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## TOUSA: \$300 Million Revolving Loan Facility Avoids Fraudulent Conveyance Attack

In a second decision of the United States District Court for the Southern District of Florida involving secured lenders to bankrupt homebuilder TOUSA, Inc., on March 4, 2011, Judge Adalberto Jordan affirmed the dismissal of fraudulent conveyance claims brought against the lenders on a revolving credit facility. In dismissing those claims, the Bankruptcy Court had emphasized that, because the revolving credit agreement was entered into, and the liens securing it were pledged, well before the company's alleged insolvency, they were immune from fraudulent conveyance attack. In affirming, the District Court rejected the argument advanced by the unsecured Creditors' Committee that new transfers occurred while the company was insolvent because the debtors continued to draw on the line and because the revolver loan agreement was amended and restated, and the liens securing it reperfected, within the alleged period of insolvency.

The decision provides additional comfort to lenders that *ex post* deteriorations of a debtor's financial condition will not expose lenders on committed credit facilities to fraudulent conveyance liability merely for honoring their pre-existing lending commitments, even if those agreements are amended after the borrower becomes insolvent.

### FACTS

Prior to filing for Chapter 11 protection in early 2008, TOUSA, Inc. and its various subsidiaries (collectively, "TOUSA") were one of the nation's largest homebuilders. In March 2006, a lending syndicate administered by Citicorp North America, Inc. extended the company an \$800 million revolving credit line for working capital and other general corporate purposes. The credit agreement was amended on several subsequent occasions, including in October 2006 to provide for upstream guaranties by the company's subsidiaries and to secure the debt with liens on substantially all of the subsidiaries' assets, and in January 2007 to give the subsidiaries the right to draw on the revolver directly as co-borrowers.

Shortly thereafter, it became apparent that the enterprise's viability was threatened by the parent company's exposure on guarantees to lenders to a failed joint venture in which the parent company had invested. The enterprise reached an agreement in principle to settle that claim for \$420 million in cash and certain other consideration. This agreement necessitated an amendment to the revolver permitting TOUSA to take \$500 million in secured term loans to finance the settlement, which closed in July 2007. The July 2007 revolver amendment reduced the \$800 million cap on the credit line to \$700 million and permitted the enterprise to pledge their assets to secure the term loans. Thereafter, all of the liens were perfected anew to reflect the addition of the term lenders as additional secured parties.

Beginning in August 2007, a series of events unfolded that caused a freeze in the world's credit markets with corrosive effects on TOUSA's business. In an effort to keep the enterprise afloat, the revolver

was amended twice more in late 2007 to waive certain covenants that would have frozen additional borrowings. But on January 29, 2008, the enterprise filed petitions for Chapter 11 bankruptcy protection. At the time of that filing, over \$300 million was outstanding on the revolver.

TOUSA's Committee of Unsecured Creditors brought an adversary proceeding challenging the various transactions that closed in July 2007 as fraudulent conveyances on the grounds that TOUSA was insolvent at that time. Under Section 548 of the Bankruptcy Code, a transfer (such as a lien) or an obligation (such as the promise to repay a loan) can be avoided if (i) it was made while the debtor was insolvent, or it rendered the debtor insolvent, and (ii) the debtor received less than reasonably equivalent value from the transaction. Critical to the Committee's claims against the revolver was the allegation that it involved transfers that occurred in or after July 2007, when TOUSA was allegedly insolvent, and not during some earlier period. To that end, the Creditors' Committee argued that the July 2007 transactions, including the amendments of the revolver, rendered the revolver a "new loan" and sought to avoid the lien transfers and repayment obligations, even though the revolver dated back to March 2006 and the liens to October 2006, when the enterprise's solvency was not in dispute.

## **IN THE BANKRUPTCY COURT**

The Committee made several unsuccessful attempts to prosecute its revolver-related claims in the Bankruptcy Court. Opposing the motion to dismiss its initial complaint, the Committee argued that every draw on the revolver after July 2007 constituted the incurrance of a new obligation, even though the credit facility had been formed and the liens pledged long before then. The Committee based this argument on *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir. 1981), in which the Second Circuit held that guarantors "'incurred' an 'obligation' of repayment, although admittedly a contingent one, whenever [the principal borrower] borrowed under the loan line."

