The Creative Aspect of Transactional Lawyering: Structuring the Transaction and Drafting the Agreement to Resolve a Legal Issue

John F. Hilson & Stephen Sepinuck

Stephen Sepinuck:

Well, welcome. My name is Stephen Sepinuck. I am a professor at Gonzaga Law School.

John Hilson:

My name is John Hilson, and I am a professor at UCLA School of Law.

Stephen Sepinuck:

And so, we are going to talk a little bit about our favorite aspect of teaching transactional skills, which is adapting a transaction for the law or dealing with the law. So much of many transactional skills courses focus on what is really important, which is getting the language right, precision in drafting, and avoiding ambiguity, and we certainly cover that *ad nauseam* in our book, but that is not what I think of as the most fun aspect of transactional lawyering. I think the most fun aspect is dealing with the law and emphasizing to students, therefore, that you really have to know the law. Not just the law related to the transaction, but the law related to each individual clause in the agreement, if you are going to be accurately representing your client.

And so, what we are going to go through is a series of problems. All of them are in our book, but we are not here to sell you our book. We are here to illustrate the type of thing that you can cover in a class. I am going to switch periodically to my reading glasses. So, if you raise your hand, I probably will not see it. So, if you have a question, comment, criticism, whatever, just yell it out. We do not mind the interruption, I will not speak for John.

So, imagine you are reading advance sheets. I read advance sheets every morning, because I am anal-retentive, and this case, we found recently, actually we did not find it in 2014, we found it more recently. So, this is a case out of the Court of Appeals of New York as you know, the highest court in New York. And it seemed to reach a rather interesting, perhaps, unexpected result.

It involved an exclusive distributorship agreement, and there was a claim of breach brought by the distributee, and there was a disclaimer of liability, and the disclaimer of liability covered as you can see, all indirect, special, and consequential damages. The claim was for lost profits. The court of appeals was dealing with well, does lost profits fall under indirect, special, or consequential damages? Normally, lost profits would be consequential damages. So, you would think, "Well, this has been disclaimed." However, the court of appeals says, "No it has not," at least in the context of this particular arrangement, this exclusive distributorship, the natural consequence of the breach would have been loss of profits and so, they were not adequately disclaimed, and the case could go forward.

So okay. Let's turn that into a problem.

So, you put your student in the position of representing the grantor of the distributorship, the one that wants an effective disclaimer. You say, "Okay, read this case," and hopefully they have gone out and read it, it is not a very long case. Now, how do you modify the language so that you have a proper disclaimer? So, let me turn it over to you. How would you modify the language?

Speaker 3:

Well one way would be to define one of those terms to include lost profits.

Stephen Sepinuck:

Or maybe even just add lost profits to the list. It is not a hard problem, right? It is a fairly easy problem to solve.

Speaker 4:

There is another case, I cannot remember who said it. Lost profits from collateral business arrangements. That would at least narrow it a little bit.

Stephen Sepinuck:

Okay. Maybe you do not want it to be as broad as all lost profits, right? Okay. You can have this discussion with your students, and so you get them to see, hey, first of all, it is important to stay up on the law. Then you adjust your contract forms, whether they are a commercial form, which hopefully you are not using, or your law firm's forms from a prior transaction. You go ahead, and you make the necessary adjustments, but it means you need to be aware of what is going on in the courts.

I like to tell this story. Those of you who are—John and I are commercial lawyers—so we will bore you with commercial law stuff throughout this presentation. There was a case I think in 2005, a bankruptcy court case called In re Adelphia Communications that involved what is known as grid interest. Basically, a borrower was supposed to pay interest based on two primary factors. One was, its financial statements, what it reported in its financial statements, and market interest. The problem was, the borrower had given the lender false financial statements for years, with the result that it had underpaid, what was it, hundreds of millions?

John Hilson:

Hundreds of millions.

