In re TOUSA—Florida District Court Reverses and Quashes Bankruptcy Court Fraudulent Transfer Decision

Introduction

On February 11, 2011, Judge Alan S. Gold of the United States District Court for the Southern District of Florida issued a 113-page opinion in *In re TOUSA, Inc.* (the "District Court decision")[1] in which he reversed the *TOUSA* bankruptcy court's decision.[2] In that prior decision, the bankruptcy court had found that certain lenders (referred to in Judge Gold's decision as the "Transeastern Lenders") were the recipients of fraudulent transfers when TOUSA's indebtedness to them (the "Transeastern Loans") was paid in full from the proceeds of $500 million in term loans made in 2007 (the "New Term Loans").

District Judge Gold reversed the bankruptcy court on every major issue, and in a somewhat rare procedural move, quashed the bankruptcy court's opinion, rather than remanding the matter back to the bankruptcy court to enter new findings and issue a new opinion consistent with the District Court decision. In so ruling, Judge Gold also sharply criticized the bankruptcy court for its near-complete adoption of the post-trial submissions of the plaintiff in the case (TOUSA's Official Committee of Unsecured Creditors (the "Committee")) in the bankruptcy court's own findings of fact.

Facts

TOUSA and its affiliates, homebuilders with operations in various parts of the country, commenced Chapter 11 cases on January 29, 2008 (the "Petition Date"). As of the Petition Date, TOUSA had more than $1 billion of bond debt (guaranteed by nearly all subsidiaries), approximately $320 million under a revolving credit facility and $500 million outstanding of New Term Loans. The New Term Loans had been extended approximately six months before the bankruptcy to finance TOUSA's repayment of the debt of one of its affiliates, referred to in the opinion as the Transeastern Joint Venture, and to resolve litigation relating thereto, thereby avoiding cross-defaults on TOUSA's bond and loan debt from a material judgment. The New Term Loans, unlike the loans that had been extended by the Transeastern Lenders, were guaranteed by substantially all of TOUSA's subsidiaries, which also pledged their assets to secure such guarantees.

On July 14, 2008, the Committee commenced an adversary proceeding against the lenders which had advanced the New Term Loans (the "New Lenders") as well as the Transeastern Lenders. The Committee asserted that the Transeastern Lenders had received fraudulent transfers from the "Conveying Subsidiaries" (those TOUSA affiliates that had not guaranteed or otherwise had been obligated for the Transeastern Loans, but that had guaranteed the New Term Loans) because, among other things, (i) the New Term Loans rendered the Conveying Subsidiaries insolvent and (ii) the Conveying Subsidiaries did not receive reasonably equivalent value for the

incurrence of the guarantees of New Term Loans or the granting of the related liens.

Bankruptcy Court Opinion

On October 30, 2009, Bankruptcy Judge Olson held that the Transeastern Lenders were the direct transferees, under Section 548 of the Bankruptcy Code, of fraudulent transfers made by the Conveying Subsidiaries. Additionally, he held that the Transeastern Lenders were entities "for whose benefit" the Conveying Subsidiaries had granted liens to the New Lenders, rendering such lenders liable under Section 550(a) of the Bankruptcy Code. Accordingly, the bankruptcy court avoided the transfers and ordered the Transeastern Lenders to disgorge the approximately $433 million in New Term Loan proceeds that they had received to satisfy TOUSA's outstanding indebtedness to them. The Transeastern Lenders posted bonds of more than $531 million and appealed the bankruptcy court order.

Additionally, with respect to the New Term Loans, the bankruptcy court found that the Conveying Subsidiaries' incurrence of the obligations to repay the New Term Loans constituted fraudulent transfers, including a finding that the industry-standard guaranty "savings clause" was ineffective. This separate appeal remains pending before District Judge Adalberto Jordan.

District Court Opinion

Because the bankruptcy court adopted the plaintiff's proposed findings nearly verbatim, the district court held that those findings were not entitled to substantial deference under the "clearly erroneous" standard of review. Instead, the district court undertook essentially a *de novo* review of the facts and issues on appeal. The two issues on appeal, as framed by the district court, were as follows:

- **The Direct Transferee Issue:** Whether the Transeastern Lenders could be compelled to disgorge funds originally lent to, and repaid by, a parent to satisfy a legitimate, uncontested debt, where the Conveying Subsidiaries did not control the transferred funds; and
- **The For Whose Benefit Issue:** Whether the Transeastern Lenders could be liable as entities "for whose benefit" the Conveying Subsidiaries transferred liens to the New Lenders, where the Transeastern Lenders received no direct and immediate benefit from the liens transferred to the New Lenders.

