385
24 F.3d 72, 81 (1st Cir. 2004). An expert may rely on otherwise inadmissible evidence so long as such
25 evidence is reasonably relied upon by experts in the field. *Carson Harbor Village, Ltd. v. Unocal Corp.*, 270
26 F.3d 863, 873 (9th Cir. 2001). Schafer relied on inadmissible evidence in coming to his expert opinion that
27 GSM was insolvent at the time of the Transaction because he relied on the Hateley Declaration, which was
28 never received into evidence at trial, and Hateley did not himself testify at trial. This reliance is permissible
so long as such evidence is a type reasonably relied upon by experts in the field (i.e., the field of
determining "insolvency" for our purposes). The court finds that Schafer and other experts in his field
would be reasonable in relying on the Hateley Declaration because, post-petition, Hateley acted as the
Chief Administrative Officer of GSM, and communicated regularly with Honarkar regarding the debtor's
financial condition and its business practices. *Hateley Declaration* at 2, ¶ 4. When forming an opinion
regarding the financial stability of the debtor, it was reasonable for Schafer to consider the statements of
Hateley, who was at one time GSM's Chief Operating Officer, who was knowledgeable about GSM's
postpetition financial condition.

1 Moreover, as to the alleged admissions of Honarkar, the Hateley Declaration does
2 not state when such admissions were made by Honarkar to Hateley, and Hateley was
3 unavailable for cross-examination at trial to clarify this important point. Honarkar may
4 well have made the alleged admissions long after the Transaction occurred when he
5 became aware of the other financial problems GSM was having from its relationship with
6 Cingular as Honarkar testified. But if Honarkar made the alleged admissions before or at
7 the time of the Transaction in March 2003, this would have perhaps shown actual
8 fraudulent intent, but the evidence of his making such admissions by the date of the
9 Transaction is inconclusive.

10 **4. Rebuttal Testimony: Balance Sheet Approach**

11 Defendants offered the expert testimony of Philip Lieberman in rebuttal to the
12 expert testimony of John Schaffer on the issues of solvency and valuation. Lieberman
13 was qualified to testify as an expert because he is both a licensed certified public
14 accountant and a licensed certified business appraiser. *Direct Examination Declaration*
15 *of Philip Lieberman* at 2:9-15. According to Lieberman, he has been a certified public
16 accountant for 27 years and is an Accredited Senior Appraiser designated as such by the
17 American Society of Appraisers, who has performed appraisals of business interests for
18 14 years. *Id.*

19 Lieberman conducted a forensic accounting analysis of GSM's solvency and
20 valuation. *Id.* at 2-9 and *Rebuttal to Expert Report of John P. Schafer*, Exhibit 1 attached
21 thereto. In conducting his forensic analysis, Lieberman interviewed Honarkar and
22 reviewed GSM's financial records, including among other documents, (1) GSM's federal
23 income tax returns for the years ending December 31, 2000 through December 31, 2004;
24 (2) Work Papers and Notes prepared internally by GSM and its accounting personnel for
25 the years 2000 to 2004; (3) GSM's financial statements for the year ended December 31,
26 2002 and the accompanying Independent Accountants' Report; (4) GSM's accountants',
27 Beaudreau and Chang's, work papers used to prepare GSM's Financial Statement for the
28 year ending December 31, 2002. *Id.* at 3:6-4:6.

1 In accordance with the balance sheet analysis methodology described in *Bay*
2 *Plastics*, Lieberman took the book values of GSM's assets and adjusted them to reflect
3 fair market valuation as of the valuation date of March 31, 2003. *Id.* at 5:1-14 and
4 *Rebuttal Report*, Exhibit 1 attached thereto at 3; *see also, In re Bay Plastics, Inc.*, 187
5 B.R. at 330-331. Based on his review of the tax return and discussions with GSM's
6 officers and directors, Lieberman made downward adjustments in the book value of
7 GSM's assets reflected on GSM's balance sheet as of March 31, 2003 to reflect actual
8 market values which totaled \$1,132,430 based on depreciated replacement cost of its
9 fixed assets (under depreciated replacement cost, Lieberman determined that fair market
10 value of furniture, fixtures and equipment at 65% of cost, of leased equipment at 65% of
11 cost, vehicle at 50% of cost and leasehold improvements at 15% of cost). *Id.*, *Rebuttal*
12 *Report*, Exhibit 1 attached thereto at 3-4. The balance sheet on GSM's short year
13 income tax return for the year ending March 31, 2003 reflected current assets of
14 \$4,689,654 (including cash, commissions receivable, inventory and intercompany and
15 other assets), fixed assets of \$3,250,035 (including furniture, fixtures and equipment,
16 lease equipment, vehicle and leasehold improvements) and other assets of \$303,079
17 (deposits) for a total of \$8,242,768. *Id.* Based on the adjustments to the book value of
18 fixed assets based on depreciated replacement cost to determine fair market valuation of
19 these assets totaling \$1,132,430, Lieberman determined that the adjusted value of
20 GSM's assets as of \$7,110,338. *Id.*

21 After subtracting GSM's liabilities of \$6,137,418 as of March 31, 2003, Lieberman
22 determined that GSM had net positive book value of its assets over liabilities of
23 \$2,105,350⁷ and the fair market value of its tangible assets exceeded by liabilities by
24 approximately \$1 million (i.e., \$972,920), which Lieberman testified showed that GSM
25 was not insolvent under the balance sheet test. *Id.* at 5:8-14 and Exhibit 1 attached

26 _____
27 ⁷ GSM's balance sheet as of March 31, 2003 reflected shareholders' equity of \$2,105,350 consisting of
28 capital stock of \$40,000 and retained earnings of \$2,065,350. *Trial Exhibit 5, GSM's March 31, 2003, IRS*
Form 1120S, U.S. Income Tax Return for an S Corporation.

1 thereto. That is, Lieberman concluded that at the time of the Transaction, GSM was not
2 insolvent according to the definitions contained in Section 101(32)(A) of the Bankruptcy
3 Code, 11 U.S.C. (“the term *insolvent* means: (A) with reference to an entity . . . financial
4 condition such that the sum of such entity’s debts is greater than all such entity’s
5 property, at fair valuation, exclusive of . . . (i) property transferred, concealed, or removed
6 with intent to hinder, delay or defraud such entity’s creditors; and (ii) property that may be
7 exempted from the estate under section 522 of this title”) and Section 3439.02 of the
8 California Civil Code (“a debtor is insolvent if, at fair valuations, the sum of the debtor’s
9 debts is greater than all of the debtor’s assets). *Id.* at 5:1-9.

10 Lieberman noted that his balance sheet analysis did not take into account GSM’s
11 intangible assets, which also have value for GSM, but were not part of the balance sheet
12 analysis. *Id.* at 5:12-6:5 and *Rebuttal Report*, Exhibit 1 attached thereto. Lieberman
13 conducted further valuation of GSM under the “income” and “market” approaches. *Id.*,
14 *Rebuttal Report*, Exhibit 1 attached thereto at 5-10. Lieberman concluded that the fair
15 market value of one hundred percent of GSM’s issued and outstanding common stock as
16 of March 31, 2003 was approximately \$8,000,000 based on its capitalization rate (“cap
17 rate”) of 21.54% divided into projected net free cash flow of \$1,699,200. *Id.* at 6:14-16.
18 Lieberman determined cash flow based on pro forma revenue (\$68,000,000) based on
19 historical figures (i.e., based on first quarter 2003 of \$17,000,000 annualized) and
20 adjusted by historical cost of goods sold (45.0%) and other costs and expenses (39.0%)
21 to determine EBITDA, and then adjusted for noncash expenses, interest and taxes (36%)
22 to determine normalized net income (\$2,099,200). *Rebuttal Report*, Exhibit 1 attached
23 thereto at 9. Noncash expenses (\$800,000) is added back to the normalized net income
24 (\$2,099,200) to determine gross cash flow (\$2,899,200), and subtracting estimated
25 annual reinvestment requirements of working capital (\$400,000) and fixed assets
26 (\$800,000) to yield net free cash flow (\$1,699,200). *Id.* While not offering any valuation
27 analysis of his own, Trustee criticized Lieberman’s methodology and rebuttal report as
28 “utterly hypothetical” (see *Plaintiff’s Proposed Findings of Fact and Conclusions of Law* at

1 43:8 (Proposed Conclusions of Law, ¶ 31), the court determines that Lieberman’s
2 analysis and opinion to be credible and reasonably consistent with GSM’s historical
3 financial data as of March 31, 2003.⁸ Based on his income analysis, Lieberman opined
4 that the \$3,000,000 paid to Fernandez de Castro for his fifty percent interest in the issued
5 and outstanding common stock of GSM at the time of the Transaction was reasonable.
6 *Id.* at 6:16-17. The court also finds that this valuation determination is also reasonable
7 based on Lieberman’s income approach.

8 Lieberman relied upon GSM’s short year federal income tax return for the period
9 ending March 31, 2003 as well as the financial workpapers of GSM’s independent
10 accountant, Chang. Both sides heavily relied upon GSM’s short year income tax return
11 for the period ending March 31, 2003 for their respective positions. Based on Schafer’s
12 opinion, Trustee argued that because the return reflected a loss of \$532,377 for the short
13 year, this indicated that GSM was in the “zone of insolvency” as of that date. However,
14 as Trustee’s expert witness, Schafer acknowledged on cross-examination at trial (and as
15 Lieberman testified at trial), GSM’s federal income tax return for the short fiscal year
16 ending March 31, 2003 showed that GSM had deferred income of \$2.8 million reflected
17 on its books and on its tax return that if it had been recognized during that quarter for
18 income tax purposes would have shown that GSM actually had a net positive taxable
19 income of \$2,292,730 on that tax return. *Schafer Trial Testimony*, April 29, 2010 at 9:40-
20 9:53 a.m.; *Direct Examination Declaration of Philip Lieberman* at 7:12-21; *see also Trial*
21 *Exhibit 5, GSM’s March 31, 2003, IRS Form 1120S, U.S. Income Tax Return for an S*
22 *Corporation*. Trustee further argues that GSM would be unable to pay its debts as shown
23 by starting off 2003 with “a balance of negative \$189,000,” apparently referring to the
24

25 ⁸ Trustee argues that Lieberman’s testimony and analysis should be disregarded as hypothetical because
26 as he “patently failed” to consider actual events post-dating the Transaction (*Plaintiff’s Proposed Findings*
27 *of Fact and Conclusions of Law* at 43:22-23 (Proposed Findings of Fact, ¶ 33)), but it seems to the court
28 that to do as Trustee argues would have engaged in improper hindsight rather than evaluating
developments that could have been reasonably foreseen at the time of the Transaction. *See, In re R.M.L.,*
Inc., 92 F.3d at 155.

1 “Accumulated Adjustments Account” on the 2002 income tax return. *Plaintiff’s Proposed*
2 *Findings of Fact and Conclusions of Law* at 8:1-9:2 (Proposed Findings of Fact, ¶¶ 26
3 and 27, and 39:18-41:2 (Proposed Conclusions of Law, ¶ 24(6)). The court finds that this
4 evidence is not probative because no testimony was offered to explain the relevance of
5 the “Accumulated Adjustments Account” to GSM’s solvency.

6 **5. GSM Not Insolvent Based on Equity or Cash Flow Approach**

7 Lieberman also determined that at the time of the Transaction, GSM was not in
8 what Schafer defines as the “zone of insolvency.” *Direct Examination Declaration of*
9 *Philip Lieberman* at 7:23-28. Using Schafer’s definition of the term, as of March 31,
10 2003, GSM should have been expected to meet its short-term and long-term financial
11 obligations. *Id.* at 9:12-13. It had not suffered any real loss as of the first quarter of
12 2003, only a taxable loss due to deferred income unrecognized on the tax return. *Id.* at
13 7:15-21; *see also Trial Exhibit 5, GSM’s March 31, 2003, IRS Form 1120S, U.S. Income*
14 *Tax Return for an S Corporation.* Thus, according to Lieberman, GSM was profitable at
15 the time of the Transaction. *Id.* at 7:21-21.

