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February 2011

**BUSINESS RESTRUCTURING,
CREDITORS' RIGHTS &
BANKRUPTCY UPDATE**

Round Two of TOUSA Battle Goes to Lenders

In October 2009, the court overseeing the TOUSA, Inc. bankruptcy cases in the Southern District of Florida set off considerable alarm bells throughout the lending community when the court unraveled a refinancing transaction as a fraudulent conveyance. This finding was based, in primary part, on the fact that certain subsidiaries of TOUSA, Inc. pledged their assets as collateral for a new loan that was used to repay prior debt that was not secured by those subsidiaries' assets. The bankruptcy court's pronouncement required the disgorgement of hundreds of millions of dollars in payments received by the prior lenders and the avoidance of liens that encumbered the subsidiaries' assets that were given to the take-out lenders. As of February 11, 2011, secured lenders can breathe a little easier now that the district court for the Southern District of Florida has reversed a portion of the bankruptcy court's decision in the TOUSA bankruptcy cases.

THE TOUSA BANKRUPTCY CASES

TOUSA, Inc., together with its numerous affiliates and subsidiaries (collectively, "Tousa"), was a large regional residential developer and builder. In July 2007, Tousa entered into a financing arrangement with a group of lenders (the "New Lenders") for the purpose of funding a litigation settlement with another group of lenders (the "Old Lenders") that had previously provided separate financing for a failed joint venture involving certain Tousa entities.

Under the new financing, a number of Tousa subsidiaries (the "Conveying Subsidiaries"), who were not parties to the loans with the Old Lenders, were named as borrowers on the New Lenders' loans. The Conveying Subsidiaries granted security interests and liens on certain of their assets as security for the new financing, and the settlement payment to the Old Lenders was funded.

Not long after entering into the new lending arrangement with the New Lenders, the housing market in Florida (and elsewhere) took a decided turn for the worse (an "economic Pearl Harbor," according to one media report cited in the district court opinion), freezing credit markets and drying up the pool of home buyers, which, in turn, doomed Tousa.

Tousa filed for bankruptcy protection in January 2008. Shortly thereafter, an official committee of unsecured creditors (the "Committee") was appointed, and in July 2008, the Committee brought a lawsuit on behalf of Tousa's bankruptcy estate against a number of prepetition secured creditors of Tousa, seeking, among other things, avoidance and recovery of substantial prepetition payments and lien interests under preference and fraudulent transfer theories. Included in the action were claims brought on behalf of the Conveying Subsidiaries against the Old Lenders and the New Lenders for avoidance of alleged fraudulent transfers under 11 U.S.C. § 548 (the "Bankruptcy Code") as a result of the 2007 financing and settlement payments.

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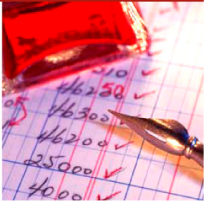
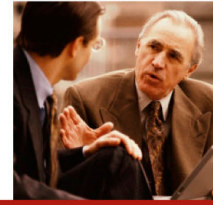
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“TOUSA 1”¹

In its complaint, the Committee alleged that the July 2007 transaction, including the settlement payment to the Old Lenders, was an avoidable fraudulent transfer because the Conveying Subsidiaries were rendered insolvent as a result of the transaction and they did not receive “reasonably equivalent value” in return.

After a bench trial lasting more than two weeks and involving nearly two dozen witnesses and thousands of trial exhibits, the bankruptcy court issued a 182-page opinion, in which it held in favor of the Committee on all claims. Specifically, it held that that the settlement payment to the Old Lenders, supported by the pledges of assets, could be set aside as a fraudulent transfer, and that the obligations incurred by the Conveying Subsidiaries to the New Lenders, and the liens securing those obligations, could be set aside as fraudulent transfers because they were for the ultimate benefit of the Old Lenders. The court also set aside other transfers, including a transfer of lien rights, acquired pursuant to an after acquired property clause, that attached to the right to a substantial tax refund arising during the 90-day period prior to Tousa’s bankruptcy.

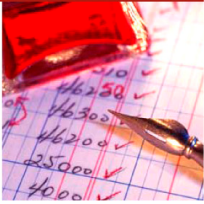
The holdings in *Tousa 1* and their accompanying rationales caused justifiable anxiety among many lenders and commentators apprehensive that the decision represented a dramatic expansion of so-called avoidance rights under the Bankruptcy Code. A number of appeals were taken from *Tousa 1* to the U.S. District Court for the Southern District of Florida, one of which – involving an appeal by the Old Lenders – was recently decided.

