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District Court Overturns the *TOUSA* Fraudulent Transfer Ruling

ROBIN RUSSELL, JOHN J. SPARACINO, AND CHASLESS L. YANCY

The authors of this article explain a recent federal district court decision which overturned a bankruptcy court's ruling that loan obligations and related asset pledges made by various subsidiaries of home builder TOUSA, Inc. prior to their bankruptcy filings were fraudulent conveyances.

A federal district court has reversed a bankruptcy court's ruling that loan obligations and related asset pledges made by various subsidiaries (the "Conveying Subsidiaries") of home builder TOUSA, Inc. ("TOUSA") prior to their bankruptcy filings were fraudulent conveyances. The district court held that the company's lenders did not have to return nearly $480 million in loan repayments to the debtors' estates for the benefit of their creditors.

In a 113-page opinion, Judge Alan Gold of the United States District Court for the Southern District of Florida overturned a 2009 bankruptcy court decision by Judge John K. Olson, which ordered the company's lenders to return $421 million plus pre-judgment interest to TOUSA's bankruptcy estate. Judge Gold found that the previous ruling was "clearly erroneous," as Judge Olson had erred in his legal definitions of such terms as "value" and "property," and found that the bankruptcy court's decision would place an "impossible burden" on lenders. The district court opinion appears to sup-

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port TOUSA and its subsidiaries' business judgment in entering the transactions previously found to be fraudulent and as such should restore confidence in the market that bankruptcy courts will respect the arms-length financial decisions of sophisticated parties.

BACKGROUND

TOUSA and its subsidiaries are a large conglomerate of home building companies. The assets of the TOUSA group consist of land and homes in various stages of development and related assets. Historically, the TOUSA group's two main principal sources of funding were bonds and a revolving credit facility. Additionally, TOUSA had received third party financing related to a joint venture with Transeastern Properties, Inc. TOUSA was the primary obligor on the bond, revolving credit facility and Transeastern obligations. Many of TOUSA's subsidiaries were guarantors of the bond and revolving credit facility obligations; however, virtually none of the subsidiaries were responsible for the debt associated with the Transeastern joint venture.

In late 2006, the lenders associated with the Transeastern joint venture financing (the "Transeastern Lenders") declared TOUSA to be in default, and litigation ensued. In July 2007, TOUSA entered into two term loan agreements, a First Lien Term Loan of $200 million and a Second Lien Term Loan of $300 million, in order to fund the settlement of the Transeastern litigation. Because the settlement included the Conveying Subsidiaries as "Subsidiary Borrowers" and required them to pledge their assets — which were already pledged under TOUSA's revolving credit facility — as security for the loans, the lenders under the revolving credit facility required TOUSA and its subsidiaries to enter into an amended and restated revolving loan agreement. The majority of the proceeds of the two term loans were used to pay off the Transeastern debt.

Shortly thereafter, it became clear that the July 2007 loan transactions would not be sufficient to keep TOUSA and its subsidiaries operating as a going concern. The bulk of the companies' financial troubles were attributable to the declining economic market. On January 29, 2008, TOUSA and most of its subsidiaries filed voluntary Chapter 11 petitions in the Southern District of Florida. In July 2008, the Official Committee of Unsecured Creditors

(the "Creditors' Committee") filed an adversary proceeding against TOUSA's lenders asserting, among other things, that the Conveying Subsidiaries' pledges of assets in the July 2007 loan transactions constituted fraudulent conveyances.

In October 2008, the bankruptcy court agreed with the Creditors' Committee, holding in a 182-page decision that (i) a fairly common fraudulent transfer "savings" clause in the amended and restated revolving credit facility was invalid and could not provide a shield against fraudulent transfer liability and (ii) the Conveying Subsidiaries had not received reasonably equivalent value for the pledge of their assets to the term loan lenders. The bankruptcy court thus held that the July 2007 credit transactions constituted a fraudulent transfer as to the Conveying Subsidiaries and ordered that the value of such transfers, plus pre-judgment interest, be returned to the TOUSA debtors' estates.

The bankruptcy court opinion was controversial, both for its finding that no reasonably equivalent value was given and its rejection of the savings clause. The district court has, for now, resolved at least one half of the controversy.

THE DISTRICT COURT OPINION

The district court reversed portions of the bankruptcy opinion, finding that they were both legally and factually incorrect. Most importantly, the district court reversed the bankruptcy court's determination that no reasonably equivalent value was given to the Conveying Subsidiaries in exchange for their pledge of assets in connection with the term loans. In reversing, the district court held that reasonably equivalent value need not be concrete dollar-for-dollar value, but can be found where the value given is intangible, such as an economic benefit. Specifically, Judge Gold held:

- "Contrary to the Bankruptcy Court's legal conclusion, the weight of authority supports the view that indirect, intangible, economic benefits, including the opportunity to avoid default, to facilitate the enterprise's rehabilitation, and to avoid bankruptcy, even if it proved to be short lived, may be considered in determining reasonably equivalent value. An expectation, such as in this case, that a settlement which would avoid

default and produce a strong synergy for the enterprise, would suffice to confer 'value' so long as that expectation was legitimate and reasonable."

- "What is key in determining reasonable equivalency then is whether, in exchange for the transfer, the debtor received in return the continued opportunity to financially survive, where, without the transfer, its financial demise would have been all but certain."
- "[I]t is enough that the July 31 Transaction left the Conveying Subsidiaries in a better position to remain as going concerns than they would have been without the settlement."

In making these determinations, Judge Gold eschewed the bankruptcy court's stringent hindsight test. "[M]uch of what the Bankruptcy Court did was to review the transactions at issue through the lens of retrospection to point out that bankruptcy ultimately was not avoided. But whether a debtor received reasonably equivalent value must be evaluated as of the date of the transaction."

The district court's ruling as to reasonably equivalent value should provide significant comfort to lenders. The court clearly rejected a mechanical "dollar-for-dollar" equivalency analysis. Rather, the various types of intangible values held to be applicable and relevant to a reasonable equivalency analysis should enhance lenders' ability to defend against fraudulent transfer claims in connection with loans to multi-entity corporate families.

It is important to note, however, that one issue left open by the district court opinion is the bankruptcy court's rejection of the fraudulent conveyance savings clauses as invalid. Although the court "quashed" the bankruptcy court's order as it related to the Transeastern Lenders, the issue of the amended and restated revolving credit facility, and the savings clause set forth therein, remains open for another day. It remains to be seen whether the bankruptcy court's *per se* rejection of the savings clause will be addressed in further proceedings or applied by other bankruptcy courts. For the moment, however, it appears that the lending community must continue to be cognizant of that aspect of the bankruptcy court's decision.