$118M Rennert Verdict Serves As Costly Cautionary Tale

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Law360, Wilmington (February 27, 2015, 9:28 PM ET) -- The jury verdict Friday that found Ira Rennert and his firm liable for $118 million from Magnesium Corp. of America's 2001 bankruptcy stands as a stark warning for insiders to tread carefully when extracting money from a company, lest they land on a particularly pricey hook if it ends up insolvent, experts said.

After a four-week trial, a **New York federal jury found** that moves in the late 1990s to take shareholder dividends by Rennert and his firm Renco Group Inc., which owned the Utah-based magnesium producer, were so-called fraudulent conveyances that were extracted while the company was dealing with massive pollution liabilities and stiff competition from Asian producers.

While several bankruptcy practitioners told Law360 that the case, at its core, is a typical fraudulent transfer dispute — where under the Bankruptcy Code estates can claw back money the company paid a certain period of time before filing if the transfer left it unable cope with expected costs — the dollar amount at issue is eye-popping and serves as an uncomfortable reminder that investors, especially insiders, must be extra cautious to ensure any money taken out doesn't even appear to tip the investment into insolvency.

Restructuring financial consultant Edward T. Gavin, founding partner of Gavin Solmonese LLC, said insiders in particular must keep their eyes on what he called the "solvency clock" in order to avoid not only being found liable for a fraudulent transfer, but being open to a breach of fiduciary duty claim as well.

"As with any management decision, you always want to stop for a moment and ask yourself: 'What if?'" Gavin told Law360. "If you're taking a large sum of money out of a company on Monday and it becomes insolvent on Thursday, you're going to end up in the same situation you have here."

While the nature of the claims may have been typical, the fact that it went before a jury was unusual and, Gavin said, likely a strategic move by MagCorp's Chapter 7 trustee Lee Buchwald.

Veteran bankruptcy attorney Gregory W. Werkheiser of Morris Nichols Arsht & Tunnell LLP was also surprised the case made it to a jury, but added it only punctuated the risk such claims can pose.

"Managers and investors are going to need to be more mindful of the risk of adverse creditor trustee actions if the fortunes of such companies turn," he said.

Of course, being able to predict a company's future is a difficult proposition, but Werkheiser said the probability of exposure can be reduced.

Companies ought to prepare documented analyses that look at likely future valuations of a company that can be used as supporting evidence for any decision to extract money, in addition to the general due diligence associated with any corporate process that must be airtight to ensure the transaction isn't vulnerable, he said.

Buchwald argued that part of the case against Rennert hinged on the personal benefit he received from the transfers, with the trustee claiming it was evident in the lavish 67,000-square-foot mansion he'd built in the Hamptons, which has attracted much of the attention in the case because of its extravagance.

Bankruptcy attorney Corey R. Weber of Ezra Brutzkus Gubner LLP said that if money is taken out of a company for the benefit of a principal, it would be wise for the principal and the company to have separate counsel take independent looks at the transaction.

"Principals and officers and directors should tread lightly," Weber said. "If the company is insolvent or unable to pay debts as they come due, there could be a big issue later on."

Matthew G. Roseman of Cullen and Dykman LLP went a step further and contended that the verdict could have actually been worse for investors had the trustee gotten the full award he was seeking.

Roseman said Buchwald was seeking roughly $700 million on the argument the transfer actually decimated the going-concern value of MagCorp. Had that been the result from the jury, it could have sent chills through some investors.

“If I’m a shareholder, will a trustee look back five or 10 years from now and take the position that because of what I did, my liability far exceeds [the transfer]?” he asked.

The trustee was not successful on that position in the case, but the still huge numbers in the verdict are enough to give many investors pause, Roseman said.

The case, which has been a dozen-year legal marathon ever since MagCorp filed for Chapter 11 protection in 2001 amid a glut of cheaper magnesium from Asia and a $900 million pollution lawsuit from the U.S. Environmental Protection Agency, is not likely to be finished even now that the trial is done, with the Rennert side nearly certain to appeal the verdict.

The Rennert entities have denied wrongdoing and blamed MagCorp's collapse on the economic recession and volatility in the global magnesium market, and his attorney Peter Haveles of Kaye Scholer LLP moved for a mistrial immediately following the verdict, arguing that the jury's findings on various liability theories were inconsistent. That request wasn’t granted Friday.

And a Renco representative released a statement shortly after the verdict came in saying the trustee’s argument was “wholly unsupported” and that the jury’s decision there were fraudulent conveyances didn’t make sense because they also found MagCorp was solvent and had adequate capital.

But what the verdict did do was reinforce the role of the bankruptcy trustee as the sometimes last line of defense for creditors to find some sort of recovery, bankruptcy attorneys said.

“It’s one of the last and best rights of creditors, so they don’t end up holding the bag,” Gavin said.

The case is Magnesium Corp. of America et al. v. Renco Group Inc. et al., case number 1:13-cv-07948, in the U.S. District Court for the Southern District of New York.

--Additional reporting by Andrew Scurria. Editing by Chris Yates and Kat Laskowski.