16 Finally, as defendants’ rebuttal expert witness, Lieberman, testified, GSM based
17 on its financial condition at the time of the Transaction in March 2003 would have been
18 able to afford to make the buyout payments to Fernandez de Castro and would have
19 remained solvent and profitable for several years. *Lieberman Trial Declaration* at 8:3-26.
20 That is, Lieberman concluded that at the time of the Transaction, if all things had
21 remained constant, GSM had the ability to pay Fernandez de Castro for his fifty percent
22 interest in the issued and outstanding common stock of GSM without becoming insolvent
23 as a result of meeting its payment obligation of \$250,000 a month for twelve consecutive
24 months. *Id.* at 8:15-17. Lieberman’s testimony and analysis, which the court finds
25 credible, show GSM would reasonably have expected a positive cash flow for the years
26 2003 and 2004 after making the \$250,000 monthly payments to Fernandez de Castro if
27 all things had remained constant with GSM’s operations and there were no interruptions
28 or disruptions to its business due to Cingular’s policy changes. *Id.* Thus, according to

1 Lieberman's analysis, even though the projections show that GSM might have expected
2 a \$330,082 negative net cash flow after taking into account \$1,200,000 in estimated
3 annual reinvestment requirements, GSM would reasonably have expected a positive net
4 cash flow by the end of 2004 in the amount of \$510,000. *Id.* at 8:10-12. According to
5 Lieberman, GSM's historical income statements reflected EBITDA (Earnings Before
6 Interest, Taxes, Depreciation and Amortization) of \$1,399,059 for calendar year 2002
7 based on gross commission income and sales of \$43,335,881 with cost of sales of
8 \$23,773,845 and other costs and expenses of \$18,182,977. *Id.*, *Rebuttal Report*, Exhibit
9 1 attached thereto at 6; *see also, In re Red Mountain Machinery Co.*, 448 B.R. 1, 8 n. 14
10 (Bankr. D. Ariz. 2011)(explaining EBIDTA). According to Lieberman, GSM's historical
11 income statements reflected EBITDA of \$1,399,059 for the first quarter of 2003 ending
12 March 31, 2003 based on gross commission income and sales of \$17,955,938 with cost
13 of sales of \$9,899,383 and other costs and expenses of \$5,804,357. *Id.*, *Rebuttal*
14 *Report*, Exhibit 1 attached thereto at 6. The evidence of positive EBITDA for 2002 and
15 first quarter of 2003 indicates to the court that GSM was a viable going concern and does
16 not indicate that it was in the zone of insolvency as argued by Trustee.

17 Lieberman's cash flow projections for 2003 and 2004 based on this historical
18 income data for 2002 and first quarter of 2003 are reasonable based on this data known
19 as of March 31, 2003 and show that GSM would have had the ability to make the
20 payments from its residual income to Fernandez de Castro without running a deficit. *Id.*
21 According to Lieberman, GSM's historical financial data showed that it had gross
22 commission income and sales of \$24,976,158 for 2001, and of \$43,335,881 for 2002,
23 reflecting an increase of 73.5 percent from 2001 to 2002. *Id.* GSM's historical financial
24 data showed commission income and sales of \$17,955,938 for the first quarter 2003, and
25 based on the volume of sales for this quarter, Lieberman projected the same volume of
26 sales based on the first quarter results to forecast commission and sales income for the
27 remaining three quarters of 2003 at \$50,000,000, which the court finds to be reasonable.
28 *Id.* Based on GSM's historical financial data for 2001 to first quarter 2003, Lieberman

1 projected commission income and sales for GSM of \$75,000,000 for 2004, roughly a 10
2 percent increase, which the court finds also to be reasonable. The sales growth for 2001
3 to the first quarter of 2003 based on GSM's actual financial data validate Lieberman's
4 opinion that GSM as a going concern would be able to meet its payment obligations
5 under the Transaction with sufficient cash flow.

6 **6. Conclusion Regarding Insolvency**

7 Trustee's evidence of GSM's insolvency at the time of the Transaction or by the
8 Transaction consists of Schafer's opinion testimony and alleged admissions of Honarkar
9 and Fernandez de Castro. The court does not give much weight to Schafer's opinion
10 testimony because it is based on the Hateley Declaration, which is inadmissible itself and
11 in turn is based in part on alleged admissions of Honarkar, which are taken out of
12 context. The court finds that the alleged admissions of Honarkar and Fernandez de
13 Castro do not establish that GSM was insolvent at the time of the Transaction and by the
14 Transaction. Moreover, Trustee's expert, Schafer, did not conduct a balance sheet
15 analysis, and thus, Schafer's insolvency analysis does not compare with Lieberman's as
16 it did not comport with the statutory test for insolvency under the California Uniform
17 Fraudulent Transfer Act in California Civil Code, § 3439.02. On the other hand,
18 defendants' expert witness, Lieberman, has shown that GSM's assets exceeded its
19 liabilities at the time of the Transaction, and thus for purposes of § 3439.02(a), under the
20 balance sheet approach, it was not insolvent at the time of, or rendered by, the
21 Transaction. Moreover, the court finds that Trustee has also failed to show by a
22 preponderance of the evidence that GSM was unable to pay its debts as they became
23 due to raise the presumption under California Civil Code, § 3439.02(c) that GSM was
24 insolvent at the time of the Transaction. Thus, the court finds that Trustee has not met
25 his burden in showing by preponderance of the evidence GSM was insolvent at the time
26 of the Transaction, or that the Transaction rendered GSM insolvent.

27
28

1 **B. Trustee Has Not Established That GSM Intended or Believed it Would**
2 **Incur Debts Beyond Its Ability to Pay as They Become Due**

3 In support of the constructive fraudulent transfer claims against defendant, Trustee
4 argues that at the time of the Transaction in March 2003, defendants as GSM's directors
5 "intended to incur, or believed or reasonably should have believed" that GSM would incur
6 debts beyond its ability to pay as they became due under California Civil Code
7 § 3439.04(a)(2)(B). *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 35:8-
8 11 (Proposed Conclusions of Law, ¶ 16). Specifically, Trustee argues: "The pertinent
9 facts likewise show that it was unreasonable for Honarkar and Fernandez de Castro as of
10 March 2003-April 2004 to believe that GSM would have the ability to meet its debts and
11 obligations when they came due, while GSM sent \$3 million in cash to Fernandez de
12 Castro and received no equivalent cash in return." *Id.* As noted by Trustee, "As to basic
13 facts, the transfers of GSM funds to Fernandez de Castro were undertaken monthly in
14 the amount of \$250,000 from April 2003 to roughly April 2004 for the total sum of
15 \$3,000,000." *Id.* at 34:7-9 (Proposed Conclusions of Law, ¶ 11). As Trustee further
16 contends, "By October 2003, it is irrefutable that GSM could not meet its debts and
17 obligations as they matured/came due and ceased paying its payroll taxes and
18 terminated its payroll service because it did not have the necessary cash to pay them."
19 *Id.* at 34:10-12 (Proposed Conclusions of Law, ¶ 12).

20 Trustee argues that the liability of defendants is established by an alleged
21 admission by Honarkar in a state court pleading that "[a]s a result of the cash flow
22 pressures caused by the buyout of DeCastro and the need to defend and settle litigation
23 brought in bad faith by a law firm specializing in fomenting labor disputes, GSM was
24 unable to meet its payroll tax obligations during the fourth quarter of 2003 and the first
25 three quarters of 2004." *Id.* at 34:15-21 (Proposed Conclusions of Law, ¶ 13), *citing Trial*
26 *Exhibit 91*, ¶ 19; *see also, id.* at 11:17-24 (Proposed Findings of Fact, ¶ 34). That is,
27 "[Honarkar] thus has admitted that the transfers rendered GSM insolvent and unable to
28 meet its debts and obligations as they came due or matured." *Id.* at 34:21-22 (Proposed

1 Conclusions of Law, ¶ 13); see *also, id.* at 38:14-39:17 (Proposed Conclusions of Law,
2 ¶ 24(5)). Defendants vigorously dispute this argument, stating that Trustee’s “remaining
3 so called evidence of GSM’s alleged insolvency relies exclusively on circumstantial
4 evidence of GSM’s nonpayment of its payroll taxes beginning in November 2003, over 8
5 months after the Transaction.” *Defendant Honarkar’s Objections to Trustee’s Proposed*
6 *Findings of Fact and Conclusions of Law* at 12:24-26 and 13:22-14:5. While perhaps
7 supportive of the Trustee’s position, this alleged admission of defendant Honarkar does
8 not establish by a preponderance of the evidence that GSM was unable to pay its debts
9 at the time of the Transaction because Honarkar’s allegation in the later filed pleading
10 related to GSM’s ability to pay debts as of the fourth quarter of 2003 based on its payroll
11 tax problems, which is not the relevant time. Other evidence is needed to prove
12 Trustee’s argument on this point.

13 Trustee argues that “[t]he remaining evidence . . . likewise shows that the
14 inadequate financial circumstances of GSM were known when the Transaction was
15 agreed to, and should have been reasonably anticipated by anyone examining the facts
16 and circumstances at issue.” *Plaintiff’s Proposed Findings of Fact and Conclusions of*
17 *Law* at 34:23-25 (Proposed Conclusions of Law, ¶ 14). The court examines the other
18 evidence which Trustee in his proposed findings of fact and conclusions of law argues
19 indicates that the Transaction prejudiced GSM’s financial condition to establish that the
20 Transfer was a fraudulent transfer.

21 Trustee contends that GSM was generally not paying its debts as they became
22 due as shown by GSM’s debts existing before and at the time of the Transactions, by its
23 taking loans from shareholders, Honarkar and Fernandez de Castro, prior to 2002 to pay
24 expenses and by its failure to pay its employment tax obligations in November 2003. *Id.*
25 at 34:10-14 (Proposed Conclusions of Law, ¶ 12), at 35:3-7 (Proposed Conclusions of
26 Law, ¶ 15), apparently citing *Id.* at 18:7-23:21 (Proposed Findings of Fact, ¶¶ 58-60)
27 (referring to “debts and obligations as noted above in chart form”), at 37:17-24, 38:7-40:6
28 (Proposed Conclusions of Law, ¶¶ 24, 24(1), 24(4), 24(5) and 24(6)).

1 Trustee argues that GSM's bankruptcy schedules show that GSM had "repeated
2 debts dating back to 2001 and early 2002 that were still unpaid as of the bankruptcy in
3 2005." *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 38:7-13
4 (Proposed Conclusions of Law, ¶ 24(4)). While the GSM's schedules to its bankruptcy
5 petition indicates that GSM had debts as of the bankruptcy filing in 2005, including payroll
6 tax debts, the debts listed on the bankruptcy schedules filed in 2005 do not necessarily
7 show that GSM had debts or was insolvent at the time of the Transaction in March 2003.
8 Trustee relies upon GSM's bankruptcy schedules, specifically, Schedules D and F, listing
9 creditors holding secured claims and general unsecured claims, as showing debts of the
10 company going back to 2001 and 2002. *Id.* at 18:17-23:21 (Proposed Conclusions of
11 Law, ¶¶ 58-60), *citing Trial Exhibits 96 and 98, Schedule D-Creditors Holding Secured*
12 *Claims and Schedule F-Creditors Holding Unsecured Non-Priority Claims*. The court
13 does not find that the schedules are probative of GSM's debts as of the Transaction in
14 March 2003 because there is no direct evidence of the listed claims establishing such
15 debts as of that date, there is no evidence showing who and how the schedules were
16 prepared, or whether Honarkar or Fernandez de Castro had any involvement in the
17 preparation of the schedules to attribute the information in the schedules to them, and the
18 information on the schedules do not necessary show that the listed debts were incurred
19 by the time of the Transaction since many, if not most, of the reference dates listed for
20 the claims are lease creation dates and not lease default dates. Trustee did not offer
21 other evidence to show that that GSM had incurred or failed to pay the debts on the
22 schedules as of the time of the Transaction in March 2003.