“TOUSA 2”²

In a harshly critical opinion, the federal district court judge reversed the bankruptcy court’s decision as to the Old Lenders, holding that the transfers to the Old Lenders were not avoidable under Bankruptcy Code Section 548 and related provisions. First, the district court held that the payment sought to be avoided was not a transfer of property of the Conveying Subsidiaries; thus, an essential element of Bankruptcy Code Section 548 could not be met. Instead, the proceeds of the new loans were property of the parent. Moreover, the court held that even if the Conveying Subsidiaries indirectly transferred interests in their property, they also received reasonably equivalent value in return by way of corresponding direct and indirect benefits in the form of averting defaults under other obligations³ and a likely bankruptcy, as well as substantial tax benefits and an opportunity to rehabilitate their businesses. The court neither accepted nor rejected the bankruptcy court’s finding that the Conveying Subsidiaries were insolvent at the time of the transaction.

THE BROADER IMPLICATIONS OF *TOUSA 2*: WHAT DOES THE FUTURE HOLD?

Tousa 2 involved one subset of appeals arising out of multifaceted transactions involving numerous borrower, guarantor and lender parties, replete with factual and legal intricacies and complexities. As such, its holding is, for now, limited to the precise transactions before it. Nonetheless, the reverberations of *Tousa 2* may be substantial and the implications far-reaching.



First, the *Tousa 2* opinion supports the practice of allowing subsidiaries to incur obligations for the benefit of their parent under the theory that the total enterprise benefits from the obligations incurred by the individual members of the enterprise. Further, the opinion discusses in detail how the bankruptcy court erred in applying the benefit of 20/20 hindsight to second-guess transactions that, at the time, appeared legitimate and realistic based on the information then available.

The opinion also decides important issues relevant to the other appellate proceedings and severely undermines the reasoning and rationale of *Tousa 1*. Perhaps most significantly, it chastises the bankruptcy court's uncritical and nearly wholesale adoption of the Committee's proposed findings of facts and conclusions of law as its own – not even attempting to harmonize inconsistencies therein – thereby casting serious doubt on the credibility of those findings and conclusions as to the other appellate proceedings.

As mentioned, *Tousa 2* is the first decision to arise out of the currently pending appeals from *Tousa 1*. Other appeals involve transfers and parties not directly before the court in *Tousa 2*. Given this, it is not out of the question that another district court judge, when presented with a different set of transactions, parties and legal considerations, will arrive at a different or partially different result. Moreover, given the high stakes (nearly a half-billion dollars, including pre-judgment interest), a further appeal from *Tousa 2* to the next level, the Eleventh Circuit Court of Appeals, appears likely. In other words, *Tousa 2* does not totally negate the impact of *Tousa 1* once and for all.

What is certain though is that, at a minimum, *Tousa 2* limits *Tousa 1*'s fallout and lessens its reverberative impact. The *Tousa 2* opinion relentlessly and persuasively undermines the bankruptcy court's analysis at nearly every step, and it could be a harbinger of things to come in the other appeals.

While the final chapters of the *Tousa* saga remain to be chronicled, for now at least, lenders can take a good deal of comfort from this first of perhaps several aftershocks of *Tousa 1*.

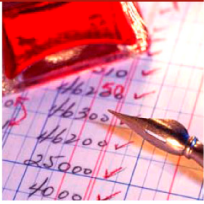
FOR MORE INFORMATION

Thompson Hine's Business Restructuring, Creditors' Rights & Bankruptcy and Commercial & Public Finance practice groups assist lenders in structuring financing transactions in a manner designed to enhance protections against preference and fraudulent transfer liabilities that may arise after a borrower goes into distress.

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¹ *Official Committee of Unsecured Creditors of Tousea, Inc. v. Citicorp North America, Inc. (In re Tousea, Inc.)*, 422 B.R. 783 (Bankr. S.D. Fla. 2009).

² *3V Capital Master Fund Ltd. v. Official Committee of Unsecured Creditors of Tousea, Inc. (In re Tousea, Inc.)*, Case No. 10-60017 (S.D. Fla. Feb. 11, 2011).

³ Tousea’s operations were financed in large part by issuances of unsecured bond indebtedness and a revolving credit facility, under which most of the numerous Tousea entities were jointly and severally liable as borrowers, pledgors and/or guarantors. Testimony at trial implied that had TOUSA, Inc. not settled with the Old Lenders, defaults may have been triggered under the bonds and/or credit facility.