FILED
UNITED STATES
DISTRICT COURT
DISTRICT OF UTAH

AUG 12 10 58 AM '88

MARKUS B. ZIMMER
CLERK

BY ________
DEPUTY CLERK

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

259

* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

In Re )

JON C. VASILACOPULOS )
dba Vasilacopulos and
Associates, )

Debtor, ) 82C-01031

84PC-1101

MAIN HURDMAN, Trustee, )

Appellee, )

v. ) DECISION

CHAD ANDERSON, et al., ) Re: 86-C-2526

Appellants ) Case No. 86-C-0246S

* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

This action is before the court on appeal by defendants/ appellants (the appellants) from Findings of Fact and Conclusions of Law issued by the United States Bankruptcy Court for the District of Utah. The appellants are individuals who deposited monies with the debtor of the bankruptcy proceeding in expectation of high future returns. The plaintiff/appellee Main Hurdman (the trustee) asserts the bankruptcy court correctly determined the transfers of funds to the appellants in excess of the amounts deposited constitute fraudulent conveyances as defined in 11 U.S.C.

25

§ 548(a)(2), and may be avoided by the trustee. The appellants counter that the trustee has not met its burden of proof to show the transfer was fraudulent. After reviewing the record on appeal, the arguments of counsel and pertinent authorities, the court is persuaded to affirm the bankruptcy court's order that excess transferred funds be returned to the debtor's estate.

## I. Facts

Jon Vasilacopulos (Jon or the debtor) of Vasilacopulos & Associates (V&A) started an operation in January, 1981, in which he sold diamonds to "investors" who were led to believe the diamonds were purchased from South Africa, and could be resold every 28 days at 30% profit. Jon represented he had a direct source of diamonds through the DeBeer's diamond cartel in South Africa. The investors were given the choice to leave the diamonds with V&A for resale, keep the diamonds or take the diamonds and return them at the time of sale by V&A. Initial investors were able to call in and withdraw money at a 30% return on their investments. The entire enterprise collapsed eleven months after it started, during which period, V&A allegedly defrauded more than 3,300 people of over $12 million.

On April 29, 1982, an involuntary petition under Chapter 7 of the United States Bankruptcy Code was filed against the debtor. The bankruptcy court converted the case to Chapter 11 on October 3, 1982, and appointed Main Hurdman as the trustee. On August 14, 1984, the trustee commenced this adversary proceeding seeking determination that the debtor's transfers of funds to the appellants in amounts excess of the initial investment were fraudulent conveyances under 11 U.S.C. § 548(a)(2), and requesting avoidance of the transfers and recovery of the transferred amounts for the benefit of the estate.

On October 16, 1985, the issue of the appellants' liability on the trustee's fraudulent claim was tried on its merits in the bankruptcy court. On March 19, 1986, the bankruptcy court issued Findings of Fact and Conclusions of Law holding the appellants liable for the amount in excess of their initial deposits, with individual liability to be determined at a later hearing. This appeal is taken from that final order.

II. Standard of review

The standard of review on a bankruptcy appeal is found in Bankruptcy Rule 8013, which provides in pertinent part: "Findings of Fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." The bankruptcy court's findings will not be disturbed except for the "most cogent reasons appearing in the record." In re Reid, 757 F.2d 230, 233-34 (10th Cir. 1985) (quoting Kansas Fed. Credit Union v. Niemeier, 227 F.2d 287, 291 (10th Cir. 1955)). On review of factual findings, the district court does not weigh the evidence, and should not reverse any finding because it would have reached a different decision in the first instance. Findings will not be reversed if the perception of the evidence is logical and reasonable on the record, In re Branding Iron Motel, Inc., 798 F.2d 396, 400 (10th Cir. 1986); however, conclusions of law are considered de novo. Id. at 399-400.

## III. Avoidance of transfers under 11 U.S.C. § 548(a)(2)

The trustee's powers to avoid pre-petition transfers made by a debtor are statutory. Section 548(a)(2) of 11 U.S.C. empowers the trustee to avoid a transfer of property from the debtor's estate under the following circumstances:

> (a) The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if . . . the debtor
>
> (2)(A) received less than reasonably equivalent value in exchange for such transfer or obligation; and
>
> (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (ii) was engaged in business, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts mature.

After taking evidence, the bankruptcy court determined Jon's business was a "Ponzi" scheme and that the trustee had met its burden to prove the transfers of funds to the appellants in excess of the amounts deposited constitute fraudulent conveyances under 11 U.S.C. § 548(a)(2).

> A "Ponzi" scheme refers to an investment scheme in which returns to investors are not financed through the success of the underlying business venture, but are taken from principal sums of newly attracted investments. Typically, investors are promised large returns for their investments. Initial investors are actually paid the promised returns, which attract additional investors.