23 Trustee showed that GSM failed to pay its payroll tax debts, but these debts first
24 became a problem in the fourth quarter of 2003, which was six months after the
25 Transaction in March 2003. *Honarkar Direct Examination Declaration* at 21:11-13; *Trial*
26 *Exhibit 91, ¶ 19; Fernandez de Castro Deposition* at 66:6-13.

27 Trustee did not offer other evidence to show that GSM had failed to pay any debts
28 at the time of the Transaction in March 2003. Thus, Trustee argues not so much that

1 GSM was not paying its debts as they became due as of the Transaction in March 2003,
2 but that by October 2003, it had problems paying its debts as they became due because
3 of its obligation to pay the buyout payments to Fernandez de Castro from the Transaction
4 along with its business expansion promoted by Honarkar and the pending labor law
5 litigation against GSM.⁹ *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at
6 38:14-39:17 (Proposed Conclusions of Law, ¶ 24(5)). However, Trustee did not offer any
7 evidence to show that the labor law lawsuit had any impact on GSM being unable to pay
8 its debts as they became due as of the Transaction in March 2003.

9 The court finds that Trustee has not otherwise demonstrated that defendants as
10 GSM's directors "intended to incur, or believed or reasonably believed" GSM would incur
11 debts beyond its ability to pay as they became due at the time of the Transaction. First,
12 Trustee argues that this is shown because prior to 2002, GSM was forced to cover its
13 expenses by taking loans from shareholders to the business and was already delinquent
14 on taxes. *Id.* at 37:22-24. However, while there is some evidence that defendants made
15 loans to GSM for it to pay expenses, this does not necessarily show that GSM was
16 incurring debts beyond its ability to pay as the debts became due. *Fernandez de Castro*
17 *Deposition* at 31:25-32:2. Apparently, defendants made loans to GSM to pay expenses,
18 and the loans were repaid, but the evidence does not show as argued by Trustee that
19 GSM was incurring debts beyond its ability to pay.

20 Therefore, based on the evidence presented at trial, the court finds that Trustee

21 ⁹ In February 2003, GSM and its stockholders were named as defendants in a class action lawsuit (the
22 "Class Action Lawsuit"). The plaintiffs in the Class Action Lawsuit asserted that GSM violated California
23 labor laws and sought damages in excess of \$1,000,000 plus interest, treble damages and attorneys' fees
24 and expenses. GSM's April 15, 2003 Financial Statements indicate that GSM had retained legal counsel to
25 represent it in the litigation and intended to seek an out-of-court settlement for substantially less than
26 \$1,000,000. *Trial Exhibit 57 – GSM Wireless Inc.'s Financial Statements at December 31, 2002 and for the*
27 *Year then Ended and Independent Accountants' Report* at 10. The evidence before the court is
inconclusive whether this lawsuit had any actual impact on GSM's solvency at the time of the Transaction
since no evidence was presented as to the outcome of the lawsuit. The lawsuit was settled in 2004, but
there was no evidence presented as to the nature of the claim. *Plaintiff's Proposed Findings of Fact and*
Conclusions of Law at 38:14-39:17 (Proposed Conclusions of Law, ¶ 24(5)); *Defendant and Cross-*
Complainant Mohammad Honarkar's Objections to the [Proposed] Findings of Fact and Conclusions of Law
Submitted by Plaintiff GSM Wireless, Inc., filed on June 11, 2010, at 13:22-27.

1 has not met his burden of proving by a preponderance of the evidence that GSM was not
2 paying its debts as they became due as of the date of the Transaction in March 2003.
3 However, the Trustee's arguments that the cumulative effect of GSM's obligations to pay
4 Fernandez de Castro from the Transaction rendered it insolvent or left it with
5 unreasonably small assets to operate will be discussed below.

6 The court finds that at no point during the negotiations of the Transaction did either
7 Honarkar or Fernandez de Castro believe or intend to incur debts on behalf of GSM
8 beyond its ability to pay. Relying on the advice of their financial advisors, including
9 GSM's outside independent accountant, Chang, and after considering GSM's past
10 performance, both defendants believed that the transaction would leave GSM financially
11 stable and Honarker with a valuable position in GSM moving forward from the
12 Transaction. The court also finds that Trustee's argument is rebutted by defendants'
13 evidence of intervening events, including evidence that Cingular's new policies affecting
14 GSM following the Transaction significantly contributed to GSM's subsequent financial
15 problems. Defendants could not have predicted the economic downturn after the buyout,
16 the increased competition from other Cingular stores (*Honarkar Direct Examination*
17 *Declaration* at 18:1-5), higher wholesale prices on inventory (*Honarkar Trial Testimony,*
18 *April 28, 2010* at 11:28-11:30 a.m.), Cingular's practice of understating GSM's share of
19 new activation commissions and residual commissions (*Honarkar Direct Examination*
20 *Declaration* at 18:22-25), Cingular's unilateral change of the credit evaluation policy and
21 deposit requirements for Enlace customers (*Id.* at 17:20-27), Cingular's refusal to allow
22 GSM to close the Enlace stores that were losing money (*Id.*), and the altered residual
23 payment terms resulting in 20% less commissions (*Id.* at 20:4-18) were all significant
24 intervening factors that drastically affected GSM's ability to meet its operating expenses.
25 As discussed herein, defendants have shown that GSM's inability to pay its employment
26 tax obligations was due to cash flow problems that arose after the Transaction from
27 Cingular's policy changes. Therefore, the court finds that Trustee has failed to show by a
28 preponderance of the evidence that GSM was not paying its debts as they became due

1 at the time the Transaction in March 2003 and the Transaction caused it to be unable to
2 pay its debts as they became due.

3 **C. GSM's Remaining Assets Were Not Unreasonably Small in**
4 **Comparison to the Transaction**

5 California Civil Code § 3439.04(a)(2)(A) provides that a transfer may be avoided if
6 the debtor is left with assets that are “unreasonably small in relation to the business or
7 transaction.” California Civil Code § 3439.04(a)(2)(A). “The subparagraph focuses
8 attention on whether the amount of all the assets retained by a debtor was inadequate,
9 i.e., unreasonably small in light of the needs of the business or transaction in which the
10 debtor was engaged or about to engage.” California Civil Code § 3439.04, Legislative
11 Committee Comment Note 4; *Intervest Mortgage Investment Co. v. Skidmore*, 655 F.
12 Supp. 2d 1100, 1105-1106 (E.D. Cal. 2009) (defining assets as “unreasonably small” if
13 they are “not reasonably likely to meet the debtors’ present or future needs.”).
14 Unreasonably small assets signify an inability to generate enough cash flow from
15 operations and the sale of assets to remain financially stable. *Duke Salisbury v. Texas*
16 *Commerce Bank-Houston, N.A. (In re WCC Holding Corp.)*, 171 B.R. 972, 985 (Bankr.
17 N.D. Tex 1994).

18 Trustee argues that GSM had “negative retained earnings going into 2003 and
19 significant tax losses for both years [2002 and 2003], including a loss for the first quarter
20 of 2003 in excess of \$500,000 – all before the payments to Fernandez de Castro
21 commenced.” *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 37:25-28.
22 However, this is not what the evidence showed. According to GSM's federal income tax
23 return for 2002, GSM had ordinary income of \$756,255 and retained earnings of \$37,506.
24 *Trial Exhibit 4, GSM's December 31, 2002, IRS Form 1120S, U.S. Income Tax Return for*
25 *an S Corporation*. There were no losses for 2002 or no negative retained earnings going
26 into 2002. *Id.*; see also, *Trial Exhibit 57, GSM Wireless, Inc. Financial Statements at*
27 *12/31/02 and For the Year Then Ended and Independent Accountants' Report* at 3
28 (Balance Sheet). As acknowledged by Trustee's own expert, Schafer, and testified to by

1 Lieberman, GSM's short year March 31, 2003 income tax return shows deferred income
2 that, if realized during that quarter for tax purposes, would have shown that GSM actually
3 had a net positive income of \$2,292,730. *Schafer Trial Testimony*, April 29, 2010, at
4 9:40-9:53 a.m.; *Direct Examination Declaration of Philip Lieberman* at 7:12-21; see also,
5 *Trial Exhibit 5, GSM's March 31, 2003 U.S. Income Tax Return for an S Corporation*
6 (Schedule M-1, Reconciliation of Income (Loss) per Books With Income (Loss) per
7 Return); *Trial Exhibit 57, GSM Wireless, Inc. Financial Statements at 12/31/02 and For*
8 *the Year Then Ended and Independent Accountants' Report* at 3 (Balance Sheet). The
9 balance sheet on the short year return for March 31, 2003 indicated that positive retained
10 earnings of \$2,065,350. *Trial Exhibit 5, GSM's March 31, 2003, IRS Form 1120S, U.S.*
11 *Income Tax Return for an S Corporation.*

12 Trustee also argues that despite GSM not having funds to cover expansion,
13 Honarkar decided to continue the expansion of GSM. *Plaintiff's Proposed Findings of*
14 *Fact and Conclusions of Law* at 38:1-6. In support of this argument, Trustee cites the
15 *2005 Fernandez de Castro Deposition* at 31:12-15, where Fernandez de Castro responds
16 affirmatively that, ". . .[GSM] was not able to finance both its expansion and its
17 operations directly or only from [its own] operations . . ." The impression given by this
18 statement from Fernandez de Castro's deposition testimony does not appear to be
19 supported by the financial data. For example, GSM's federal income tax return for 2002,
20 GSM reported ordinary income of \$756,255 based on gross income of \$42,335,881, cost
21 of goods sold of \$19,923,765 and other deductions of \$22,655,861. *Trial Exhibit 4,*
22 *GSM's December 31, 2002, IRS Form 1120S, U.S. Income Tax Return for an S*
23 *Corporation.* That is, GSM was not losing money in 2002 as shown by its tax return.¹⁰

24 _____
25 ¹⁰ Moreover, the balance sheet for GSM on this tax return reported shareholders' equity of \$77,506 (capital
26 stock of \$40,000 and retained earnings of \$37,506) as of December 31, 2002. *Trial Exhibit 4, GSM's*
27 *December 31, 2002, IRS Form 1120S, U.S. Income Tax Return for an S Corporation.* The shareholders'
28 equity at the end of 2002 would have been much higher if Honarkar and Fernandez de Castro had not
received stockholder distributions of \$978,673 during 2002. *Trial Exhibit 57, GSM Wireless, Inc., Financial*
Statements at December 31, 2002 and for the Year Then Ended and Independent Accountants' Report at
4.

1 Honarkar also testified that throughout 1998 and 2002, Cingular gave GSM money
2 by rapidly increasing GSM's line of credit and allowing it to open stores and expand.
3 *Honarkar Direct Examination Declaration* at 3:8-10. However, the sole fact that Cingular
4 increased GSM's line of credit between 1998 and 2002 does not establish that the
5 remaining assets of GSM were unreasonably small in relation to the Transaction.

