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RECOVERING FRAUDULENT TRANSFERS: THE *TOUSA* DECISION PROVIDES SOME HELPFUL TOOLS FOR EXPANDING THE UNIVERSE OF POTENTIALLY LIABLE ENTITIES

By James H. Millar[*]

Introduction

When a company enters bankruptcy, it often times owes a debt to its secured lender, which has a lien over all of the company's assets to secure that debt. If the amount of the debt exceeds the value of the assets, then the secured creditor is said to be "underwater"—that is, even if it were to realize the full value of all of its collateral, it still is owed additional money that is allowed as an unsecured claim. That spells trouble for run-of-the-mill unsecured creditors, because, on first blush, it may not seem that there is any value available to make a distribution on their claims.

There might be, however, avoidance actions that can bring money into the estate for the benefit of unsecured creditors. The typical ones we think about are preferences and fraudulent transfers. In this regard, we have to keep a couple of ideas separate. The first is avoidance of a transfer, as either a preference (under Section 547 of the Bankruptcy Code) or a fraudulent transfer (under Sections 548 and 544(b)). Next, once a transfer is avoided, we turn to Section 550 of the Bankruptcy Code to find out from whom the estate can recover.

Under Section 550, the estate representative may recover an avoided transfer from not only a transferee, but also from an "entity for whose benefit such transfer was made." That means that somebody who did not get the transferred property—either directly from the debtor or somewhere down the chain of transfer as a so-called "mediate transferee"—nevertheless is required, as determined by the court, to return the transferred property or to pay back the value of the trans-

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ferred property to the estate. Identifying "who benefited" from a transfer, particularly in a complex fraudulent transfer context, is not always obvious.

The Eleventh Circuit's decision in *In re TOUSA, Inc.*[1] provides an opportunity to consider some interesting variations for recovering a fraudulent transfer or its value from "an entity for whose benefit" the transfer was made. One would not necessarily think that, if a debtor repaid its existing senior secured lender with the proceeds of a new senior secured loan specifically meant to repay that existing lender, that in fact the existing lender had received a fraudulent transfer. Indeed, isn't payment of an existing debt defined in Section 548(d)(2)(A) as "value?" Nevertheless, the Eleventh Circuit found the existing lender in that scenario liable for a fraudulent transfer. Let's analyze the *TOUSA* situation to see what guidance it might provide for future cases.

What Happened in *TOUSA*?

In June 2005, TOUSA, Inc. ("TOUSA") formed a joint venture to acquire certain homebuilding assets owned by Transeastern Properties, Inc.[2] To finance the acquisition, it borrowed money from a lending syndicate known as the "Transeastern Lenders."[3] TOUSA's operating subsidiaries were not obligors or guarantors on the Transeastern loan.[4]

When the housing downturn hit in 2006, the Transeastern loan went into default.[5] In January 2007, the Transeastern Lenders sued TOUSA for over $2 billion.[6] Later that year, TOUSA reached a settlement by which it promised to pay $421 million to the Transeastern lenders.

To fund the settlement, TOUSA took out new loans syndicated by Citicorp (the new lending syndicate, the "New

[1] *In re TOUSA, Inc.*, 680 F.3d 1298, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012).

[2] 680 F.3d at 1302.

[3] 680 F.3d at 1302.

[4] 680 F.3d at 1302.

[5] 680 F.3d at 1302.

[6] 680 F.3d at 1302.

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Lenders").[7] Of critical importance, certain of TOUSA's subsidiaries (the "Conveying Subsidiaries") granted liens on their assets to the New Lenders as credit support for the new loans.[8] The new loans required that the funds be used to pay the settlement amount to the Transeastern Lenders.[9] When the funding closed, Citicorp (as agent for the New Lenders) wired money to a TOUSA subsidiary that was not a Conveying Subsidiary, and that entity immediately wired the money to the Transeastern Lenders.[10]

Six months later, TOUSA and the Conveying Subsidiaries filed for bankruptcy under chapter 11.[11] The official unsecured creditors' committee filed a fraudulent transfer action to avoid the transfer of the liens to the New Lenders by the Conveying Subsidiaries because the Conveying Subsidiaries were insolvent at the time of the transfer and did not receive reasonably equivalent value.[12] (Keep in mind that the Conveying Subsidiaries were not obligors on the Transeastern loan, so their participation in securing the new loan was essentially gratuitous.) The committee was successful at trial before the bankruptcy court in avoiding the transfer of the liens by the Conveying Subsidiaries, which findings were affirmed by the Eleventh Circuit.[13]

The committee also alleged that it could recover from the Transeastern Lenders the proceeds of the new loans under Section 550(a) of the Bankruptcy Code because, as it alleged, the Transeastern Lenders were entities "for whose benefit such transfer was made."[14] The Transeastern Lenders argued that they were not "entities for whose benefit the transfer was made," but rather were subsequent transferees of the loan proceeds.[15] Under Section 550, the distinction is meaningful.