In re Indep. Clearing House Co., 77 Bankr. 843 n.2 (D. Utah 1987). The bankruptcy court's conclusion that Jon ran a "Ponzi" scheme is largely based on the testimony of witnesses at trial, and examination of the record persuades the court there is sufficient evidence to support this characterization of V&A's business activities. The record shows approximately 3,300 individuals invested $12,127,033.00 in V&A. Tr. 32, 48. Jon and his agents represented to each investor that Jon owned and purchased diamonds equal to or greater than the amounts on deposit. In truth, Jon only possessed some 400 stones worth approximately $900,000.00 (Tr. 45, 58-59, 95) that were used over and over to induce sales to the investors. Jon never resold any of the diamonds to wholesalers or retailers to produce the promised profits of 30% per month. Tr. 35-45, 48-63. No profits or earnings were ever produced by the business to pay the investors. Id. Thus, the bankruptcy judge found Jon's income was a fictitious income derived solely from the deposits of investors. Findings of Fact and Conclusions of Law at 5.

The appellants raise various objections to the bankruptcy court's findings; however, they present no concrete evidence to refute the trustee's evidence. They essentially challenge assertedly unsupported portions of the witnesses' statements without providing countervailing evidence to bolster the challenges; that is, their arguments simply go to the weight the bankruptcy court gave the trustee's witnesses. Therefore, the court is persuaded the bankruptcy court did not commit clear error by finding the debtor was engaged in a "Ponzi" scheme.

The court will now consider whether the transfers of funds to the appellants in excess of the their individual investments should be returned to the debtor's estate. The trustee asserts the excess transfers are avoidable as fraudulent conveyances under § 548(a)(2) because (1) the property was transferred within one year before the date of filing of the petition; (2) the debtor was insolvent on the date of the transfers; and (3) the debtor received less than a reasonably equivalent value in exchange for the transfers.

The appellants do not contest the assertion the property was transferred to the appellants within one year of the filing of the debtor's bankruptcy petition. However, some of the appellants argue the money transferred to the appellants was not "property" of the debtor but of V&A, which is a separate and distinguishable entity. Examination of the record persuades this court otherwise. There is sufficient evidence to support the bankruptcy court's finding Jon's associates were his employees or agents. Jon's financial records introduced at trial demonstrate that virtually all the amounts received from the defendants were deposited in V&A bank accounts on which Jon was a signatory, and the payments to appellants were made by checks drawn from Jon's bank accounts. Hence, there is sufficient basis for the bankruptcy court's finding the appellants received funds from the debtor.

The bankruptcy court determined the debtor was insolvent at the time of the transfers because the debtor's business was a "Ponzi" scheme. Case law supports the notion that a "Ponzi" scheme is by definition insolvent from the commencement of its operation. Indep. Clearing House, 77 Bankr. 843; In re Coastal Equities, 33 Bankr. 898, 900 n.5 (Bankr. S.D. Cal. 1983) (a characteristic of a "Ponzi" scheme is that "the more the business succeeds, the more insolvent it becomes"); United States v. Shelton, 669 F.2d 446, 449 n.2 (7th Cir.) (a "Ponzi" scheme "requires an ever increasing stream of investors in order to fund obligations to the earlier investors, with resulting pyramiding of the liability of the enterprise"), cert. denied, 456 U.S. 934, 102 S. Ct. 1989, 72 L. Ed. 2d 454 (1982); Rosenberg v. Collins, 624 F.2d 659 (5th Cir. 1980). Further, the bankruptcy court's finding that Jon was insolvent is supported by the trial record. The record indicates the trustee made an extensive accounting of Jon's business including his deposits, withdrawals, assets and liabilities. On the basis of the trustee's detailed and exhaustive testimony, the bankruptcy court found Jon's total liability greatly exceeded his assets. In contrast, the appellants did not produce any witnesses or evidence to support their claim of Jon's solvency. They merely argue the trustee failed to account for a $24,000,000 transfer Jon allegedly made to purchase diamonds from South Africa. Because Jon was able to make a $24,000,000 transfer, they contend, he could not have been insolvent. Upon an examination of the trial transcript, the court considers the appellants' argument without foundation. The trustee introduced the $24,000,000 transfer document only to show one of the witnesses relied upon it, not to prove the transfer actually took place. The record indicates that none of the people intimately involved with Jon ever saw a single diamond allegedly paid for by the $24,000,000 transfer. Some of the appellants further assert Jon was involved in selling gold and silver along with the diamonds. The court also rejects this assertion as unfounded. The record is devoid of evidence that gold or silver was ever sold in any significant amount to investors. Consequently, the court upholds the bankruptcy court's conclusion that Jon was insolvent at the time of the subject transfers.