Stephen Sepinuck:

Hundreds of millions of dollars less interest than it was supposed to. When it went into bankruptcy, the lender filed a claim for all that interest it should have earned, or been paid. The bankruptcy judge said, "Well, where does it say you are entitled to that? The agreement says that interest is based on this grid, which is based on the financial statements. Here is what the financial statements say. It does not say if they were fraudulent, you get to readjust it."

I do not know this as a fact, but I would imagine that within minutes, every major New York law firm had changed its loan agreement that dealt with grid interest. Now it turns out, the case was reversed on appeal, but I imagine whatever gloss has been added to all those agreements is still there, because of that probably erroneous decision.

John Hilson:

We still have contracts with Y2K representations to this date.

Stephen Sepinuck:

You know, this is something that lawyers do. They have to adjust their documents to the law, and this is a very simple way to do it. You could find almost any recent case, and give it to your students, say, "Read the case. How do you change the transaction documents?"

John Hilson:

Okay. The next problem takes a little bit of setting up. So, assume that you are representing the prospective buyer of a very valuable piece of art, and you are going to—your client is going to—buy it from an art dealer to which it is being consigned. The consignor here has owned it for some 30 years. So, you know that the—you have got a legitimate art dealer. This is not some fly-by-night. Your client is willing to pay millions and millions of dollars for this piece of artwork, and the real concern is the provenance, because beyond the 30 or so number of years that the consignor has owned it, the provenance regarding this particular piece of art is uncertain. It is unclear.

So, the hypothetical we are trying to focus you on is, how might you represent your client, the prospective buyer, in a manner that protects the client, if years down the road a claim is made by a third-party claiming ownership or any other kind of property interest in the piece of art? I think the first thing that we want you to make sure you understand as a predicate, is that a claim of conversion by that hypothetical third-party does not arise, and the statute of limitations does not begin to run, until the point in time that that third-party knows or reasonably should know who is in possession of the piece of art.

So, you can imagine that this particular piece of art was plundered during World War II by the Nazis. It then went through all kinds of different hands. It now ends up in this art dealership in La Jolla, California, and all we know is that for 30 years, it was supposedly owned by the consignor, and the consignor is not a bad actor, the dealer is not a bad actor, but your client wants to know, "Well, I want to make sure that nobody is going to come and take it away from me." Okay? So, Steve, what is the first thing that occurs to you relative to what the UCC has to say about this?

Stephen Sepinuck:

Well, the seller is going to be making a warranty of title, that the seller is the owner of the goods and that transfer is rightful. That is a warranty under 2-312. It exists unless carefully disclaimed.

John Hilson:

Right.

Stephen Sepinuck:

So, it is not technically an implied or express warranty. It is its own special type, but it is going to be there in the transaction.

John Hilson:

Okay, I think we can all go have a cocktail. Are we not all done here? I mean, we have a UCC statutory warranty of title, and we are good to go, are we not?

Stephen Sepinuck:

No, we are not, because the claim on the warranty of title is going to be subject to the statute of limitations under the UCC, which is typically four years. That is going to start running on the date of the sale. Whereas the conversion claim might only be two years long, but it will not start until the rightful owner knows that the client has bought it, which might not happen for years from now, and so the statute of limitations might run on the warranty claim before the third-party's conversion claim.

John Hilson:

Okay. Any—

Stephen Sepinuck:

Everyone with us so far?

John Hilson:

What we wanted to do was to throw it out to you. We have our own ideas as to what you could or could not do, but we thought it might be interesting to have you make some suggestions as to ways in which you could protect your client under these circumstances. The client wants to buy it. The negotiation regarding the purchase price and so forth has all been agreed to, so there is no debate regarding the sale of the good, but what might you do to try and deal with the concern that your client has, that it will be taken away at some point in the future?

Can I suggest something? We are going to do what we do in class a lot. Turn to the person next to you, talk about it for three minutes. Come up with as many ideas as you can.

So, you have had a chance to talk amongst yourselves and to come up with probably more ideas than Steve and I had but can somebody start and give us the ideas that your little mini-group came up with. I see a hand at the back row there.