6 Trustee additionally argues that GSM was unable to obtain financing before or
7 after the Transaction. *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at
8 41:3-5. As Honarkar testified, GSM was reliant on Cingular for its inventory and credit.
9 *Honarkar Direct Examination Declaration* at 5:6-7. The Agency Agreements between
10 Cingular and GSM required GSM to purchase its entire inventory from Cingular. In order
11 to compete with other cellular agents and participate in Cingular sponsored incentive
12 programs, GSM was then forced to sell its inventory for a loss. *Id.* at 5:7-10. The cost of
13 handsets was not recovered through retail sales, but rather was offset against the
14 amount of commissions owed to GSM in a given month by Cingular. *Id.* 5:11-12. The
15 nature of the Agency Agreements made it difficult for GSM to procure outside financing
16 and ultimately made GSM dependent on Cingular for GSM's financing. GSM's difficulty
17 obtaining outside financing was a result of the binding nature of the Agency Agreements
18 – not a symptom of GSM's financial distress. This fact by itself does not establish that
19 the remaining assets of GSM were unreasonably small in relation to the Transaction.

20 Finally, Trustee argues that GSM listed a "multi-million dollar loan" from Honarkar
21 as an asset on its balance sheet and that this greatly skewed GSM financial soundness.
22 *Plaintiff's Proposed Findings of Fact and Conclusions of Law* at 41:8-11. Lieberman's
23 testimony and analysis demonstrated that at the time of the Transaction, if all things had
24 remained constant for GSM, GSM would have been able to afford to make the payments
25 to Fernandez de Castro and remain solvent and profitable for several years. *Direct*
26 *Examination Declaration* at 7-8 and Exhibit 1 attached thereto at 5-7. Lieberman's
27 testimony and analysis further show that as of March 31, 2003, if all things had remained
28 constant with GSM's operations and there were no interruptions or disruptions to its

1 business, GSM would reasonably have expected a positive cash flow for the years ended
2 2003 and 2004 after making the \$250,000 monthly payments to Fernandez de Castro.
3 *Id.* Thus, even though the projections show that GSM might have expected a \$330,082
4 negative net cash flow after taking into account \$1,200,000 in estimated annual
5 reinvestment requirements, GSM would reasonably have expected a positive net cash
6 flow by the end of 2004 in the amount of \$510,000. *Id.* This would have resulted in a
7 \$180,000 net positive cash flow for GSM over the course of the payments to Fernandez
8 de Castro in 2003 and 2004. *Id.* Moreover, Lieberman's testimony and analysis show
9 that even after making the payments to Fernandez de Castro in 2003 and 2004, GSM
10 should have expected to have net tangible assets (recorded at book value) that exceeded
11 its liabilities by approximately \$2,100,000 and \$3,100,000 respectively. *Id.* After
12 conducting a forensic accounting analysis of GSM's financial records and projecting cash
13 flows from historical financial data, Lieberman testified that at the time of the Transaction,
14 GSM would have been able to make the payments to Fernandez de Castro and remain
15 solvent for several years based on the financial information known as of March 31, 2003,
16 proximate in time to the Transaction which occurred about a month before. *Id.* The
17 court finds that Lieberman's financial analysis and cash flow projections are conservative
18 and consistent with on GSM's historical financial data relating to revenues and expenses,
19 and are thus reasonable. Based on this testimony and analysis, the court concludes that
20 Trustee's argument that a loan from Honarkar skewed GSM's financial soundness lacks
21 merit.

22 The court finds that Trustee has failed to meet his burden of showing that GSM
23 was engaging in a business or a transaction for which the remaining assets of GSM were
24 unreasonably small in relation to the Transaction. Trustee contends that because the
25 company subsequently went bankrupt, the Transaction must have been the primary
26 cause. However, the court finds that Trustee's argument is rebutted by Defendants'
27 evidence of intervening events, including evidence that Cingular's new policies affecting
28 GSM succeeding the Transaction significantly contributed to GSM's demise. Specifically,

1 the court notes that the increased competition from other Cingular stores (*Honarkar*
2 *Direct Examination Declaration* at 18:1-5), higher wholesale prices on inventory
3 (*Honarkar Trial Testimony, April 28, 2010* at 11:28-11:30 a.m.), Cingular's practice of
4 understating GSM's share of new activation commissions and residual commissions
5 (*Honarkar Direct Examination Declaration* at 18:22-25), Cingular's unilateral change of
6 the credit evaluation policy and deposit requirements for Enlace customers (*Id.* at 17:20-
7 27), Cingular's refusal to allow GSM to close the Enlace stores that were losing money
8 (*Id.*), and the altered residual payment terms resulting in 20% less commissions (*Id.* at
9 20:4-18) were all significant intervening factors that drastically affected GSM's ability to
10 meet its operating expenses. While the court does realize that the Transaction did have
11 an immediate detrimental impact on GSM's business as testified, the Transaction by itself
12 still provided GSM with enough assets and continued cash flow to continue to operate
13 profitably as illustrated by Lieberman's testimony and financial analysis.

14 Therefore, because the assets of GSM were not left unreasonably small in relation
15 to the business because of the Transfer and GSM would have been able to operate
16 profitably as attested to by Lieberman's testimony and analysis, the court finds that the
17 Transfer should not be recovered or avoided under California Civil Code §
18 3439.04(a)(2)(A).

19 **D. Trustee Has Established that the Transaction Was Made Without**
20 **Receiving Reasonably Equivalent Value as to Honarkar, but not as to**
21 **Fernandez de Castro**

22 Lack of reasonably equivalent value is a question of fact, and Trustee bears the
23 burden of proof on this issue in a fraudulent transfer action. *Pajaro Dunes Rental*
24 *Agency, Inc. v. Spitters (In re Pajaro Dunes Rental Agency, Inc.)*, 174 B.R. 557, 578
25 (Bankr. N.D. Cal. 1994) (citations omitted). Reasonably equivalent value is not the same
26 as fair market value. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 536 (1994). In
27 determining whether a transfer was for a reasonably equivalent value, the court must
28 compare the value of the property surrendered with the value of what a debtor received in
exchange for the transfer. *In re Pajaro Dunes Rental Agency, Inc.*, 174 B.R. at 578

1 (citations omitted). Reasonably equivalent value “is to be judged from the standpoint of
2 the creditors of the debtor.” California Civil Code § 3439.03 Legislative Committee
3 Comment Note 2; *see also, In re Pajaro Dunes Rental Agency, Inc.*, 174 B.R. at 578
4 (whether debtor received reasonably equivalent consideration “is determined from the
5 perspective of creditors of the estate”).¹¹

6 In regards to the Transaction at issue, Honarkar argues that the transfer of \$3
7 million from GSM for him to buy Fernandez de Castro’s stock was made for a reasonably
8 equivalent value on grounds that GSM received valuable consideration from Honarkar in
9 connection with the Transaction in the form of (1) the Promissory Note from Honarkar;
10 (2) Honarkar Personal Guaranty and Security Pledge of all of GSM’s debts and
11 obligations to Cingular; (3) the Non-Compete Agreement from Fernandez de Castro; and
12 (4) an extension of the Cingular Exclusive Agency Agreements for five additional years.
13 Honarkar argues that from Fernandez de Castro, GSM received a Non-Competition
14 Agreement (at a time when Fernandez de Castro had already taken steps to form a
15 competing business in the markets GSM occupied).

16 This court finds that Trustee has shown by a preponderance of the evidence that
17 GSM did not receive reasonably equivalent value for the \$3 million paid for Honarkar to
18 purchase the shares belonging to Fernandez de Castro at the time of the Transaction.
19 The items described above in exchange to GSM for Honarkar’s buyout of Fernandez de
20 Castro with GSM’s residual income had some value, the court concludes that it was not
21 reasonably equivalent value. Reasonably equivalent value “is to be judged from the
22 standpoint of the creditors of the debtor.”

23

24 ¹¹ From Fernandez de Castro’s perspective, he gave reasonably equivalent value for his one-half interest
25 in GSM in light of Lieberman’s valuation of his interest based on the income approach. *Lieberman Trial*
26 *Declaration* at 6-7 and *Rebuttal Report*, Exhibit 1 attached thereto at 9. In the court’s view, Fernandez de
27 Castro sold his GSM stock to Honarkar for reasonably equivalent value when he sold it for \$3 million. In
28 this three-cornered transaction between Honarkar, Fernandez de Castro and GSM, Fernandez de Castro
gave up reasonably equivalent value for the money received in the Transaction. The lack of reasonably
equivalent value occurs in the Transaction as to the loan between Honarkar and GSM since GSM, which
was to be totally owned and controlled by Honarkar, financed the Transaction for Honarkar.

1 The court concludes that the major component of the consideration that Honarkar
2 gave for the loan from GSM to buy out Fernandez de Castro was his promise to repay
3 the \$3 million that GSM paid on his behalf from its residual income. Honarkar's promise
4 to repay the loan by GSM is memorialized in the "contingent" promissory note he gave to
5 GSM, which had an important limiting condition that the loan principal and interest would
6 only be due and payable by Honarkar only to the extent that he received dividends from
7 GSM. *Trial Exhibit 31, Promissory Note*. This favorable condition to Honarkar's loan is
8 because Honarkar was on both sides of the transaction as the borrower and the 100-
9 percent owner of the lender, signing the note for both sides. Thus, if GSM turned out to
10 be profitable in the future would he have to repay the obligation when he received his
11 dividends from GSM, but if GSM had no profits to be able to pay dividends or could not
12 due to insolvency in the future, then Honarkar has no obligation to repay the loan despite
13 his getting the benefit of GSM's payment of residual income from Cingular to pay off his
14 acquisition of Fernandez de Castro's one-half interest in GSM, and the creditors would
15 have to absorb the loss from the loan nonrepayment. In essence, Honarker in the
16 Transaction got a risk-free loan from GSM to buy out Fernandez de Castro's stock (in
17 other words for Honarkar, the contingent loan was a "heads I win, tails you lose"
18 proposition). That is, Honarkar is only obligated to pay if GSM made money and paid him
19 dividends, but if it did not make money and did not pay dividends, then some other
20 parties would bear the loss from the nonrepayment of the loan, most likely, GSM's
21 creditors. Accordingly, the court concludes that reasonably equivalent value was not
22 given by Honarkar for his benefiting from the Transaction.

23 Apparently, Honarkar argues that reasonably equivalent value was given because
24 the Transaction was functionally the same as a stock redemption because while receiving
25 Fernando de Castro's interest and becoming GSM's sole shareholder was a "nominal
26 benefit," he testified that "GSM gained the contingent Promissory Note through which it
27 would be reimbursed for any payments made to Mr. Fernandez de Castro through any
28 dividends that GSM might declare to me." *Honarkar Direct Examination Declaration at*

1 16:20-28. The court does not find that this argument has merit because the Transaction
2 was structured not as a stock redemption, but as a stock purchase financed with GSM's
3 future residual income and Honarkar chose not to use GSM's current funds to pay for the
4 stock (and he did not use his personal funds).

5 Honarkar could also argue that at the time of the Transaction, GSM had some
6 ability to pay dividends as reflected in its balance sheet on its short-year March 31, 2003
7 income tax return showed that it had retained earnings of \$2,065,350, which could have
8 been used to pay dividends, so creditors could have had a reasonable expectation of
9 repayment of the loan as of March 31, 2002. California Corporations Code, § 500(a) and
10 (b)(1) and (2); *Trial Exhibit 5, GSM's March 31, 2003, IRS Form 1120S, U.S. Income Tax*
11 *Return for an S Corporation*. However, the court concludes that this would not make a
12 difference because Honarkar was getting a risk-free loan for himself from GSM and
13 shifting the risk of loss from nonpayment to the creditors, and thus, at least as between
14 GSM and Honarkar, the transfer of GSM's funds to Fernandez de Castro, reasonably
15 equivalent value was not given.