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[7] 680 F.3d at 1302.

[8] 680 F.3d at 1302.

[9] 680 F.3d at 1302.

[10] 680 F.3d at 1302.

[11] 680 F.3d at 1302.

[12] 680 F.3d at 1302.

[13] 680 F.3d at 1303, 1310–13.

[14] 680 F.3d at 1302

[15] 680 F.3d at 1303

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Section 550(a) allows for the estate representative to recover "the property transferred, or, if the court so orders, the value of such property, from (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee."[16] This section contemplates a broad range of possible entities that could bear liability. Subpart (1) of Section 550(a) includes the initial transferee and the entity for whose benefit the transfer was made. Subpart (2) of Section 550(a) includes anyone downstream from the initial transferee—while the statute uses the terms "immediate" and "mediate," practitioners colloquially refer to this group as "subsequent transferees."

Section 550(b), however, provides a very important defense that is only available to subsequent transferees. It states that the estate representative cannot recover from a transferee that took "for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided."[17] Sometimes referred to as the "bona fide purchaser for value" or "BFP" provision, this powerful defense allows subsequent transferees with clean hands to escape liability if they gave value, which could include repayment of a debt, in return for the transferred property.

The bankruptcy court found that the Transeastern Lenders were "entities for whose benefit the transfer was made" because they "directly received the benefit of the [t]ransaction and the [t]ransaction was undertaken with the unambiguous intent that they would do so."[18] The district court reversed, citing the Seventh Circuit's *Bonded Financial* decision regarding the distinction between initial and subsequent transferees, on the one hand, and entities for whose benefit the transfer is made, on the other.[19] The district court concluded that the Transeastern Lenders did not obtain any ben-

[16] 11 U.S.C.A. § 550(a).

[17] 11 U.S.C.A. § 550(b).

[18] In re TOUSA, Inc., 680 F.3d at 1308 (quoting *In re TOUSA, Inc.*, 422 B.R. 783, 870 (Bankr. S.D. Fla. 2009)).

[19] *In re TOUSA, Inc.*, 444 B.R. 613, 673–74 (S.D. Fla. 2011), aff'd in part, rev'd in part, 680 F.3d 1298, 56 Bankr. Ct. Dec. (CRR) 135, 67 Collier Bankr. Cas. 2d (MB) 1035, Bankr. L. Rep. (CCH) P 82276 (11th Cir. 2012)

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efit from the initial transfer—that is, they did not benefit from the lien granted by the Conveying Subsidiaries to the New Lenders.[20] Moreover, the district court considered whether the Transeastern Lenders could bear liability under Section 550(a)(2) as subsequent transferees of the proceeds of the loan.[21] It rejected liability based on the BFP defense of Section 550(b), concluding that the Transeastern Lenders took in good faith and for value, given that the word "value" as used in Section 550(b)(1) included the payment of the Transeastern loan.[22]

On appeal to the Eleventh Circuit, the Transeastern Lenders argued that they were "subsequent transferees" of the loan proceeds, not entities for whose benefit the initial transfer of the liens was made.[23] The court summarily rejected this argument as contrary to the record: "The new loan agreements required that the loan proceeds be used to pay the Transeastern settlement, and the Transeastern settlement expressly depended on the new loans. When the liens were transferred to the New Lenders, the proceeds of the loans went to the Transeastern Lenders."[24] Other than this factual recitation, the Eleventh Circuit did not tease out what it means to be an entity for whose benefit the transfer is made as opposed to a subsequent transferee. Let's see if we can flush out some of the analysis.

What's the Mainstream View About Being an Entity for Whose Benefit the Transfer is Made?