Speaker 5:

So, the first thing that came to mind within the contract, and we are not entirely sure whether this would be effective for several decades, would be to have, not just to rely on the warranty claim under common law, but to have an indemnification provision and then stating that the indemnification provision survives the statute of limitations indefinitely. However, I do not know whether that would actually be enforced.

John Hilson:

We are going to come back to what works. Right now, it is just getting the ideas on the table.

Speaker 5:

This is the kind of thing that a lot of students would attempt to do in this situation.

Stephen Sepinuck:

Okay. Anything else?

Speaker 6:

Authentication by a third-party or requiring them to have insurance, which the insurance company would have authentication before issuing policy.

Stephen Sepinuck:

Okay. Okay. Yes.

Speaker 7:

So, a couple of things we came up with. Obviously, an indemnity provision, that only works if the seller will be okay with all that. If we know it is four-year statute of limitations, perhaps require three-quarters of that money to be held in an escrow account for four years.

John Hilson:

However, the claim of the third-party might not be made for 15 years. How long are you going to hold all this money?

Speaker 7:

So, in that case, we then go to different types of insurance. We would determine whether the seller has errors and omissions insurance. We would require warranty, or representation, and have that backed by representation and warranty insurance, and we have the buyer purchase title insurance.

John Hilson:

Okay.

Stephen Sepinuck:

Any other ideas?

Speaker 3:

Probably buy a reproduction instead.

John Hilson:

As we all know, clients do not like lawyers who screw the deal up.

Stephen Sepinuck:

Yes.

Speaker 10:

Publicize to get the statute running on the original true owner.

Stephen Sepinuck:

Oh.

John Hilson:

That is intriguing. Where would you think you were going to publish, publicize it though?

Speaker 10:

New York Times, Wall Street Journal, Paris Daily News.

John Hilson:

Le Monde.

Stephen Sepinuck:

Any other ideas? We will give you a few others that at least came to our minds. Maybe have an express warranty that the title will be good for X number of years, for 20 years, or waive the statute of limitations or extend the statute of limitations, or you might be familiar with representations that you bring down at a future time. Could you sort of bring down the warranty by having a covenant to remake the warranty in the future? John, you want to talk about it?

John Hilson:

Yes, let's start with the renewal if you will, of the warranty periodically. I think it needs to be clear that if the seller does not do what the seller has obligated him, her, or itself in the contract to do, you have a breach of the contract, but you may not have any damages at that moment. So, for example, if it said that the day before each fourth anniversary, you will re-up the warranty regarding title, so that you have kind of an evergreen feature to it, if the seller at some point just simply refuses to do so, it is a breach of contract. It is only a breach of the obligation to re-up the indemnity, and there may not be—

Stephen Sepinuck:

Re-up the warranty.

John Hilson:

Re-up the warranty, thank you. It may not be that a claim has come from a third-party, and so there may not be any damages associated with that particular breach.

Stephen Sepinuck:

So that is a really good reminder, because students often seem to think that, "Ah, if I have a breach of warranty claim, a breach of contract claim, that everything is okay," and like well no, not always.

John Hilson:

The next one, I am going to deal with two of them, kind of in the same breath, the waiver to extend the limitations period, and the warranty of good title for a specified period. Taking the first one, the Uniform Commercial Code section is 2-725?

It says that you cannot extend the statute of limitations. The code expressly states that it is not enforceable to extend the warranty of title statute of limitations under the Uniform Commercial Code. So, that is probably not going to be availing. Whether you could do it regarding the non-statutory warranty, and whether you would do it relative to the contractual warranty regarding title, you could debate, but probably a court is going to look at the UCC and determine that it is not enforceable.

Stephen Sepinuck:

So, I would add, so you have had the students come up with ideas, and now they have to go out and research, do the ideas work? I think the prevailing wisdom is the first two do not work under Article 2, so, you know, good idea, but a reminder that yeah, even transactional lawyers need to do legal research.

John Hilson:

The reason I wanted to talk about the two in combination is that warranting good title for a specified period strikes me as backing into the equivalent of extending the statute of limitations period. It is a little bit more clever, and there might be some arguments there, but if you cannot do it directly, you probably are not going to get away with doing it indirectly. So, we sort of look at these as equivalent and problematic.

