

# Real Estate Workout Advisory

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## How to Avoid a Fraudulent Transfer Finding: What the *In re Tousa, Inc.* Fraudulent Transfer Decision Teaches About Savings Clauses, Solvency Opinions, and Due Diligence

A recent decision from the U.S. Bankruptcy Court for the Southern District of Florida, *In re TOUSA*,<sup>1</sup> has received widespread attention for its seemingly sweeping rejection of insolvency / fraudulent conveyance “savings clauses,” and its finding that a syndicate of prominent banks engaged in a fraudulent transfer. The resulting order (now on appeal) requires lenders to disgorge hundreds of millions of dollars. We have received a number of questions regarding the impact of this decision, and we provide below some insights, gleaned from the decision, for commercial lenders who hope to avoid a similar fate.

### Background

In 2005, homebuilder TOUSA and Transeastern Properties, Inc. entered into a joint venture funded by certain lenders (the “Transeastern Lenders”). The joint venture was described by the Court as “disastrous,” and led to litigation between TOUSA and the Transeastern Lenders. In July 2007, TOUSA settled the litigation with a payment of approximately \$420 million to the Transeastern Lenders. TOUSA financed the settlement payment with new loans from a different group

of lenders (the “First and Second Lien Lenders”) totaling \$500 million (the “2007 Financing”), which were secured by liens on substantially all the previously unencumbered assets of certain subsidiaries (the “Conveying Subsidiaries”). Significantly, the Conveying Subsidiaries were not obligated to the Transeastern Lenders in connection with the original joint venture financing, and were not parties to the litigation or the settlement.

Shortly after the 2007 Financing, TOUSA and the Conveying Subsidiaries filed for bankruptcy. The Official Committee of Unsecured Creditors commenced an adversary proceeding to avoid as fraudulent transfers the liens granted by the Conveying Subsidiaries as part of the 2007 Financing, and to recover the approximately \$420 million paid to the Transeastern Lenders. In a detailed 182-page ruling, the Bankruptcy Court found that the Conveying Subsidiaries did not receive reasonably equivalent value in exchange for the liens they granted as part of the 2007 Financing, were insolvent both before and after the 2007 Financing, and had unreasonably small capital to operate as a result of the 2007 Financing. Since all elements