In dismissing the Committee's complaint, the Bankruptcy Court rejected "the notion that the transfer occurs at a time after the granting of the lien." The Court granted the Committee leave to replead, and the Committee filed an amended complaint challenging the revolver under a different theory: instead of characterizing each draw as a separate conveyance, the Committee argued that the various amendments to the Revolver in July and later in 2007 had the effect of dissolving the credit facility and forming a wholly new credit facility, thus "resetting" the transfer dates of the underlying liens and obligations. The Bankruptcy Court rejected this argument too, finding that subsequent amendments did nothing to change the transfer dates of liens that had already been granted. The Committee was again granted leave to replead but, after submitting a third amended complaint, elected instead to withdraw that complaint and to pursue an appeal of the Bankruptcy Court's ruling in the District Court.

## **THE DISTRICT COURT'S RULING**

In the District Court, the Committee advanced three theories for reversal. First, the Committee argued that the execution of an amended and restated revolving loan agreement in July 2007 constituted the incurrance of a new obligation. Second, it argued that the lenders' reperfecting of their liens following the July 2007 closing constituted new transfers. Third, it argued that each draw by TOUSA on the revolver after July 31, 2007 constituted the incurrance of a new obligation.

In rejecting the first argument, the District Court found that no new obligations were incurred as a consequence of the amended and restated revolving loan agreement in July 2007. The court pointed to language in that agreement to the effect that obligations incurred and liens granted under the prior

version of the revolver shall remain in effect. The District Court also rejected the Committee's argument that, because the amended and restated revolver was materially altered from the prior version to permit TOUSA to take on \$500 million in term loan debt, the July 2007 agreement was a new obligation. The District Court observed that, while the July 2007 revolver permitted TOUSA to take in term loan debt, it did not require such. Thus, TOUSA incurred no new obligation under the revolver.

The District Court also rejected the Committee's second theory -- that the reperfecting of the liens after July 2007 constituted new transfers. The Court observed that, while the liens were reperfected to add the term loan lenders as secured parties, that reperfecting did not in any way alter the rights of the revolver lenders. Under Bankruptcy Code Section 548(d), "a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee." Under this standard, the Court found, the transfers occurred on the original lien perfection dates, not at the time of reperfecting.

Finally, the District Court rejected the Committee's third argument that every draw on the revolver after July 31, 2007 constituted the incurring of a new obligation, a theory premised on the Second Circuit's holding in *Rubin*, the continuing validity of which the District Court seemed to question. In any event, the District Court easily disposed of this argument by observing that the Committee had explicitly disclaimed this theory of liability: when it filed its amended complaint, it told the Bankruptcy Court: "We do not reargue [*Rubin*] and we do not rely on it. . . . We are, if anything, arguing the opposite of *Rubin*." Consequently, the District Court deemed the argument waived (i.e., "intentional[ly] relinquish[ed]").

## CONCLUSION

In affirming the dismissal of the fraudulent conveyance claims, the District Court has set a precedent of importance to secured lenders, especially those in revolving credit facilities. This decision strengthens the argument of lenders that borrowers' obligations (and the corresponding responsibility of lenders to perform due diligence into the borrowers' financial condition) are incurred upon formation of a lending agreement and the granting of liens and not spawned anew with subsequent amendments to the credit agreement or draws on the facility.

\* \* \*

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Our client alerts are for general informational purposes and should not be regarded as legal advice. If you have any questions regarding this alert, please contact any of the following:

### New York

Seven Rivera  
+1 (212) 408-5529  
[srivera@chadbourne.com](mailto:srivera@chadbourne.com)

Thomas J. Hall  
+1 (212) 408-5487  
[thall@chadbourne.com](mailto:thall@chadbourne.com)

Thomas J. McCormack  
+1 (212) 408-5182  
[tmccormack@chadbourne.com](mailto:tmccormack@chadbourne.com)

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