All courts seemingly agree with the proposition from the Seventh Circuit's seminal decision in *Bonded Financial* that

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(citing and quoting *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 895-97, 17 Bankr. Ct. Dec. (CRR) 299, 18 Collier Bankr. Cas. 2d (MB) 155 (7th Cir. 1988), rev'd, In re TOUSA, Inc., 680 F.3d at 1298.

[20] 444 B.R. at 674.

[21] 444 B.R. at 674.

[22] 444 B.R. at 675.

[23] In re TOUSA, Inc., 680 F.3d at 1313–14 (relying on circuit precedent in *In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293, 17 Bankr. Ct. Dec. (CRR) 1385, 18 Collier Bankr. Cas. 2d (MB) 973, Bankr. L. Rep. (CCH) P 72302 (11th Cir. 1988)).

[24] 680 F.3d at 1314.

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a "subsequent transferee cannot be the 'entity for whose benefit' the initial transfer was made."[25]

> The structure of the statute separates initial transferees and beneficiaries, on the one hand, from "immediate or mediate transferee[s]", on the other. The implication is that the "entity for whose benefit" is different from a transferee, "immediate" or otherwise.
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> Someone who receives the money later on is not an "entity for whose benefit such transfer was made"; only a person who receives a benefit from the initial transfer is within this language.[26]

That said, courts have not settled on a uniform test for determining when a party qualifies as "an entity for whose benefit the transfer is made." The majority view in the case law holds that, at a minimum, the party must actually receive a benefit.[27] "[F]raudulent transfer is a form of disgorgement, so that no recovery can be had from parties who participated in a fraudulent transfer but received no benefit from it."[28]

Chief Judge Wedoff promulgated a three-part test in his 2005 decision in *In re McCook Metals* that other courts have adopted to determine when a party is "an entity for whose benefit the transfer is made."[29] That test provides that "(1) [the benefit] must actually have been received by the benefi-

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[25] Bonded Fin. Servs., Inc., 838 F.2d at 895. Indeed, the Eleventh Circuit favorably cited Bonded Financial in its TOUSA decision. See In re TOUSA, Inc., 680 F.3d at 1314.

[26] 838 F.2d at 895–96.

[27] *In re Meredith*, 527 F.3d 372, 376, 50 Bankr. Ct. Dec. (CRR) 45, 59 Collier Bankr. Cas. 2d (MB) 1382, Bankr. L. Rep. (CCH) P 81252 (4th Cir. 2008) (rejecting proposition that "an entity need not actually benefit, so long as the transfer was made for his benefit" as stated in by *In re Bullion Reserve of North America*, 922 F.2d 544, 547, 21 Bankr. Ct. Dec. (CRR) 326, 24 Collier Bankr. Cas. 2d (MB) 698, Bankr. L. Rep. (CCH) P 73771 (9th Cir. 1991)). See also *Freeland v. Enodis Corp.*, 540 F.3d 721, 740, 50 Bankr. Ct. Dec. (CRR) 134, 60 Collier Bankr. Cas. 2d (MB) 524, Bankr. L. Rep. (CCH) P 81315 (7th Cir. 2008) (and cases cited therein).

[28] 527 F.3d at 376 n.5 (quoting *In re McCook Metals, L.L.C.*, 319 B.R. 570, 591, 44 Bankr. Ct. Dec. (CRR) 44, 53 Collier Bankr. Cas. 2d (MB) 1281 (Bankr. N.D. Ill. 2005)).

[29] See, e.g., *In re Green Field Energy Services, Inc.*, 2018 WL 1116374, *1 (Bankr. D. Del. 2018) (citing In re McCook Metals, L.L.C., 319 B.R. at 590–94).

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ciary; (2) it must be quantifiable; and (3) it must be accessible to the beneficiary."[30] And, as noted from *Bonded Financial*, the benefit in question must flow from the initial transfer.[31]

In re Brooke Corp. illustrates a recent application of that test. In that case, the debtor paid the expenses of certain franchisees that were otherwise unable to pay their expenses on their own.[32] The trustee sued the secured lender of the franchisees as the "entity for whose benefit" the fraudulent transfers to the franchisees' vendors were made.[33] The trustee alleged that the secured lender benefitted in three ways: (1) the collateral for the loans remained viable and intact; (2) the secured lender continued to get loan payments because the franchisees continued in business; and (3) the secured lender was paid face value when it sold the loans while they were performing and not in default.[34]

The bankruptcy court ruled against the trustee by applying the *McCook Metals* factors. Of critical importance, it noted at the outset that any alleged benefit to the secured lender must be from the initial transfer from the debtor to the franchisees' vendors.[35] In this regard, it was the franchisees—not the secured lender—who principally benefitted from the payment of expenses because they were relieved of the duty to pay the vendors with their own funds.[36] Any benefit to the secured lender was "secondary," "theoretical and amorphous."