Having determined the debtor was engaged in a "Ponzi" scheme, the bankruptcy court concluded that payments of fictitious profits to investors in the scheme were not made for a reasonably equivalent value, and thus are avoidable as fraudulent conveyances. Lawless v. Anderson (In re Moore), 39 Bankr. 571 (Bankr. M.D. Fla. 1984); see Rosenberg, 624 F.2d 659 (affirming the district court's decision that transfers in excess of a defendant's total cash deposits were without fair consideration); Larrimer v. Feeney, 411 Pa. 604, 192 A.2d 351 (1963) (transfers in excess of a defendant's investment plus the legal rate of interest were without fair consideration under the Pennsylvania Fraudulent Conveyance Act); Eby v. Ashley, 1 F.2d 971 (4th Cir. 1924), cert. denied, 266 U.S. 631, 45 S. Ct. 197, 69 L. Ed. 478 (1925). In Indep. Clearing House, this district held,

> The law allowing a trustee to avoid payments of fictitious Ponzi scheme profits as fraudulent conveyances embodies the principal [sic] that no one should profit from a fraudulent scheme at the expense of others. Were the defendants allowed to keep payments in excess of their undertakings, they would be profiting at the expense of those who entered the scheme late and received little or nothing. The fortuity that these defendants got into the scheme early enough to make a profit should not entitle them to a reward at the expense of equally innocent undertakers who entered the scheme later, perhaps as a result of misplaced faith borne of prior undertakers' success. On the other hand, if the trustee is allowed to avoid transfers of fictitious profits the defendants are not hurt but will be in roughly the same position they were in before they

> entrusted their money to the debtors. They will still have all the funds that they invested . . . . We therefore hold that, to the extent the defendants received more than their undertaking, the debtors did not receive a reasonably equivalent value in exchange for the transfers, the defendants did not give value in exchange for the transfers, and the trustee can avoid the transfers under section 548(a)(2), as well as under section 548(a)(1).

77 Bankr. at 870. Following this line of authority, the court concurs in the bankruptcy court's finding that the debtor received less than a reasonably equivalent value in exchange for the transfers.

Accordingly, the court determines the bankruptcy court, upon finding the facts supporting its conclusion that the trustee met its three-prong statutory burden, correctly reached its ultimate conclusion that the transfers were fraudulent conveyances under § 548(a)(2). The court will now address some of the other arguments raised by the appellants.

IV. Propriety of conversion from Chapter 7 to Chapter 11

The appellants represented by George K. Fadel argue that because the debtor's bankruptcy case was converted from Chapter 7 to Chapter 11 without proper notice and hearing, the trustee was not authorized to commence the adversary proceedings. However, review of the record leads the court to conclude the case was properly converted from Chapter 7 to Chapter 11.

The conversion of bankruptcy cases from Chapter 7 to 11 is governed by 11 U.S.C. § 706 which provides in pertinent part, "On request of a party in interest and after notice and a hearing, the court may convert a case under this chapter (11 U.S.C. 701) to a case under chapter 11 of this title (11 U.S.C. 1101) at any time." The record reflects that on October 8, 1982, the creditors served a proposed Order Converting Case from Chapter 7 to Chapter 11 upon the debtor and other interested parties. The proposed Order requested that the motion be granted without hearing unless the debtor or any other interested party should object. On October 15, 1982, the bankruptcy judge, after determining that a conversion would benefit all interested parties, and receiving no objections, ordered that the case be converted to Chapter 11. Under § 706(b), the decision whether to convert the case is left to the sound discretion of the bankruptcy judge. Notes of Committee on the Judiciary, S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978). Therefore, the court concludes the bankruptcy judge did not abuse its discretion by converting the case from Chapter 7 to Chapter 11.

V. Use at trial of Jon's criminal record

Appellant Winegar asserts that because the trustee did not introduce evidence at trial of Jon's criminal record, the record may not be considered on appeal. This court need not reach that argument because it is irrelevant to the question whether the trustee met its burden in establishing the elements of a fraudulent conveyance.

VI. Conclusion

The court affirms the bankruptcy court's order that the trustee may recover excess funds transferred to each appellant, together with prejudgment interest at the legal rate, in amounts to be determined at a bankruptcy hearing.

DATED this 12th day of August, 1988.

BY THE COURT:

David Sam

DAVID SAM
U.S. DISTRICT JUDGE

cc: attys 8/12/88:dp
Carolyn Montgomery, Esq.
George K. Fadel, Esq.
Paul N. Cotro-Manes, Esq.
Bankruptcy Clerk