Analysis

THE DIRECT TRANSFEREE ISSUE

In its decision, the bankruptcy court held that the Conveying Subsidiaries had an interest in the proceeds of the New Term Loans transferred at closing to the Transeastern Lenders. In particular, the bankruptcy court held that "the Conveying Subsidiaries had a property interest in the loan proceeds … but the value of that property interest to the Conveying Subsidiaries was minimal."[3] However, in determining whether the Conveying Subsidiaries received "reasonably equivalent value" (an element of a cause of action for a constructive fraudulent transfer under Section 548), the bankruptcy court identified the entire amount transferred (more than $400 million) to the Transeastern Lenders as the amount of the transfer, and found no reasonably equivalent benefit to the Conveying Subsidiaries.

The district court reversed, holding that the terms of the New Term Loan documents and the totality of the circumstances surrounding the New Term Loans were clear: the proceeds of the New Term Loans were to be paid to the Transeastern Lenders and the Conveying Subsidiaries never had control over the proceeds of the New Term Loans. Because the Conveying Subsidiaries never had any "interest" in such proceeds, payment of loan proceeds to the Transeastern Lenders in satisfaction of TOUSA's debt could not be a fraudulent transfer.

The district court went on to find that even if the Conveying Subsidiaries had any interest in the proceeds of the New Term Loans, such interest was "minimal." As a result, the district court agreed with the arguments of the Transeastern Lenders that the Conveying Subsidiaries received reasonably equivalent value for any transfer of their minimal interest in the proceeds, because repayment of the Transeastern Loans eliminated the potential cross-default under the $1 billion bond debt that would result from an adverse judgment in the Transeastern litigation.

In particular, the district court concluded that "eliminating the threat of these claims against the Conveying Subsidiaries' parent, and indirectly against each of them, constituted **an enormous economic benefit to these subsidiaries** in terms of their viability as going concerns and their continued access to financing through the TOUSA parent, which, in turn, allowed them, for a period of time, to continue to pay interest to the bondholders, the very creditors at issue." (emphasis added). In short, the district court ruled that indirect economic benefits to a corporate group could, and should, be considered in the calculus of adequate consideration for fraudulent conveyance purposes.

THE FOR WHOSE BENEFIT ISSUE

The bankruptcy court alternatively had held that the Transeastern Lenders also were liable under Section 550 of the Bankruptcy Code as entities "for whose benefit" the Conveying Subsidiaries transferred the liens to the New Lenders. The district court rejected this holding, noting that "the bankruptcy court's overly broad interpretation of Section 550(a) erroneously neglects to analyze the specific text of that provision."

In the district court's analysis, there are three types of entities from whom a trustee may recover an avoidable transfer: (i) an initial transferee, (ii) an entity for whose benefit the initial transfer was made and (iii) a subsequent transferee. It was undisputed that the Transeastern Lenders never received any portion of the lien interest that the Conveying Subsidiaries granted to the New Lenders, so, consequently, they could not be considered initial or subsequent transferees. The district court further rejected the notion that the Transeastern Lenders could be considered entities for whose benefit the transfers were made solely because they had received some of the proceeds of the New Term Loans. As District Judge Gold noted, in the typical case, Section 550(a) is meant to capture "the benefit to a guarantor by the payment of the underlying debt of the debtor."

The district court found that the bankruptcy court's analysis of Section 550(a) in this case would drastically and improperly expand the Section's scope; the district court also ultimately rejected the Committee's attempt to collapse the granting of the liens and payment of the Transeastern Loans into a single transaction as against the weight of the evidence and inconsistent with positions that the Committee took on other issues at trial.

Conclusion

The District Court decision in TOUSA is an emphatic overruling of all aspects of the bankruptcy court's opinion that were before it on appeal.

The District Court decision's length and considerable complexity are due to, among other things: (i) the complex factual history relating to the Transeastern Loans and New Term Loans; (ii) the numerous, holdings of the bankruptcy court that resulted in it finding the Transeastern Lenders liable under Section 548 and Section 550(a) of the bankruptcy court; and (iii) the district court's focus on creating a clear record, and various alternative bases for its decision, in the event of a subsequent appeal to the Eleventh Circuit.

A decision relating to the appeal of the New Lenders (which, as noted above, is being heard by

a separate district court judge) is expected soon, but in the interim, District Judge Gold's opinion offers some additional clarity and comfort to lenders that receive payment from the proceeds of a new facility that involves additional co-obligors or collateral. We note, however, that even after the lengthy, emotional TOUSA decisions, fraudulent conveyance cases remain highly fact-specific, and the remedies provided in the law for purported fraudulent conveyances remain somewhat uncertain.

Endnotes

[1] *3V Capital Master Fund Ltd. v. Official Committee of Unsecured Creditors of TOUSA, Inc. (In re TOUSA, Inc.)*, S.D. Fla., 10-60017, [Dkt. No. 131].

[2] For more information, please see our Legal Update, "Viability of Guaranty "Savings Clauses" Questioned by Florida Bankruptcy Court Decision" available at http://www.mayerbrown.com/publications/article.asp?id=8195&nid=6.

[3] District court opinion, p. 56.

For more information about the TOUSA decision or any other matter raised in this Legal Update, please contact your regular Mayer Brown lawyer, or one of the following lawyers.

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