Steve, a number of people have talked about an indemnity, and the first point that I did not hear is, who is going to be our indemnitor? Is the indemnitor going to be the art dealer? Or is the indemnitor going to be the consignor?

Stephen Sepinuck:

Well, I want it to be the deepest pocket. And I am paying these millions of dollars to the consignor, so I am assuming it is going to be the consignor who is the real party in interest here.

John Hilson:

Yes. Right. I would think so. I just wanted to tease that out, because it was unspecified.

Speaker 11:

Is there a reason you could not get it from the art dealer as well?

Stephen Sepinuck:

I would be surprised if the art dealer would be willing to do it.

John Hilson:

Yes. The art dealer is getting a commission, and maybe it would put its commission at risk, but not beyond that. Okay. Steve, I want to come back to indemnities in just a minute. So, can you tell us—you and I have had this conversation that you have done some research regarding insurance, and maybe you can tell the group what you have learned regarding getting insurance.

Stephen Sepinuck:

So, I contacted a friend of mine who is in the business of dealing with UCC insurance. His company would not touch this with a 10-foot pole. But, he put me in touch with or gave me the name of some other insurance companies that might do this, that appear to be reputable. And, so it might be available, near as I can gather, it is going to be extremely expensive, because the risk associated with each transaction is unique. It is very hard to spread the risk, and so, near as I can gather, the premium might be as much as 20% of the purchase price, which, you know, I would be surprised if either party is willing to pay that. So, it is a theoretical answer, but essentially alters the deal terms in a very significant way.

John Hilson:

So, circling back to the indemnity, sort of telegraphing our preferred item, we like the idea of the indemnity. But Steve, why is it that the indemnity works better than the warranty?

Stephen Sepinuck:

All right. Well, the theory is that a warranty of title is breached if at all, at the time of sale. And so, the statute of limitations starts to run at the time of sale. But an indemnity is a covenant. It is not covered. It is not a warranty at all, it is a covenant, and it is breached if at all, when the person refuses to indemnify after the claim is made. And so, the theory is, the statute of limitations does not start to run until the claim is made.

John Hilson:

Right.

Stephen Sepinuck:

That is the theory.

John Hilson:

Yes, that is the theory. There is a case in our book that we talk about involving securities and a sale of a loan portfolio, where each of the relevant loans was subject to, not only a warranty, but also an indemnification by the seller. And the court says that the indemnity began to run at the time that the portfolio was sold, not at the time when claims were made relative to the underlying securities. We think that that case is distinguishable in many different respects, but we think that if there is an opportunity here to help your client or to enhance your client's position, it would be for an indemnity.

Stephen Sepinuck:

Let me just add one thing if I may, about that case. So that, oddly enough, that is another New York case, New York Court of Appeals. So, may I suggest that in our choice of law, we pick some other state's law to govern, and so, because yes, I think the case is distinguishable, but I would rather it not be binding at all.

John Hilson:

Fair enough. So, let's talk about the covenant to indemnify. Steve, imagine that I draft the language—on behalf of the seller—and you are receiving it on behalf of the prospective buyer, and I say, "Our client agrees to indemnify, defend, and hold your client harmless, for and on account of any claims made regarding the breach of warranty of title." That is what I say. Is that good enough for you?

Stephen Sepinuck:

I like it, but, I am concerned that if the statute of limitations has run on the breach of warranty, that somehow that might undermine the indemnification obligation. So, I would rather the indemnification not be tied to the breach of the warranty of title, but rather tied to some claim of ownership made against the painting.

John Hilson:

Okay. So on the screen is your revised language. I teed up the agreement, Steve looked at it, he marked it up, and he sent it back to me. Indemnified regarding a claim of ownership to the painting. "Well, I do not like that Steve, because that means that any claim of ownership arising from facts that occurred on or after the date that my client sold the painting are covered. That should be your client's risk, it should not be my client's risk."