16 Trustee argues that the court's preliminary factual finding on his motion for
17 preliminary injunction that GSM did not benefit from the Transaction indicates the lack of
18 reasonably equivalent value. However, the court's findings of fact made in connection
19 with a motion for preliminary injunction is not a binding adjudication on the merits.
20 *University of Texas v. Camenisch*, 451 U.S. 390, 395 (1981); *Hophag Research Ltd. v.*
21 *Garcia*, 475 F.3d 1029, 1035 (9th Cir. 2007); 3 Schwarzer, Tashima and Wagstaffe,
22 *California Practice Guide: Federal Civil Procedure Before Trial*, ¶ 13:179 at 13-80 (2012).
23 However, this is a moot point because the court finds in favor of Trustee on this issue as
24 to Honarkar, but not as to Fernandez de Castro.

25 **E. Trustee Has Not Established that the Transaction Was a Fraudulent**
26 **Transfer as to a Creditor Whose Claim Arose Before the Transaction.**

27 In order for Trustee to maintain a claim for constructive fraudulent transfer, Trustee
28 must show that there were creditors whose claims arose before the Transaction.

1 *California Civil Code*, §§ 3439.01(b) and (c) and 3439.05; *In re Bay Plastics, Inc.*, 187
2 B.R. at 331-332. As discussed above, Trustee has not shown that there was any creditor
3 whose claim arose before the Transaction in order to assert a claim of constructive
4 fraudulent transfer in this case (the only exception was Cingular, which consented to the
5 Transaction). *Schafer Trial Testimony*, April 29, 2010 at 9:58-9:59 a.m.; *Honarkar Trial*
6 *Testimony*, April 28, 2010 at 10:20-10:29 a.m.; *see also, Trial Exhibit 2, List of Creditors*
7 *Holding 20 Largest Unsecured Claims; Trial Exhibit 96, List of Creditors Holding Secured*
8 *Claims; Trial Exhibit 98, List of Creditors Holding Unsecured Non-Priority Claims.*
9 Trustee had not laid a proper foundation for these documents to establish that there were
10 prepetition creditor claims that arose before the Transaction on or about March 1, 2003.

11 Because Trustee has failed to prove by a preponderance of the evidence that (1)
12 GSM was insolvent at the time of the Transaction or was rendered insolvent by the
13 Transaction; (2) the Transaction left GSM unable to pay its debts as they became due;
14 (3) the Transaction left GSM with unreasonably small assets in relation to the business;
15 (4) GSM did not receive reasonably equivalent value from the Transaction, and (5) there
16 were claims of creditors whose claims arose before the Transaction, Trustee has not met
17 his burden of proving that the payments to Fernandez de Castro were “constructively”
18 fraudulent transfers pursuant to California Civil Code, § 3439.04(a)(2) and § 3439.05.

19 **II. Actual Fraudulent Conveyance Under California Civil Code Section**
20 **3439.04(a)(1)**

21 Trustee’s claim for actual fraudulent transfer under California Civil Code § 3439.04
22 against defendants was brought under California Civil Code § 3439.04(a)(1), which
23 provides:

24 A transfer made or obligation incurred by the debtor is fraudulent as to a
25 creditor, whether the creditor’s claim arose before or after the transfer was
26 made or the obligation was incurred, if the debtor made the transfer or
incurred the obligation as follows: (1) With the actual intent to hinder,
delay, or defraud any creditor of the debtor.

27 Trustee as the plaintiff bears the burden of proving a claim based on actual
28 fraudulent transfer. *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 805-806

1 (9th Cir. 1994). However, under actual fraud, Trustee need not prove that the debtor was
2 insolvent, rendered insolvent, or otherwise in a vulnerable financial condition. *Id.*; *Plotkin*
3 *v. Pomona Valley Imports (In re Cohen)*, 199 B.R. 709, 716-717 (9th Cir. BAP 1996).
4 The standard of proof for actual intent under California Civil Code § 3439.04(a) is by a
5 preponderance of the evidence. *Decker v. Voisenat (In re Serrato)*, 214 B.R. 219, 229
6 (Bankr. N.D. Cal. 1997); *Whitehouse v. Six Corp.*, 40 Cal.App.4th at 533-534.

7 Because there is usually no direct evidence demonstrating actual intent, courts
8 generally infer actual fraudulent intent from the circumstances surrounding the
9 transaction. *In re Acequia, Inc.*, 34 F.3d at 805-806. Thus, “proof by a creditor of certain
10 objective facts (for example, a transfer to a close relative, a secret transfer, a transfer of
11 title without transfer of possession, or grossly inadequate consideration) would raise a
12 rebuttable presumption of actual fraudulent intent.” *BFP v. Resolution Trust Corp.*, 511
13 U.S. at 541. In a fraudulent transfer inquiry based on actual intent, the court needs to
14 focus on the state of mind of the transferor. *In re Cohen*, 199 B.R. at 716-717.

15 Section 3439.04(b) sets forth a nonexclusive, eleven-factor test for determining
16 whether a transfer was made with an actual intent to hinder, delay, or defraud a creditor.
17 Consideration may be given, among other factors, to any or all of the following:

- 18 (1) Whether the transfer or obligation was to an insider;
- 19 (2) Whether the debtor retained possession or control of the property
20 transferred after the transfer;
- 21 (3) Whether the transfer or obligation was disclosed or concealed;
- 22 (4) Whether before the transfer was made or obligation was incurred,
the debtor had been sued or threatened with suit;
- 23 (5) Whether the transfer was of substantially all of the debtor’s assets;
- 24 (6) Whether the debtor absconded;
- 25 (7) Whether the debtor removed or concealed assets;
- 26 (8) Whether the value of the consideration received by the debtor was
27 reasonably equivalent to the value of the asset transferred or the
amount of the obligation incurred;
- 28 (9) Whether the debtor was insolvent or became insolvent shortly after

- 1 the transfer was made or the obligation was incurred;
- 2 (10) Whether the transfer occurred shortly before or after a substantial
3 debt was incurred;
- 4 (11) Whether the debtor transferred the essential assets of the business
5 to a lienholder who transferred the assets to an insider of the
6 debtor.

6 California Civil Code, § 3439.04(b). In considering the indicia of a fraudulent
7 transfer, the court “should evaluate all of the relevant circumstances involving a
8 challenged transfer” and “may appropriately take into account all indicia
9 negating as well as those suggesting fraud. . . .” *Annod Corp. v. Hamilton &*
10 *Samuels*, 100 Cal.App.4th 1286, 1298 (2002), *quoting*, Legislative Committee
11 comment for California Civil Code, § 3439.04, *12A West’s Ann. Civ. Code*
12 following California Civil Code, § 3439.04 (referring to statutory language before
13 2004 amendment of § 3439.04).

14 In evaluating the factors under California Civil Code § 3439.04(b), the court
15 determines some factors weigh in favor of Trustee and some factors weigh in favor of the
16 defendants, but on balance, the factors weigh in favor of defendants.

17 In this case, Fernandez de Castro received \$3,000,000 transferred by GSM to him
18 pursuant to the Transaction in which Honarkar borrowed against the residual income of
19 GSM, which became his wholly owned and controlled company in the Transaction, to buy
20 out Fernandez de Castro. Thus, the court finds that the first factor of Section 3439.04(b)
21 weighs in favor of Trustee because the transfer was made to Fernandez de Castro, an
22 insider of GSM, the transferor, since he had been a 50% shareholder, director and
23 president of GSM. The court determines that the transfer took place at the time of the
24 Transaction in which the contractual obligations were incurred by the parties to the
25 Transaction, Fernandez de Castro, Honarkar and GSM. The court analyzes the
26 Transaction as consisting of two components: (1) the sale and purchase of GSM stock
27 transferring it from Fernandez de Castro to Honarkar; and (2) the loan by Honarkar from
28 GSM causing the transfer of funds to pay Fernandez de Castro, and these parties were

1 contractually committed to the Transaction. Therefore, the court does not agree with
2 Trustee's argument that the transfer should be considered when the monthly installment
3 payments of \$250,000 were actually made from its residual income to Fernandez de
4 Castro.

5 The second factor does not weigh in favor of Trustee because GSM, the
6 debtor/transferor, did not retain possession or control of the transferred property, the
7 \$3,000,000, after the transfer to Fernandez de Castro. This is not a situation where the
8 transferor engages in a sham transfer to retain the right to exercise dominion and control
9 over the ostensibly transferred property. The money actually went to Fernandez de
10 Castro, the transferee.

11 The third factor is not present because the transfer was disclosed and not
12 conceals as the transfer was the culmination of a multi-party, multi-round series of
13 negotiations in which the debtor/transferor, GSM, its insiders, Honarkar and Fernandez
14 de Castro, and its primary business partner, Cingular, were actively involved in the
15 negotiations, were represented by counsel and other professionals and the transfer was
16 part of an extensively negotiated and documented transaction.

17 Fourth, regarding pending litigation, although GSM, the debtor/transferor, was
18 sued in a labor law action in 2003, this factor does not weigh because the transfer was
19 not intended to defeat such litigation, but to transfer control of GSM in one of the founding
20 shareholders. The litigation was not a motivating factor for the transfer here alleged to be
21 fraudulent. Moreover, Trustee did not offer sufficient evidence that this litigation had a
22 significant adverse impact on GSM's financial condition.

23 The fifth factor does not weigh in favor of Trustee because the transfer did not
24 involve substantially all of debtor/transferor GSM's assets. Rather, the transfer involved
25 payment by Cingular of GSM's monthly residual income of \$250,000 to Fernandez de
26 Castro for a limited period of 12 months. As shown by Lieberman's analysis and report,
27 GSM had other assets besides the residual income.

28 The sixth factor does not weigh in favor of Trustee because there is no evidence

1 that the debtor/transferor, GSM, absconded. To the extent that Honarkar is deemed the
2 debtor/transferor, there is no evidence that he absconded.

3 The seventh factor does not weigh in favor of Trustee because there is no
4 evidence that the debtor/transferor, GSM, removed or concealed assets. To the extent
5 that Honarkar is deemed the debtor/transferor, there is no evidence that he removed or
6 concealed assets.

7 The eighth factor weighs in favor of Trustee because, while the debtor/transferor,
8 GSM, received several forms of consideration in exchange for the \$3,000,000, including
9 (i) the Promissory Note from Honarkar; (ii) the Guarantee and Security Pledge
10 Agreement from Honarkar; (iii) the Non-Compete Agreement from Fernandez de Castro;
11 and (iv) five new Agency Agreements consolidating terms for each market and extending
12 the exclusive relationship between GSM and Cingular for several more years, the primary
13 consideration for the loan was Honarkar's commitment to repay the loan to GSM. The
14 terms of the loan had a huge contingency, that is, Honarkar was not obliged to repay the
15 loan unless GSM paid him dividends, so if GSM became unable to pay him dividends,
16 Honarkar had no obligation to repay the loan, even though he got the loan and any
17 benefit from it. Thus, the Transaction as between Honarkar and GSM, namely, the loan
18 by GSM to Honarkar, the consideration given by Honarkar was not reasonably equivalent
19 value to the transfer for the reasons discussed previously. However, the Transaction as
20 between Fernandez de Castro and Honarkar, namely, the purchase and sale of
21 Fernandez de Castro's stock in GSM, Fernandez de Castro gave reasonably equivalent
22 value for the transfer of his stock to Honarkar for the reasons discussed previously.

23 The ninth factor does not weigh in favor of Trustee, as discussed herein, the
24 debtor/transferor, GSM, was not insolvent at the time of the Transaction and did not
25 become insolvent as a result of the Transaction discussed previously.

26 Tenth, the Transfer did not occur shortly before GSM incurred substantial debt.

27 Eleventh, the essential assets of the business, GSM, were not transferred to a
28 lienholder who then transferred the assets to an insider of the debtor.