So, the principles from the case law are:

1. a subsequent transferee cannot be the entity for whose benefit the initial transfer was made;
2. an entity for whose benefit the transfer is made must actually receive a benefit; and
3. the benefit in question must flow from the initial transfer sought to be avoided.

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[30] 2018 WL 1116374 at *1.

[31] *In re Brooke Corp.*, 488 B.R. 459, 469, 57 Bankr. Ct. Dec. (CRR) 208 (Bankr. D. Kan. 2013) (citing Bonded Fin. Servs., Inc., 838 F.2d at 896).

[32] 488 B.R. at 464.

[33] 488 B.R. at 465

[34] 488 B.R. at 469.

[35] 488 B.R. at 469.

[36] 488 B.R. at 469.

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How Does *TOUSA* Compare to the Enunciated Principles?

Let's set the stage for the *TOUSA* analysis by looking at the transfers of property. The Conveying Subsidiaries granted liens on their property to the New Lenders. With the liens in hand, the New Lenders transferred cash to a TOUSA subsidiary, which then immediately transferred the funds to the Transeastern Lenders. The Eleventh Circuit ignored the presence of the subsidiary in the chain of transfer, finding that it was merely a conduit that did not have control over the funds.[37] So the legally relevant fact pattern is as follows: Transfer #1—Conveying Subsidiaries grant liens to New Lenders; and Transfer #2—New Lenders transfer cash to Transeastern Lenders.

The Eleventh Circuit rejected the Transeastern Lenders' argument that they were in fact subsequent transferees (and thus could not be entities for whose benefit the transfer was made). The critical fact, it seems, is that the transferred property changed forms. Transfer #1 involved a transfer of property rights (a lien) in presumably many and varied assets of the Conveying Subsidiaries to the New Lenders. Transfer #2 involved the transfer of cash by the New Lenders. Without question, the New Lenders would not have conveyed cash to the Transeastern Lenders without receiving the grant of the lien, so the transfers were necessarily linked.

That said, an underlying premise of the Eleventh Circuit's decision is that the Transeastern Lenders are not subsequent transferees of the grant of the security interest. They might well be transferees of something else (cash, in this case) that is dependent upon and flows from the grant of the security interest, but that apparently is not enough. The change in form of the value as it flowed through the New Lenders seems to be enough to prevent subsequent transferee status.[38]

Principles 2 and 3 concern benefit: what benefit did the Transeastern Lenders receive and was it from the initial transfer? Here, the Eleventh Circuit seems to conflate some critical concepts.

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[37] See In re TOUSA, Inc., 680 F.3d at 1314.

[38] For a discussion critical of the Eleventh Circuit's approach, see Christopher W. Frost, Inter-Corporate Obligations, Reasonably Equivalent Value, and Beneficiary Liability: In re TOUSA, Inc., 32 No. 9 Bankruptcy Law Letter 1 (Sept. 2012).

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At the end of the day, the benefit received by the Transeastern Lenders was the payment of money. In that regard, it meets the *McCook Metals* factors: (1) the money was actually received by the Transeastern Lenders; (2) it certainly was quantifiable as a sum certain; and (3) it was accessible as cash on the barrelhead.

Did the transfer of cash flow from the Conveying Subsidiaries' initial grant of the security interest? That's a more interesting question. The Eleventh Circuit focused in part on how the new loan agreements "required that the loan proceeds be used to pay the Transeastern settlement."[39] Without question, there is an expressed ***intent*** in the new loan agreements to benefit the Transeastern Lenders, but we know the intent by itself is not sufficient. Moreover, at least with respect to the new loans, the Transeastern Lenders presumably were not parties to the new loan agreements and presumably could not enforce them as third-party beneficiaries.

Perhaps the rule we can draw from *TOUSA* is that, while mere intent to benefit is not enough, the contractual commitment to provide a benefit might be sufficient. We might add to that proposition that the commitment must actually be fulfilled. In other words, if TOUSA had kept the proceeds of the new loan in violation of the covenant to pay the Transeastern Lenders, then in all likelihood the Transeastern Lenders would not have been entities for whose benefit the initial transfer of the liens was made.