Stephen Sepinuck:

That is a fair point. So, we should deal with any claim arising prior to the sale.

John Hilson:

Also, how do we deal with the—and we will not know up front, but we all know that there will be good claims, that is, legitimate claims that have traction to them. Of course, you want an indemnity for those, but I do not like the idea of indemnifying you for any spurious claims that might come out of the woodwork. Maybe it is just a shakedown, and I think that that is inherent in owning an asset.

Stephen Sepinuck:

Well, let me think about this. So, we might want to draw a distinction between—as in real estate—between a special warranty deed and a general warranty deed. If it is a claim by some true third-party that is spurious, maybe that is my client's risk, but if it is a claim that comes out of you, so you granted a lien on this painting at some time in the past, and you now say it is discharged, and maybe it is discharged, but the creditor does not think it is, yes, I think that should be covered by the indemnification.

John Hilson:

The reason that we are going into this amount of detail regarding the indemnity, is to show that once you have identified what you think is the right vehicle, or the student thinks is the right vehicle, the work is not done. There are secondary and tertiary issues that they need to think through, they need to talk to their client about, they need to resolve, and not leave unaddressed in the drafting of this particular indemnification clause.

Stephen Sepinuck:

How long is the indemnification going to last? Is it eternal? That would be nice.

John Hilson:

Yes. Okay.

Stephen Sepinuck:

Any questions, comments?

Speaker 12:

So, you mentioned insurance, and I understand it is cost prohibitive. But in problems like this, I try and use that as a way to focus on value, which is a very subjective thing, especially when talking about something like this. So, the parties negotiated for this Cezanne, and they came up with a price.

Stephen Sepinuck:

That is a Renoir.

Speaker 12:

Is it a Renoir? Intro to art was a little long ago. They came up with a price for a Renoir, and now when everyone has dug into this, and done their due diligence, they realize well, this is a Renoir with a dubious provenance, starting at just about World War II. And so, that is worth something less than a guaranteed good provenance Renoir. And getting the students to see, maybe the buyer thinks they are selling the Renoir, they believe that that is great. But the market looks at it and says, this is dodgy goods in the same way that a seller is trying to sell foreclosed real estate that is vacant, thinks it is still a $300,000 house, whereas the buyer thinks, well, I do not think it is worth that much. And if you try and buy insurance on foreclosed properties, you will find that it is egregiously expensive, because the dispossessed owners have a tendency to come back with cans of gasoline, and other things like that. So, bringing that out, because the nice thing, as you showed that the indemnification leads you down all these crazy rat holes, you have got to take care of this, it really does work. If you can find a way to lay it off on somebody else, it may be worth that price.

Stephen Sepinuck:

I think you raise a great point because it—and I am going to sound like I am being critical, and I do not mean to at all—it gets to, what is it you are trying to teach? So, John teaches a third-year business deals class. I teach a first-year required, transactional skills class. So, what is it that I want to cover, and do I want them to learn about how to value assets and this thing, or do I want them to learn to brainstorm, and then go back and research the law, and then draft it?

So, in some classes I might be very eager to do what you are doing. And in other classes I might not be, depending on what my pedagogical goals are.

Speaker 12:

I think that is absolutely appropriate. The only reason I got back to insurance was after I went down, what you were doing right with your students who tend to think through all those ratchets.

Stephen Sepinuck:

Yes.

John Hilson:

Okay.

Speaker 13:

How old is the seller, what is the seller's health, and where, in what country are the seller's assets?

Stephen Sepinuck:

Yeah, great question.

John Hilson:

Wonderful question.

Stephen Sepinuck:

Yeah, because indemnification is only good as long as the seller has the ability to make good on it.

John Hilson:

Yes, okay.

Speaker 13:

And it goes back to the point I made earlier of assuming that if you have a breach of contract claim, then your client is fine. But of course, just because you have insurance does not mean the insurance company will be good for the money either.

John Hilson:

Okay. We want to set up a problem or an exercise, but we were uncertain how grounded or not people would be in fraudulent transfer law. So, we are going to go through a rapid-fire handful of slides. It sort of gives you enough to deal with the problem, but do not for a moment think that this is comprehensive or that it gets into the complexities of fraudulent transfer.