1 As such, only several of the eleven Section 3439.04(b) factors weigh in favor of an
2 “actual” fraudulent conveyance. In evaluating the totality of the circumstances, the court
3 finds that Trustee has failed to prove by a preponderance of the evidence a claim under
4 California Civil Code § 3439.04(a)(1) to recover a fraudulent transfer with actual intent to
5 hinder, delay or defraud any creditor by the debtor.

6 In the Transaction, one founding shareholder of GSM (Honarkar) bought out the
7 other founding shareholder (Fernandez de Castro) based on an agreed price, which
8 represented the value of the 50 percent interest of the business, and unless the
9 debtor/transferor was insolvent or rendered insolvent, the business was 100 percent
10 owned by the remaining shareholder, who could use company assets totally owned by
11 him to pay for his buyout of the other shareholder. The shareholders had irreconcilable
12 differences on how the company was to be run and decided to part ways. The evidence
13 indicates that Honarkar bought out Fernandez de Castro because Honarkar thought GSM
14 had value as a going concern and would be profitable. As discussed previously, the
15 evidence indicates that GSM was not insolvent at the time of the Transaction transferring
16 the funds to Fernandez de Castro, that GSM was not rendered insolvent by the
17 Transaction at the time it was made and that the parties to the Transaction did not
18 contemplate that GSM would not have the ability to engage in the Transaction by lending
19 the funds to Honarkar. As discussed previously, post-Transaction events primarily from
20 difficulties in the relationship between GSM and Cingular, particularly over the Enlace
21 kiosk stores, led to the subsequent financial problems that GSM had in late 2003 and
22 afterwards.

23 Given the dislike of Honarkar and Fernandez de Castro for each other at the time
24 of the Transaction, it is highly unlikely that Honarkar would effectively cash out
25 Fernandez de Castro for a large sum of money if Honarkar thought the business would
26 fail soon. If Honarkar knew that the business was going to fail, the last thing he would
27 intend is give a large sum of money to his estranged business partner, Fernandez de
28 Castro, and leave himself with exposure to personal liability to creditors for the debts of a

1 business that failed. Accordingly, the court finds Honarkar's trial testimony that he did not
2 actually intend the Transaction to be a fraudulent transfer because he expected that GSM
3 would be profitable and he wanted to keep the business for himself to be credible.

4 For the foregoing reasons, the court finds that the Transaction was not a
5 fraudulent transfer of GSM's assets to Fernandez de Castro with actual fraudulent intent
6 and denies the intentional fraudulent transfer claims.

7 **III. GSM's Claim to Avoid and Recover Preferential and Post-Petition Transfers**

8 Trustee alleged claims in the amended complaints against Honarkar and
9 Fernandez de Castro to avoid and recover preferential or post-petition assets from the
10 Transaction. However, Trustee did not present any evidence or argument regarding
11 these claims at trial. That is, no evidence was presented to show that payments pursuant
12 to the Transaction were made by GSM to Fernandez de Castro after the bankruptcy
13 petition was filed in October 2005 or within the one-year preference period for insiders
14 under 11 U.S.C. § 547. Accordingly, the court concludes that these claims should be
15 denied as abandoned.

16 **IV. Rescission Under Corporations Code Section 310**

17 Trustee asserts claims for rescission of the Transaction pursuant to California
18 Corporations Code, § 310(a), arguing that the Transaction was not just or reasonable to
19 GSM at the time it was authorized, ratified and approved.

20 California Corporations Code, § 310(a) states:

21 (a) No contract or other transaction between a corporation and one or
22 more of its directors, or between a corporation and any corporation, firm or
23 association in which one or more of its directors has a material financial
24 interest, is either void or voidable because such director or directors or
25 such other corporation, firm or association are parties or because such
26 director or directors are present at the meeting of the board or a
27 committee thereof which authorizes, approves or ratifies the contract or
28 transaction, if

- (1) The material facts as to the transaction and as to such
director's interest are fully disclosed or known to the
shareholders and such contract or transaction is approved
by the shareholders (Section 153) in good faith, with the
shares owned by the interested director or directors not
being entitled to vote thereon, or

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- (2) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified, or

- (3) As to contracts or transactions not approved as provided in paragraph (1) or (2) of this subdivision, the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.

California Corporations Code, § 310(a).

Thus, under California Corporations Code § 310, a plaintiff may seek redress for a loss caused by an interested director participating in a transaction between a corporation and the director. *Walczak v. EPL Prolong, Inc.*, 198 F.3d 725, 732-733 and n. 4 (9th Cir. 1999). California Corporations Code, § 310 provides that a contract or transaction between a corporation and one or more of its directors is not necessarily invalid and that “even if the director’s personal interest was not disclosed and the transaction was not approved or ratified by a majority of the disinterested board members or shareholders, the transaction can still be valid.” *Id.* at 732. That is, “a court can uphold the Interested Director Transaction if the party asserting the validity of the . . . transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.” *Id.*, citing, California Corporations Code § 310(a)(3) (footnote and internal quotation marks omitted).

Under Section 310, where approval of a transaction was not approved by a disinterested board of directors, the party seeking to uphold the transaction has burden to prove, under Section 310(a)(3), that the transaction was just and reasonable to the corporation. *Sammis v. Stafford*, 48 Cal.App.4th 1935, 1943 (1996) (citation omitted). If a self-interested transaction violates Section 310, the contract is voidable, and the plaintiff may elect to rescind the contract and seek restitution. *See Remillard Brick Co. v.*

1 *Remillard-Dandini Co.*, 109 Cal.App.2d 405, 424 (1952).

2 However, as discussed previously, there is a general rule that corporate directors
3 owe no duty to creditors when a corporation is solvent, and only if the corporation is
4 insolvent, there may be a duty to creditors under the “trust fund” doctrine. *Berg & Berg*
5 *Enterprises, LLC v. Boyle*, 178 Cal. App. 4th at 1038-1048. Because the court has found
6 that GSM was not insolvent at the time of the Transaction and was not rendered insolvent
7 by the Transaction and that GSM’s financial distress was caused by other post-
8 Transaction supervening causes, the court concludes that Trustee lacks standing to
9 assert a claim under California Corporations Code, § 310, against Honarkar and
10 Fernandez de Castro as directors of GSM since Trustee represents the interests of
11 creditors. *Id.*

12 For the foregoing reasons, the court denies Trustee’s claims under California
13 Corporations Code, § 310.

14 **V. Rescission under Section 315 of California Corporations Code**

15 California Corporations Code, § 315(a), provides that a corporation shall not make
16 a loan to a director or officer of a company unless that transaction is approved by the
17 majority of shareholders. First, as discussed previously, the court concludes that Trustee
18 as a representative of GSM’s creditors lacks standing to assert a claim under California
19 Corporations Code, § 315, against Honarkar and Fernandez de Castro as directors of
20 GSM because there is a general rule that corporate directors owe no direct duty to
21 creditors when a corporation is solvent and because the court has found that GSM was
22 not insolvent at the time of the Transaction and was not rendered insolvent by the
23 Transaction. *Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal. App. 4th at 1038-1048.
24 Second, Trustee’s claim under Section 315 fails as a matter of law in this case because
25 Honarkar and Fernandez de Castro, the only two shareholders of GSM, unanimously
26 consented to the Transaction. Therefore, the Transaction was approved by the majority
27 of shareholders for purposes of Section 315. As such, Trustee’s claims for rescission
28 under California Corporations Code, § 315, should be denied.

1 **VI. Breaches of Fiduciary Duty to GSM**

2 Trustee has alleged three claims against Honarkar and Fernandez de Castro
3 stating that they breached their fiduciary duties as directors to GSM in the Transaction.
4 Trustee alleges claims for breach of fiduciary duty pursuant to California Corporations
5 Code, §§ 309 and 316, breach of common law fiduciary duty of a director, and aiding and
6 abetting a breach of fiduciary duty.

7 California law mandates that a director shall perform his duties as a director “in
8 good faith, in a manner such director believes to be in the best interest of the corporation
9 and its shareholders and with such care, including reasonable inquiry, as an ordinarily
10 prudent person in a like position would use under similar circumstances.” California
11 Corporations Code, § 309(a). Section 309 codifies California’s “Business Judgment
12 Rule,” which “refers to a judicial policy of deference to the business judgment of
13 corporate directors in the exercise of their broad discretion in making corporate
14 decisions.” *Gaillard v. Natomas Co.*, 208 Cal.App.3d 1250, 1263-1264 (1989). “Directors
15 owe a duty of highest good faith to the corporation and its stockholders.” *Remillard Brick
16 Co. v. Remillard-Dandini Co.*, 109 Cal.App.2d at 424. It is a violation of these duties “for
17 officers, or directors, or majority shareholders to give away or appropriate to themselves
18 any corporate assets.” *Burt v. Irvine Co.*, 237 Cal.App.2d 828, 850 (1965).

19 Section 316 further provides that directors of a corporation will be jointly and
20 severally liable to the corporation on behalf of its nonconsenting creditors if (1) they **make**
21 an improper distribution to shareholders; (2) they distribute assets to shareholders after
22 dissolution proceedings have begun, and (3) if they make a loan or guaranty contrary to §
23 315. California Corporations Code, § 316. However, liability under California
24 Corporations Code, § 316 is subject to the Business Judgment Rule codified in Section
25 309, and a director cannot be held personally liable where he has acted in accordance
26 with the business judgment rule. *Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal.App.4th
27 1020, 1045 (2009).

28 The elements of a claim for breach of fiduciary duty are: (1) the existence of a

1 fiduciary relationship; (2) the breach of that relationship; and (3) damages proximately
2 caused by the breach. *Pierce v. Lyman*, 1 Cal.App.4th 1093, 1101 (1991). Remedies for
3 a breach of fiduciary duty include damages for all harm proximately caused to the
4 corporation, as well as rescission and restitution. *Hicks v. Clayton*, 67 Cal.App.3d 251,
5 264 (1977)(citations omitted).

6 Trustee relies on California Corporations Code, § 309 to claim that Honarkar and
7 Fernandez de Castro owed fiduciary duties as officers and directors of the corporation,
8 GSM, to act in good faith and in a manner that was in the best interests of the corporation
9 and its shareholders. There is no dispute that as CEO and President of GSM, both
10 Honarkar and Fernandez de Castro acted in fiduciary capacities for GSM. Trustee
11 alleges that Honarkar and Fernandez de Castro breached their fiduciary duties to GSM
12 by unlawfully approving and distributing GSM's funds through the Transaction. Trustee
13 contends that Honarkar and Fernandez de Castro by pursuing their own personal
14 interests rather than the best interests of GSM and its creditors, GSM was therefore
15 damaged in the amount of the transfer. However, Trustee as the representative of
16 GSM's creditors in this bankruptcy case must show that he is acting on behalf of creditors
17 whose debts or claims arose before the improper distribution to shareholders and who
18 have not consented to the distribution in order to assert a claim under California
19 Corporations Code, § 316. California Corporations Code, §§ 316, 506(b); 2 Clark (ed.),
20 *Ballantine & Sterling California Corporation Laws*, § 146.01 at 8-75 – 8-76 (4th ed. 2011).
21 As discussed previously, Trustee has not offered sufficient evidence to establish that
22 there were such creditors of the estate whose claims arose before the allegedly improper
23 distribution. Without such a showing, Trustee lacks standing to assert a claim under
24 California Corporations Code, § 316.

25 Assuming *arguendo* that Trustee has standing to assert a claim under California
26 Corporations Code, § 316, the court concludes that as the only two shareholders of
27 GSM, Honarkar and Fernandez de Castro, were free to dispose of GSM's assets
28 however they chose, so long as the corporation was not insolvent or rendered insolvent.

