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RESTRUCTURING AND FINANCE DEVELOPMENTS
Controversial Fraudulent Transfer Ruling Reversed on Appeal

In a reassuring development for lenders, District Judge Alan S. Gold of the Southern District of Florida has reversed the Bankruptcy Court's decision in *In re TOUSA, Inc.* (discussed in our Nov. 2, 2009 memo, [*Bankruptcy Court Voids Subsidiary Guaranties and Liens as Fraudulent Transfers*](#)). In a strongly worded decision harshly critical of the lower court, the District Court held as a matter of law and undisputed fact that the lenders had no fraudulent transfer liability. *In re TOUSA, Inc.*, ___ B.R. ___, 2011 WL 522008 (S.D. Fla. Feb. 11, 2011). Finding no liability, the District Court did not address on appeal the expansive and draconian array of remedies and penalties the Bankruptcy Court had imposed on the lenders, which were held to be "null and void." *Id.* at *52.

The parent debtor in *TOUSA* caused its home building subsidiaries (the "Conveying Subsidiaries") to guarantee and secure \$500 million in new secured debt, the bulk of which was used to settle litigation with a prior unsecured lender group. The parent had been obligated to the prior lender group, but the Conveying Subsidiaries had not. The Bankruptcy Court found that the transaction was a fraudulent transfer to both the new lenders and the prior lenders. Each lender group appealed, and the appeals were assigned to different District Court judges. This District Court decision reversed the decision below as to the prior lenders; the appeal brought by the new lenders has not yet been decided.

The District Court's emphatic rejection of the Bankruptcy Court's characterization of the transaction as a fraudulent transfer is significant in numerous respects:

First, the District Court criticized the Bankruptcy Court's finding of lack of reasonably equivalent value to be both clearly erroneous and "contrary to well-established case law which holds that indirect benefits may take many forms, both tangible and intangible." *Id.* at *33. The District Court joined several Courts of Appeals in "reject[ing] the notion that a debtor must receive a direct, tangible economic benefit in order to receive 'value'" under fraudulent transfer law. *Id.* at *34. Under the "totality of the circumstances" test, the District Court held that *TOUSA* "is exactly the kind of case, as supported by applicable case law, that shows that a debtor's opportunity to avoid default, to facilitate its rehabilitation, and to improve its prospects of avoiding bankruptcy are precisely the kind of benefits that, by definition, are not susceptible to exact quantification but are nonetheless legally cognizable under Section 548." *Id.* at *40. In doing so, the District Court ruled that the "value" analysis could properly consider the effect of the transaction "on the viability of the *TOUSA* enterprise as a whole." *Id.* at *38.

Second, the District Court rejected as legally impermissible the use of "hindsight" in determining reasonably equivalent value as of the transaction date, and criticized the Bankruptcy Court for reviewing "the transactions at issue through the lens of retrospection to point out that bankruptcy ultimately was not avoided." *Id.* at *40.

Third, the District Court found that the Bankruptcy Court's criticism of the lenders' good faith imposed "patently unreasonable and unworkable" duties of due diligence and inquiry notice

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on the banks. Citing law that “cautions against imposing exhaustive duties to investigate upon banks and other creditors,” the District Court ruled that the prior lenders “had no reason or legal duty to conduct such extraordinary due diligence with respect to the provenance of the funds with which they were being repaid.” *Id.* at *48-*49.

Other aspects of the Bankruptcy Court’s decision that were not reached by the District Court, including the imposition of preference liability based on after-acquired collateral and the troubling *dicta* regarding contractual “savings clauses” in upstream guarantees, are likely to be considered in the new lenders’ separate appeal. District Judge Adalberto Jordan, who is presiding over that separate appeal, has entered an order requiring supplemental briefing in light of Judge Gold’s decision, and ordered the parties “not to argue whether Judge Gold’s ruling is correct,” but rather “to assume the ruling is correct.” Judge Jordan’s order, together with the strength of Judge Gold’s reversal – and, particularly, his harsh criticism of essentially everything that the Bankruptcy Court did below – renders highly questionable even those aspects of the Bankruptcy Court’s decision that have not already been expressly reversed.

Harold S. Novikoff

David C. Bryan