Stephen Sepinuck:

We are not giving legal advice.

John Hilson:

Yes, that too. So, there are three sources of fraudulent transfer law in the United States. So, you have Section 548 of the bankruptcy code. Generally, it has a two-year statute of limitations associated with it. Early on, many states adopted the Uniform Fraudulent Conveyance Act, and it has since been superseded, but it is important to note that it continues to be the law of the small state on the East Coast called New York. So, it matters, even though it is antiquated.

And then the Uniform Voidable Transactions Act. It used to have a different name, and it is the law in most states and it was updated somewhat recently. Each one of these statutes divides the law into two primary areas. One is actual fraudulent transfers. So, the transfer of an asset or the incurrence of an obligation with the actual intent to hinder, delay, or defraud creditors.

In the transactional world, it is possible to find actual fraudulent transfers. For example, a Ponzi scheme is a perfect example of actual fraudulent transfers. We are going to ignore actual fraudulent transfers for this problem. We wanted to make sure, however, that we covered it.

The second is what are called constructive fraudulent transfers. Glossing over the complexity, the simple answer or the simple way to think about a constructive fraudulent transfer, is it is a transfer or the incurrence of an obligation while insolvent, or rendered insolvent, and receiving less than reasonably equivalent value. That is the essence. And to sort of make it real for you, the law is basically saying, if you are upside-down, you cannot make gifts. That is a simple way to encapsulate this. If you are upside-down, that is if you are insolvent, you are supposed to take care of your creditors, and not your *alma mater* or your mother-in-law.

Stephen Sepinuck:

As I tell my students, they have all engaged in fraudulent transfers, because they are all insolvent. And yet, they usually give holiday gifts to friends and family.

John Hilson:

Okay. The last piece of this, and it is important that you understand this, is that the definition of insolvency in each one of the statutes is not reliant on GAAP. And what that means is, an asset will come in at its fair value. That might be higher or lower than GAAP. It also and importantly means, that liabilities that would not be reflected as a liability on a GAAP balance sheet, come on to a so-called fair value balance sheet. So, a contingent liability on account of a guarantee is to be put on that fair value balance sheet as well. Okay? Those are the basics of fraudulent transfer law that we wanted to make sure you had in mind, as we go to the next slide.

Do you want to cover this?

Stephen Sepinuck:

You go ahead.

John Hilson:

Okay. The next slide has three different options. Option 1 is a possible way to structure the transaction, where you have a parent company, which is in the manufacturing business. And by the way, each of the times that it says subsidiary, it is presumed that it is a 100% wholly-owned subsidiary. There are no minority interests outstanding. And the parent owns the subsidiary, the retailer, and so Option 1 has the parent borrow all of the money, and the subsidiary act as a guarantor. In the lingo, that is an upstream guarantee.

Option number 2, is where the lawyer says, "I do not know much about fraudulent transfer law, so I am going to make them all co-borrowers." And kind of hope for the best.

Option number 3 is where the lawyer says, "Wait a minute. I am going to have the subsidiary borrow all of the money, and I am going to have the parent act as a guarantor." And for this purpose, there is somebody in the room who is immediately thinking of something. No, the subsidiary will not be immediately upstreaming all of the money. The money is staying with the subsidiary. Okay?

So, what we wanted to do was to have you think about this, and this is where lawyers can be creative. They can start to think about, well, does the borrower really care here? In most circumstances the borrower will not care who are the borrowers, who are the guarantors, because from the company standpoint, they think every entity is obligated on the debt.

But that does not mean that the transactional lawyer representing the lender, does not have some opportunity to enhance the structure.

Stephen Sepinuck:

And I want to go in here. So, John has suggested that the borrowing entities collectively may not care which form is used. The lender might not care. Right?

John Hilson:

Right.

Stephen Sepinuck:

The lender parting with the money wants both entities to be liable, but does not really care which side gets it, and it is really the lawyers who care.

