Reinhart CLE SERIES

Attorneys at Law

FRAUDULENT TRANSFER RISK IN M&A AND LOAN TRANSACTIONS

November 19, 2015

Mindy F. Rice
414-298-8301
mrice@reinhartlaw.com

Reinhart Boerner Van Deuren s.c.
1000 North Water Street, Suite 1700, Milwaukee, WI 53202
www.reinhartlaw.com

Webinar Housekeeping

Viewing the Slides
Today's slide presentation will advance automatically in synch with the live presentation.

Handouts
If you would like a hard copy of the slide presentation, a printable version was e-mailed to you yesterday.

Adjusting Your Volume
Volume can be adjusted using the volume control on your computer or phone.

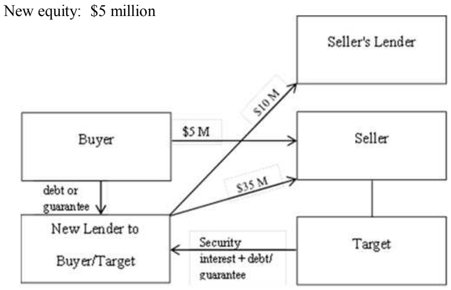
Asking Questions
Throughout the webinar, type your questions using the "QUESTIONS" section in the webinar panel. We will answer as many questions as possible during our Q & A session at the end of the presentation.

Information
This webinar provides general information about legal issues. It should not be construed as legal advice or a legal opinion. Attendees should seek legal counsel concerning specific factual situations confronting them.

Reinhart Boerner Van Deuren s.c. Attorneys at Law

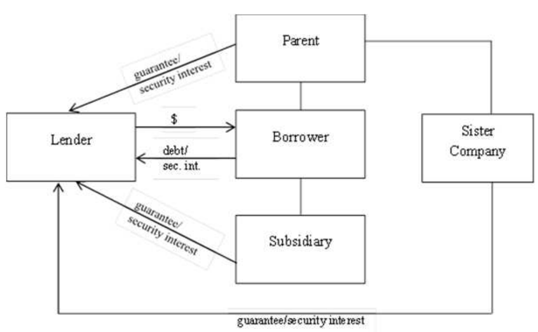
Acquisition Scenario

Total purchase price: $50 million
Cash to seller: $40 million
Existing debt: $10 million
New debt: $45 million
New equity: $5 million



Reinhart Boerner Van Deuren s.c. Attorneys at Law

Guarantee Scenario



Reinhart Boerner Van Deuren s.c. Attorneys at Law

Introduction

- Types of transactions that present fraudulent transfer risk often overlooked
  - Lending transactions with multiple obligors
  - M&A transactions, particularly leveraged acquisitions
- Recent changes to the Uniform Fraudulent Transfer Act
- Applicable state and federal standards

Uniform Fraudulent Transfer Act

- Chapter 242 of the Wisconsin Statutes
- Transfers fraudulent as to <u>present</u> and <u>future</u> creditors
  - Actual fraud—Transfers made or obligations incurred with actual intent to hinder, delay or defraud any creditor

Reinhart Boerner Van Deuren s.c. Attorneys at Law

Uniform Fraudulent Transfer Act (cont.)

- Constructive fraud—Transfers made or obligations incurred without receiving reasonably equivalent value in exchange <u>and</u> the debtor:
  - Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction or
  - Intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due

Reinhart Boerner Van Deuren s.c. Attorneys at Law

Uniform Fraudulent Transfer Act (cont.)

- Transfers fraudulent as to <u>present</u> creditors:
  - Certain transfers to insiders
  - Transfers made or obligations incurred without receiving reasonably equivalent value in exchange for the transfer or obligation <u>and</u>
    - The debtor was insolvent at that time, or the debtor became insolvent as a result of the transfer or obligation

Reinhart Boerner Van Deuren s.c. Attorneys at Law

UFTA—Definitions

- "Intent"—various factors can be considered in determining actual intent, including:
  - Insider status
  - Whether the transaction was disclosed or concealed
  - Whether the transfer included all of the debtor's assets
  - Whether the debtor was insolvent or became insolvent shortly after the transfer or incurrence of the obligation

Reinhart Boerner Van Deuren s.c. Attorneys at Law

UFTA—Definitions (cont.)

- "Insolvent"—a debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation.
  - This is not a balance sheet/book value test
  - A debtor who is generally not paying debts as they become due is presumed to be insolvent
- "Unreasonably small capital"—courts have generally held it to mean that the debtor is left with such a small capital that insolvency is reasonably foreseeable

Reinhart Boerner Van Deuren s.c. Attorneys at Law

UFTA—Recoveries

- The creditor may recover judgment for the value of the asset transferred or the amount necessary to satisfy the creditor's claim, whichever is less
- Recovery can be obtained from:
  – The first transferee of the asset or the person for whose benefit the transfer was made
  – Any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee

Reinhart
Boerner Van Deuren s.c. Attorneys at Law

UFTA—Statute of Limitations

- Generally four years for constructive fraudulent transfers not involving insiders
- One year for transfers made to insiders for an antecedent debt
- Can be extended beyond four years for actual fraud to a period one year after the transfer or obligation is or reasonably could have been discovered by the claimant
- Certain exceptions can lead to even longer periods

Reinhart
Boerner Van Deuren s.c. Attorneys at Law

Consequences of Determination of Fraudulent Transfer

- Consequences of a determination that a transaction is a fraudulent transfer are severe
  - Liens and guarantees invalidated
  - Debt subordinated
- Grant of a lien on assets to secure debt of the person granting the lien will generally not be a fraudulent conveyance (see official comment to Section 4 of the UFTA)

Reinhart Boerner Van Deuren s.c. Attorneys at Law

Consequences of Determination of Fraudulent Transfer (cont.)

- Fraudulent transfer risk arises in situations where the person receiving the proceeds of the loan (directly or indirectly) is not the person granting the lien
  - Leveraged acquisitions
  - Recaps/redemptions
  - Co-borrower
  - Upstream guarantor and other guarantors
  - Hypothecations

Reinhart Boerner Van Deuren s.c. Attorneys at Law

Minimizing the Risk

- Structuring
  - Asset sales versus stock sales
  - Asset-based loans and separate borrowing bases
- Solvency opinions and the lessons of TOUSA
- The importance of the financial projections
  - Must be anchored in company's actual performance
  - Must account for likely difficulties and incorporate some margin for error

Minimizing the Risk (cont.)

- Appraisals
- Role of equity and strength of sponsor
- Beware of negotiating too good of a sales price or taking out too much working capital
- Publicity of an acquisition
- Danger signs
- Selling shareholders and the settlement payments defense

Questions?

THANK YOU!