1 See *Miller & Lux, Inc. v. Anderson*, 318 F.2d 831, 838 (9th Cir. 1963) (holding that when a
2 “corporation is hurt, or destroyed, by the intended conduct of the owners of its shares, [it]
3 gives rise to no legal claims, either in the shareholders, or in the corporation as a legal
4 entity”); *Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal.App.4th at 1038-1048.
5 Therefore, if the shareholders unanimously consent to an action, even if the action is
6 detrimental to the company, the action does not provide legal recourse to the corporation
7 as a separate legal entity. *Id.* Honarkar and Fernandez de Castro owned one hundred
8 percent of GSM stock and because they each approved the transaction, it was
9 impossible for either Honarkar or Fernandez de Castro to breach their fiduciary duties to
10 GSM’s shareholders. *Id.* Defendants, therefore, did not violate any fiduciary duties that
11 they owed to GSM at the time of the Transaction since GSM was not insolvent at the time
12 of the Transaction or rendered insolvent by the Transaction. *Id.*; *cf.*, *In re Bay Plastics,*
13 *Inc.*, 187 B.R. at 330-331 (a leveraged buyout transaction which renders a debtor
14 insolvent may be considered a fraudulent transfer).

15 Furthermore, California Corporations Code § 309 provides an escape clause that
16 shields Fernandez de Castro and Honarkar from any liability while acting in their fiduciary
17 capacity toward GSM. Section 309 states in pertinent part:

18 (b) In performing the duties of a director, a director shall be entitled to
19 rely on information, opinions, reports or statements, including
20 financial statements and other financial data, in each case prepared
21 or presented by any of the following:

22 (1) One or more officers or employees of the corporation
23 whom the director believes to be reliable and competent
24 in the matters presented.

25 (2) Counsel, independent accountants or other persons as to
26 matters which the director believes to be within such
27 person's professional or expert competence . . .

28 so long as, in any such case, the director acts in good faith, after
reasonable inquiry when the need therefor is indicated by the
circumstances and without knowledge that would cause such reliance to
be unwarranted.

(c) A person who performs the duties of a director in accordance with
subdivisions (a) and (b) shall have no liability based upon any
alleged failure to discharge the person's obligations as a director.

1 California Corporations Code, § 309(b) and (c).

2 Defendants brought additional parties into the transaction's negotiation process,
3 including GSM's outside independent accountant, Tony Chang, their personal counsel,
4 and counsel for GSM and Cingular. The court finds that the defendants were not
5 unwarranted in their actions. GSM was not insolvent at the time of the Transaction, and
6 thus Honarkar and Fernandez de Castro were entitled to do as they saw fit with the
7 company, and under the business judgment rule, cannot be held liable for their alleged
8 failures as directors or shareholders. In fact, both Honarkar and Fernandez de Castro
9 exercised reasonable inquiry and due care as directors by including independent parties
10 and financial and legal advisors to negotiate and oversee the Transaction. By consulting
11 with their accountant who recommended an appropriate course and strategy for GSM to
12 effectively buy out Fernandez de Castro in the transaction, Honarkar and Fernandez de
13 Castro were entitled to rely on the independent accountant Chang's opinions and
14 statements in performing their duties as directors. The evidence indicates that both
15 directors of GSM acted in good faith and relied on information they believed to be reliable
16 and competent; their reliance was not unwarranted under the circumstances, and they
17 have no liability based upon their alleged failures as directors and officers of GSM.

18 Some courts have posited, however, that individual directors of financially
19 distressed corporations owe these fiduciary duties to *creditors* as opposed to
20 shareholders once the corporation operates in the "zone of insolvency" or upon
21 insolvency. See, e.g., *Credit Lyonnais Bank Nederland N.V. v. Pathe Communications*
22 *Corp.*, 1991 WL 277613 at *34 & n. 55 (Del. Ch. Ct., unpublished opinion filed on
23 December 30, 1991) ("At least where a corporation is operating in the vicinity of
24 insolvency, a board of directors is not merely the agent of the residue risk bearers [i.e.,
25 shareholders], but owes its duty to the corporate enterprise. . . . [Directors should]
26 recognize that in managing the business affairs of a solvent corporation in the vicinity of
27 insolvency, circumstances may arise when the right (both the efficient and the fair)
28

1 course to follow for the corporation may diverge from the choice that the stockholders (or
2 the creditors, or the employees, or any single group interested in the corporation) would
3 make if given the opportunity to act.”).

4 Subsequent federal and state courts considering this issue emphasize the
5 requisite of insolvency before directors owe a duty to creditors. Indeed, in *Berg & Berg*
6 *Enterprises, LLC v. Boyle*, a California Court of Appeals explained, “As long as the
7 corporation is solvent, no matter how badly managed it might be, it is able to satisfy its
8 contractual obligations to creditors who are therefore unaffected by management’s
9 business decisions.” 178 Cal.App.4th at 1039. However, once insolvency arises, “the
10 value of creditors’ contract claims may be affected by management’s business decisions
11 in a way it was not before insolvency. . . . Because insolvency shifts the residual risk of
12 management decisions from shareholders to creditors, at least some of the duties
13 formerly owed by directors only to shareholders are owed also to creditors upon that
14 circumstance. . . .” *Id.*, citing, *In re Ben Franklin Retail Stores, Inc.*, 225 B.R. 646, 652-
15 656 (Bankr. N.D. Ill. 1998).

16 The court in *Berg & Berg Enterprises* explained the general rule of no fiduciary
17 duty owed by corporate directors to creditors as follows:

18 As generally discussed by the court in *Ben Franklin*, the
19 rationale for the general rule of no duty owed to creditors is that it is the
20 shareholders who own a corporation, which is managed by the
21 directors. In an economic sense, when a corporation is solvent, it is
22 the shareholders who are the residual claimants of the corporation’s
23 assets and who are the residual risk-bearers. As long as the
24 corporation remains solvent, the business decisions made by
25 management directly affect the shareholders’ income; management
26 accordingly owes fiduciary duties to those shareholders as well as to
27 the corporation. The corporation’s creditors, on the other hand, are
28 free to protect their interests by contract. As long as the corporation is
solvent, no matter how badly managed it might be, it is able to satisfy
its contractual obligations to creditors who are therefore unaffected by
management’s business decisions. But when insolvency arises, the
value of creditors’ contract claims may be affected by management’s
business decisions in a way it was not before insolvency. At the same
time, as long as insolvency persists, shareholder value is essentially
worthless and shareholders no longer occupy the position of residual
claimants. Because insolvency shifts the residual risk of management
decisions from shareholders to creditors, at least some of the duties
formerly owed by directors only to shareholders are owed also to

1 creditors upon that circumstance, or so the theory goes.
2 178 Cal.App.4th at 1039 (footnote omitted), *citing, In re Ben Franklin Retail Stores, Inc.*,
3 225 B.R. at 652-656 and *In re Verestar, Inc.*, 343 B.R. 444, 471-472 (Bankr. S.D.N.Y.
4 2006).

5 The *Berg & Berg Enterprises* court also discussed California's "trust fund doctrine,"
6 which states that, upon a corporation become insolvent, all corporate assets "become a
7 trust fund for the benefit of all creditors." *Id.* at 1040, *citing, Pepper v. Litton*, 308 U.S.
8 295, 306-307 (1939) and its progeny. The court went on to hold that, under California
9 law, there is no fiduciary duty owed to creditors by corporate directors solely by virtue of
10 the fact that the corporation is operating in the "zone" of insolvency. *Berg & Berg*
11 *Enterprises, LLC v. Boyle*, 178 Cal.App.4th at 1041. Additionally, the court held that to
12 the extent an *already insolvent corporation* owes fiduciary duties to creditors, those duties
13 do not arise absent "trust fund doctrine" circumstances, i.e., limited "*to the avoidance of*
14 *actions that divert, dissipate, or unduly risk corporate assets that might otherwise be used*
15 *to pay creditors claims.*" *Id.* (emphasis in original); *see also, In re Moeller*, 466 B.R. at
16 533-534.

17 As discussed previously, GSM was not insolvent at the time of the Transaction in
18 2003. Thus, Honarkar and Fernandez de Castro, as the "residual risk takers" in their
19 status as shareholders were entitled to use GSM as they willed as long as it was solvent.
20 The corporate fiduciary duties did not shift from being owed to the entity over to creditors
21 because the Trustee's evidence, including the testimony of his expert, Schafer, did not
22 establish insolvency under any of the appropriate tests set forth in CUFTA. As such,
23 under California law, Honarkar and Fernandez de Castro, as corporate directors or
24 principals of a solvent GSM, did not owe fiduciary duties to GSM's creditors. *Berg & Berg*
25 *Enterprises, LLC v. Boyle*, 178 Cal.App.4th at 1038-1041; *In re Moeller*, 466 B.R. at 533-
26 534.

27 As directors of GSM, the decision made by Honarkar and Fernandez de Castro to
28 complete the Transaction is protected by the business judgment rule with respect to their

1 duties owed to the corporation itself. Additionally, Trustee has not shown that GSM was
2 not insolvent at the time of the Transaction or that it was rendered insolvent by the
3 Transaction, and thus Honarkar and Fernandez de Castro did not owe any fiduciary
4 duties to the creditors of GSM. Therefore, the court finds for defendants and against
5 Trustee for the claims under California Corporation Code, §§ 309 and 316 and the
6 common law for breach of fiduciary duty and for aiding and abetting breach of fiduciary
7 duty.

8 **VII. Breach of Loyalty**

9 In addition to claims of breach of their fiduciary duties to GSM, Trustee alleges
10 claims that defendants have breached their duty of loyalty to GSM. California courts
11 have defined the elements of these claims as analogous to a claim for breach of fiduciary
12 duty. *Huong Que, Inc. v. Luu*, 150 Cal.App.4th 400, 410 (2007); *In re Brocade*
13 *Communication Systems, Inc. Derivative Litigation*, 615 F. Supp. 2d 1018, 1036-1037
14 (N.D. Cal. 2009) (“claims for breach of an employee's duty of loyalty and aiding and
15 abetting a breach of fiduciary duty are most akin to a breach of fiduciary duty claim”). To
16 succeed on a claim for breach of the duty of loyalty, Trustee must prove that (1) the
17 existence of a relationship giving rise to a duty of loyalty; (2) one or more breaches of that
18 duty; and (3) damage proximately caused by that breach. *Huong Que, Inc. v. Luu*, 150
19 Cal.App.4th at 410.

20 In the Amended Complaints, Trustee alleges that as directors and executive
21 officers of GSM, Honarkar and Fernandez de Castro took \$3 million in funds belonging to
22 GSM as part of a personal transaction as directors and shareholders of the corporation,
23 which undermined the ability of GSM to manage its assets and receive adequate
24 consideration for them. Trustee claims that the Defendants, while acting as directors of
25 GSM, must give preference to the interests of the company and not act for their own
26 benefit to the detriment of the company. The court concludes that Trustee’s claims for
27 breach of loyalty also fails for the same reasons as the claims for breach of fiduciary duty
28 because unless GSM was insolvent, the directors and officers owed no direct duties to

1 the creditors. See, *Berg & Berg Enterprises, LLC v. Boyle*, 178 Cal.App.4th at 1038-1041.