Where Else Might an Estate Representative Apply *TOUSA*?

The obvious places to look to apply *TOUSA* are in the more formal financial arrangements within a family of corporate debtors. Often, affiliated companies will regularly move money or property between and among themselves. Sometimes, those transfers are part of a legitimate system of operations and cash management that does not leave one of the companies holding the bag. But in other instances, such as the fact pattern in *TOUSA*, companies are asked to transfer property or incur obligations without receiving reasonably equivalent value. Those are instances where an estate representative might look for a party that could be liable for a fraudulent transfer as an entity for whose benefit the transfer was made.

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[39] In re TOUSA, Inc., 680 F.3d at 1314.

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As a hypothetical, consider a company ("Seller") that prepetition carves out and sells a specific division of its larger business—and the sale occurs at arm's length and for fair value—to a third-party buyer ("Buyer"). As part of the deal, Seller agrees that its subsidiary ("Management Company") will provide transition services, and Buyer will directly pay Management Company fair value for those transition services after they are completed. Assume also that Seller instructs a different subsidiary in the corporate family ("Funding Company") to provide cash so that Management Company can pay its employees and buy materials to complete its task, given that it won't be paid by Buyer until after completion of the project. Funding Company complies and provides funds to Management Company with the express requirement that it provide the transition services to Buyer. Management Company timely performs the transition services and thereafter receives payment from Buyer (and keeps the cash). Funding Company, however, is not otherwise involved in the sale to Buyer because it did not actually own any of the desired assets nor did it receive any of the purchase price. Shortly thereafter, the entire family of companies, including Seller, Management Company and Funding Company, are found to be woefully insolvent and file bankruptcy.

In this hypothetical, it is easy to see that Funding Company gave away value (cash) without receiving anything in return, all while being insolvent—that is a fraudulent transfer. Management Company should be liable as the initial transferee of the fraudulent transfer. In addition, the transaction benefitted Seller, the corporate parent, so perhaps it should bear liability as well. Both of those companies, however, are insolvent debtors and are unable to pay much if anything by way of returning the fraudulent transfer.

Under *TOUSA*, however, Buyer might be liable. Buyer strenuously objects, claiming (quite correctly) that it paid for the transition services that it received from Management Company. But the estate representative could characterize Buyer as an entity for whose benefit the cash was transferred from Funding Company to Management Company. Similar to *TOUSA*, Buyer could be identified in the funding arrangement as the intended beneficiary of the fraudulently transferred cash that Management Company used to generate the transition services. And Buyer in fact received the transition services.

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There are some differences. Buyer expressly paid for the transition services after receiving them—should it get credit for that amount as against any fraudulent transfer liability? Remember, however, that the Transeastern Lenders had likewise lent hundreds of millions of dollars in good faith. Just like Buyer, the Transeastern Lenders gave value. Nevertheless, they were found to be liable, so parallels certainly exist.[40]

Does it matter if Buyer knew (or did not know) that Funding Company was transferring the cash to Management Company? That question seems to go to the issue of "good faith." That element, of course, is not relevant because Buyer is not a subsequent transferee and thus does not have a BFP defense available. Should that question impact the analysis in other ways—for example, could Buyer be an entity for whose benefit the transfer was made if it had no knowledge that the transfer even existed and paid fair value to Management Company for the transition services? Other hypotheticals certainly exist, and they would raise more questions.

Conclusion

The Eleventh Circuit's *TOUSA* decision imposed liability on a secured lender as an entity for whose benefit a transfer was made even though, from the secured lender's point of view, its borrower repaid the outstanding obligation through a refinancing. The court's analysis suggests that there could be more flexibility in determining the universe of potentially liable entities, particularly in situations where affiliated companies are involved in financing arrangements that result in fraudulent transfers. It is not apparent, however, what the limits of that universe might be until we get further guidance from the courts. In that regard, estate representatives and creditors' committee might consider some novel and varied applications of *TOUSA* in looking for potential sources of recovery for the benefit of unsecured creditors.

[40]The Eleventh Circuit remanded the case for a determination of the proper remedies for avoidance of a lien. See 680 F.3d at 1315. That issue was settled before it returned to the Eleventh Circuit.