John Hilson:

Yes.

Stephen Sepinuck:

Because, the question is, is the fraudulent transfer risk the same here for all three or is it different? And the point again, is the students need to understand the law. They need to understand fraudulent transfer law, because they need to understand these structures are not all the same risk.

John Hilson:

Yes. So, do people have a reaction as to which structure you find the least attractive? Representing the perspective lender?

Speaker 11:

The upstream guarantee.

Stephen Sepinuck:

Why?

Speaker 11:

Well, the money could stay at the parent level. You cannot even make the argument that they are receiving any value, because the subsidiary is not receiving any value.

Stephen Sepinuck:

Right. Right.

John Hilson:

Right.

Speaker 11:

And I cheated, I practice bankruptcy law.

Stephen Sepinuck:

Well, that is okay.

John Hilson:

Okay.

Stephen Sepinuck:

So, the concern is never really with the borrower. The borrower is getting the money. And so, there is not a concern really, that the borrower is engaged in a fraudulent transfer. There is a concern that the guarantor is, because the guarantor is not getting anything. This is not to say there is no consideration. There is of course consideration. The loan to the other party. But it is not getting anything of value in return, or reasonably equivalent value in return. And when it is the subsidiary that is the guarantor, it is getting nothing.

John Hilson:

And to add one point. Not only is there not reasonably equivalent value, but the liability on the fair value balance sheet is going in at the full amount of the liability under the guarantee, where of course if it was a GAAP balance sheet, it would be a footnoted item, if at all. So that makes a big difference. I want to stay with you if you do not mind. What is your reaction to option number 2?

Speaker 11:

Well, just because you label somebody as co-borrower does not really change where the money is going.

John Hilson:

Right.

Speaker 11:

Right, so you can completely have the same problems so, if the money is going to the sub, and the parent can make out the argument that it is an indirect value to them, then they might be able to get reasonably equivalent value.

John Hilson:

Right. But I think you are exactly right, that option B is sort of a—

Speaker 11:

It is labeling.

John Hilson:

It is a labeling thing that has no real economic substance to it. The law is going to look at who actually got the money. And so, the reality is, you are either an option A or an option C, and B does not really help you solve the problem at all.

Stephen Sepinuck:

Right. Okay?

John Hilson:

We love this stuff.

Stephen Sepinuck:

Our fundamental point here, is that the lawyer handling this transaction, faced with these alternatives has to analyze the alternatives, and it can get a whole lot more complex, just to be really clear. In our book, we have a circumstance where there is a parent, and it owns two sister subs, and those sister subs own a third or second-tier subsidiary, and the questions just multiply because of the complexity. But if you are the lawyer, or in law school, the student, you should be looking at what is the law and how is it going to affect this particular transaction? Is there something I can do to make certain that the transaction meets my client's expectations? In this case, with the caveat that the money is not immediately escaping, with that caveat, we would suggest that making the loan to the subsidiary and getting the downstream guarantee from the parent, which owns 100% of the stock and therefore arguably, has received reasonably equivalent value, that that transaction should be enforceable, and not subject to fraudulent transfer attack.

Speaker 14:

What kind of course are you seeing this used in?

Stephen Sepinuck:

Well, I do not teach this problem in my first-year second semester course. But, I want to go back and look at the three problems we just discussed, because they are at three different levels. And I do not mean levels of difficulty, I mean levels of generality with respect to the agreement. So, the first problem dealt with one clause, and whether a disclaimer of consequential damages, and special damages, covered the lost profits. So, it was about six words, but it was hey, how do we fix these six words?

The second one was about a clause. Okay, we have this legal problem of the differing statutes of limitation. How do we solve that problem presumably with one clause, or perhaps with insurance?

And then this last one is sort of more global. Let's rethink about how to structure the transaction. And so, I might teach problems like this in the same class, but I would—and in fact, I will want to teach problems like this in the same class, because I want students to be focusing on the tiny, the mid-level, and the whole thing. But they need to understand the law applicable to the entire transaction, or to that one little clause.