2 **VIII. Unjust Enrichment**

3 Trustee asserts common law claims of unjust enrichment against defendants.

4 When a defendant receives a benefit in circumstances such that it would be unwarranted
5 to retain that benefit at the expense of another, the defendant is said to be unjustly
6 enriched. *Hirsch v. Bank of America*, 107 Cal.App.4th 708, 717 (2003)(citation omitted).
7 Under California law, the elements of unjust enrichment are: (1) the receipt of a benefit;
8 and (2) the unjust retention of the benefit at the expense of another. *Peterson v. Cellico*
9 *Partnership*, 164 Cal.App.4th 1583, 1593 (2008)(citation omitted). The term “benefit”
10 refers to any type of advantage, and includes “not only when one adds to the property of
11 another, but also when one saves the other from expense or loss.” *Ghirardo v. Antonioli*,
12 14 Cal.4th 39, 51 (1996). When a party has received a benefit from another, it is required
13 to make restitution only if the circumstances of its receipt or retention are such that, as
14 between the two parties, the retention of the benefit is unjust. *Id.*; see also, *California*
15 *Medical Association, Inc. v. Aetna U.S. Healthcare of California, Inc.*, 94 Cal.App.4th 151,
16 171 n. 23 (2001)(citations omitted). As a matter of law, a quasi-contract action for unjust
17 enrichment does not lie where an express binding agreement exists and defines the
18 parties' rights. *California Medical Association, Inc. v. Aetna U.S. Healthcare of California,*
19 *Inc.*, 94 Cal.App.4th at 172 (citations omitted).

20 There is no dispute that defendants benefitted from the Transaction, i.e.,
21 Fernandez de Castro obtained \$3 million dollars in cash from GSM's residuals, and
22 Honarkar obtained full control of GSM from the transaction in buying out Fernandez de
23 Castro. However, as discussed above, here, the parties to the Transaction, Fernandez
24 de Castro, Honarkar and GSM entered into binding contractual agreements for the
25 purchase by Honarker and sale by Fernandez de Castro of Fernandez de Castro's stock
26 in GSM to Honarkar and the loan by GSM to Honarkar for the purchase and sale of
27 Fernandez de Castro's GSM stock as well as other agreements with third party Cingular
28 Wireless to permit the Transaction. Thus, under *California Medical Association*, since

1 there are binding contractual agreements here, a quasi-contractual claims for unjust
2 enrichment does not lie. 94 Cal.App.4th at 172 (citations omitted). The transactional
3 documents laid out the terms of the Transaction and Honarkar as the 100% shareholder
4 of GSM had the right to dispose of its assets as long as it was not insolvent at the time of
5 the Transaction and was not rendered insolvent by the Transaction, which did not appear
6 to be the case at the time of the Transaction. As discussed above, subsequent
7 supervening events not contemplated at the time of the Transaction show that the making
8 of the payments under the Transaction would later have an adverse effect on GSM's
9 financial condition.

10 As to Fernandez de Castro, the court concludes that the unjust enrichment claim
11 should also be denied because he gave up reasonably equivalent value, his stock in
12 GSM, for the benefit conferred on him in the Transaction, so the court cannot say that he
13 was "unjustly" enriched.

14 For the foregoing reasons, the court concludes that Trustee has not proven his
15 claims for unjust enrichment.

16 **IX. Conversion**

17 Trustee asserts common law claims of conversion against defendants.
18 Conversion is the wrongful exercise of dominion or control over the personal property of
19 another. *Farmers Insurance Exchange v. Zerin*, 53 Cal.App.4th 445, 451 (1997). The
20 elements of conversion are: (1) the plaintiff's ownership or right to possession of the
21 property at the time of the conversion; (2) the defendant's conversion by a wrongful act or
22 disposition of property rights; and (3) damages. *Id.* If the plaintiff cannot show that the
23 exercise of control over the money at issue was wrongful, the cause of action must be
24 dismissed. *Otworth v. Southern Pacific Transportation Co.*, 166 Cal.App.3d 452, 458
25 (1985)(citations omitted). Conversion is a strict liability tort that "consists in the breach of
26 an absolute duty," and so "questions of the defendant's good faith, lack of knowledge,
27 and motive are ordinarily immaterial." *Mendoza v. Rast Produce Co., Inc.*, 140
28 Cal.App.4th 1395, 1405 (2006).

1 It is undisputed that GSM had a contractual right to possession of the \$3 million
2 purchase price from the residuals paid by Cingular to it. For a conversion action to lie,
3 “[n]either legal title nor absolute ownership of the property is necessary,” and “[a] party
4 need only allege that it is entitled to immediate possession at the time of conversion.”
5 *Farmers Insurance Exchange v. Zerin*, 53 Cal.App.4th at 451. However, “a mere
6 contractual right of payment, without more, will not suffice.” *Id.* As GSM did not have an
7 immediate right to possession of the residuals, but only a contractual right, GSM cannot
8 meet the first element required for a conversion claim.

9 Additionally, defendants are not liable for conversion to GSM because Honarkar
10 and Fernandez de Castro were the 100% shareholders and they were free to dispose of
11 GSM’s assets at their discretion if GSM was solvent at the time of the Transaction and
12 not rendered insolvent by the Transaction without “the duty to avoid diversion,
13 dissipation, or undue risk to assets that might be used to satisfy creditors.” *Berg & Berg*
14 *Enterprises, LLC v. Boyle*, 178 Cal.App.4th at 1046-1047. Because the shareholders
15 unanimously consented to the disposition of GSM’s assets, the action does not give rise
16 to legal claims in the corporation as a separate legal entity. *Id.*

17 Furthermore, Honarkar never exercised control over the funds at issue as Trustee
18 alleges. He never possessed the funds because Fernandez de Castro received the
19 monthly payments directly from Cingular, GSM participated and agreed to the
20 Transaction, and GSM was not damaged because it was not insolvent at the time of the
21 Transaction and was not rendered insolvent by the Transaction, and at the time,
22 Honarkar, as the 100% shareholder of GSM in the Transaction was free to dispose of its
23 assets. These facts illustrate that the Honarkar did not wrongfully convert the funds to his
24 own use and enjoyment at the time of the Transaction.

25 The funds went to Fernandez de Castro, but there was no conversion because he
26 did not obtain the funds by a wrongful act, but through a bargained-for exchange in which
27 he gave up his equity interest in GSM to Honarkar for fair consideration.

28 Thus, the court concludes that Trustee’s claims for conversion should be denied.

1 **X. Common Count**

2 Trustee's claims for "Common Count – Claim for Money" are similar to the causes
3 of action for conversion and unjust enrichment and should also be denied. The essential
4 allegations of a common count are: "(1) the statement of indebtedness in a certain sum,
5 (2) the consideration, i.e., goods sold, work done, etc., and (3) nonpayment." *Farmers*
6 *Insurance Exchange v. Zerin*, 53 Cal.App.4th at 460 (citation omitted). A cause of action
7 for money had and received is stated if it is alleged the defendant "is indebted to the
8 plaintiff in a certain sum for money had and received by the defendant for the use of the
9 plaintiff." *Id.* (internal citations omitted). "A common count is proper whenever the
10 plaintiff claims a sum of money due . . . as an indebtedness in a sum certain." *Utility*
11 *Audit Co. v. City of Los Angeles*, 112 Cal.App.4th 950, 958 (2003)(citation omitted).

12 It is undisputed that Honarkar signed a promissory note obligating himself to pay
13 GSM \$3 million. The \$3 million is a sum certain. It is also undisputed that the \$3 million
14 was consideration for the note payable to GSM. Thus, GSM has established the first and
15 second elements of a common count. However, the third element of non-payment
16 depends on the resolution of GSM's other claims. Under the terms of the promissory
17 note, Honarkar was not obligated to pay the debt due unless and until GSM issued
18 dividends on his common stock. Because GSM has yet to issue any dividends triggering
19 the requirement that Honarkar repay the \$3 million loan, under the terms of the
20 promissory note, it might be argued that a common count claim may not be ripe as to
21 Honarkar. Because it is not now likely that GSM would ever pay a dividend, this would
22 probably mean that the debt would never be payable under Honarkar's position despite
23 his getting the benefit of GSM's payment of residual income from Cingular to pay off his
24 acquisition of Fernandez de Castro's one-half interest in GSM. This may not be an
25 appropriate result because Honarkar was on both sides of the transaction as the
26 borrower and the 100-percent owner of the lender, signing the note with the condition
27 very favorable to him personally, which limited his obligation to repay the loan to any
28 dividends from GSM, that is, only if GSM turned out to be profitable in the future would he

1 have to repay the obligation. *Trial Exhibit 31, Promissory Note.*

2 Part of the consideration that Honarkar provided for the Transaction was his
3 agreement to repay GSM for the moneys it advanced to pay off his acquisition of
4 Fernandez de Castro's ownership interest in GSM, so Honarkar's argument that
5 Trustee's common count claim should be denied because it received valuable
6 consideration is a *non sequitur*.

7 Trustee does not have a valid common count claim against Fernandez de Castro
8 because Fernandez de Castro gave fair consideration to Honarkar and GSM for giving up
9 his equity interests in GSM. Such claim should be denied as against Fernandez de
10 Castro.

11 With respect to the \$900,000 investment made by Honarkar in GSM in May 2005,
12 Honarkar asserts a postpetition claim for the funds as a loan to GSM, and Trustee has
13 objected to allowance of the claim. The post-petition loan made by Honarkar was
14 approved by the court with a reservation of rights by GSM, the unsecured creditors'
15 committee and a Chapter 7 or 11 trustee. See 11 U.S.C. § 364. The court is of the view
16 that the \$900,000 loan made by Honarkar as an "investment" in the postpetition
17 reorganization of GSM in voluntary Chapter 11 proceedings in this case should be
18 appropriately considered a partial repayment of Honarkar's debt to repay the \$3 million
19 loan for the purchase of Fernandez de Castro's one-half interest in GSM. See *Defendant*
20 *Honarkar's Proposed Findings of Fact and Conclusions of Law*, lodged on May 28, 2010,
21 at 61:9-10 ("If Honarkar would have been found liable for any amounts against GSM, the
22 amount of that liability would have been offset against the \$900,000 that is due and own
23 from GSM to Honarkar.").

24 The court considers that the parties' briefing on the common count claim against
25 Honarkar is insufficient and requests further briefing on the issues of the common count
26 claim, such as the impact of the promissory note language limiting Honarkar's obligation
27 to repay the loan from GSM's dividends when now we know it is unlikely that there will
28 ever be any in light of GSM's financial distress and the possibility of offset against

1 Honarkar's postpetition loan to GSM. Accordingly, the court orders that Honarkar and
2 Trustee parties file supplemental briefs on the common count claim with 30 days of the
3 entry of this decision and that they may file optional briefs in response to the other party's
4 original supplemental brief within 14 days thereafter.

5 **XI. Accounting**

6 An accounting is a form of discovery device whose purpose is to discover the
7 amount of a sum of money owed to the plaintiff. *Teselle v. McLoughlin*, 173 Cal.App.4th
8 156, 180 (2009)(citation omitted). A cause of action for an accounting requires a showing
9 that a fiduciary relationship exists between the plaintiff and defendant that requires an
10 accounting, and that some balance is due the plaintiff that can only be ascertained by an
11 accounting. *Id.* at 179. Thus, a complaint does not state a cause of action for an
12 accounting where the plaintiff alleges the right to recover a sum certain or a sum that can
13 be made by calculation. *Id.*

14 Trustee's second amended complaint against Fernandez de Castro indicates that
15 the bankruptcy estate is seeking to recover the \$3 million paid to Fernandez de Castro
16 from the Transaction. This amount is a sum certain. Trustee admits as much by
17 pleading a cause of action for common counts, which requires the existence of a sum
18 certain. Thus, the Second Amended Complaint against Fernandez de Castro does not
19 state a proper cause of action for an accounting since the amount claimed is a sum
20 certain and should be denied. The same is true for the first amended complaint against
21 Honarkar since the amount claimed is a sum certain, namely, the \$3 million paid to
22 Fernandez de Castro for Honarkar's control of GSM, and thus, the accounting claim
23 against Honarkar should be also denied.

24 **CONCLUSION**

25 For the reasons stated above, the court finds that Trustee has failed to prove by a
26 preponderance of the evidence the claims for relief in his amended complaints against
27 defendants, which also includes the claims for declaratory relief and objections to claims
28 dependent on the other claims, except as otherwise discussed herein.

