

## *In re General Growth Properties, Inc.:* Motions to Dismiss SPE Cases....DENIED

LENARD M. PARKINS, MICHAEL E. FOREMAN, AND TREVOR R. HOFFMANN

*The authors analyze the bankruptcy court's decision in the General Growth Properties case and its implications for real estate restructurings and structured finance.*

In the recent heyday of real estate and structured finance, the use of “bankruptcy-remote” special purpose entities (“SPEs”) as borrowers was a fundamental underwriting requirement by lenders, and a critical factor considered by ratings agencies, to shield lenders and their collateral from the potentially adverse impact of bankruptcy filings by their borrowers’ parents and affiliates. Conventional mortgage and commercial mortgage-backed securities (“CMBS”) financings, in particular, required borrowers to be structured as “bankruptcy-remote” entities to support the intent by all parties involved in the financings to insulate debt to specific properties. In this manner, parties sought to minimize credit risks to mortgagees or owners of notes collateralized by specific real estate assets or groups of mortgages in the event of financial distress by a corporate parent or affiliates owning multiple real estate properties through SPE structures. However, despite the best intentions of their creators, the SPEs were only bankruptcy remote and not bankruptcy proof. The parties to these financings tacitly recognized that federal bankruptcy law would not permit a

---

Lenard M. Parkins is a partner in the New York office of Haynes and Boone, LLP. Michael E. Foreman and Trevor R. Hoffmann are of counsel in the firm’s New York office. The authors can be reached at [lenard.parkins@haynesboone.com](mailto:lenard.parkins@haynesboone.com), [michael.foreman@haynesboone.com](mailto:michael.foreman@haynesboone.com), and [trevor.hoffmann@haynesboone.com](mailto:trevor.hoffmann@haynesboone.com), respectively.

borrower to negotiate away its right to file a bankruptcy petition. Similarly, a lender could not neutralize the court's role as the arbiter of whether a borrower could be a Chapter 11 debtor or its assets could be subject to the Chapter 11 cases of its direct or indirect parent or affiliates.

On August 11, 2009, the Honorable Alan Gropper, Bankruptcy Judge for the United States Bankruptcy Court for the Southern District of New York (the "Court") overseeing the Chapter 11 cases of General Growth Properties, Inc. ("GGP")<sup>1</sup> and 337 of its affiliates and subsidiaries (collectively, together with GGP, the "Debtors"),<sup>2</sup> issued a memorandum of opinion (the "Decision")<sup>3</sup> setting forth the Court's findings of fact and conclusions of law<sup>4</sup> upon which it denied motions by several property lenders and special servicers seeking to dismiss the Chapter 11 cases of certain GGP SPE subsidiaries as bad faith (or, in one instance, an ineligible) filings. The Court ruled that the directors and managers of GGP and its subsidiary Debtors properly considered the interests of the entire GGP group in determining whether or not to file voluntary Chapter 11 petitions for individual SPEs. Among other things, the Court determined (i) that the Chapter 11 filings of the GGP SPE Debtors in question (collectively, the "Subject Debtors") were not premature even though those specific borrowers were not yet in default or facing loan maturity; and (ii) that the Chapter 11 filings were proper even though the Subject Debtors generated sufficient cash to cover their own operating expenses. The Court credited the current disarray in the real estate financing markets with creating sufficient uncertainty for the borrowers' ability to refinance debt maturing years in the future which supported their bankruptcy filings.<sup>5</sup>

The Court explained that its consideration of the interests of the GGP group as a whole in determining not to dismiss the SPE bankruptcy cases did not trample on the fundamental rights of the lenders who had sought to be insulated with a particular SPE. The Court also cautioned, however, that bankruptcy inherently altered some of the rights these lenders had negotiated. In the end, the Court tried to focus the parties on the specific issues at hand, and offered them some practical advice on how to proceed:

It is clear, on this record, that Movants have been inconvenienced by the Chapter 11 filings. For example, the cash flows of the Debtors have

been particularly interrupted and special services have had to be appointed for the CMBS obligations. However, inconvenience to a secured creditor is not a reason to dismiss a Chapter 11 case. The salient point for purposes of these Motions is that the fundamental protections that the Movants negotiated and that the SPE structure represents are still in place and will remain in place during the Chapter 11 cases. This includes protections against the substantive consolidation of the project-level Debtors with any other entities. There is no questions that a principal goal of the SPE structure is to guard against substantive consolidation, but the question of substantive consolidation is entirely different from the issue whether the board of a debtor that is part of a corporate group can consider the interests of the group along with the interests of the individual debtor when making a decision to file a bankruptcy case. Nothing in this Opinion implies that the assets and liabilities of any of the Subject Debtors could properly be substantively consolidated with those of any other entity. These Motions are a diversion from the parties' real task, which is to get each of the Subject Debtors out of bankruptcy as soon as feasible. The Movants assert talks with them should have begun earlier. It is time that negotiations commence in earnest.<sup>6</sup>

## GENERAL GROWTH'S USE OF SPES AND CMBS FINANCINGS

In the *General Growth* context, a special purpose subsidiary entity was normally created to develop or acquire a specific shopping center. The SPE structure is designed to insulate the SPE and its assets, including cash flow, from the assets and liabilities of its corporate parent and other SPE affiliates, and the credit or bankruptcy risks and problems that may occur when a borrower with multiple assets files for bankruptcy protection. However, economic risks of the SPE itself remain.<sup>7</sup>

Under a typical *General Growth* SPE structured financing, the originating company placed into a SPE shopping center assets expected to generate a steady stream of revenue sufficient to sustain the separate property-owner entity. The SPE's original lender might sell its first mortgage loan to a new lender, which might then issue CMBS securities in the public or private markets.

While the GGP group loans — some CMBS and others property-level mortgages — do not all possess identical documentation, each one generally is evidenced by a promissory note, a loan agreement, a first-priority, perfected mortgage or deed of trust, a security agreement and an assignment of leases and rents in favor of the lenders to a specific SPE. Each SPE was formulated to have all rents generated by its property deposited into a lockbox, and each SPE established its own cash management system with respect to property-specific expenses. Although certain parent level debt may have been secured by the equity of SPE borrowers (which equity was owned by GGP or an intermediate level holding company parent), the parent level debt was structurally subordinate to the claims of the creditors of the SPE borrowers. Furthermore, the loans to the SPEs did not include parent company repayment guaranties.

The loan agreements required that the SPEs be structured as “bankruptcy remote” entities to make them more attractive to potential investors. “Separateness provisions” or covenants in loan agreements required the borrower to maintain its legal and functional separateness from its related entities. They also required the borrower’s organizational documents to contain mirroring separateness provisions. Among other things, the SPEs were organized having a board of directors (or managers, with respect to SPE limited liability companies) that included one or more independent persons whose approval was required for significant corporate actions such as a bankruptcy filing. Each SPE’s corporate purpose was limited to owning and operating only the specific real estate constituting the collateral, and was required to maintain itself as a separate and distinct entity from its corporate parents and affiliates. Entity separateness was so important that underwriters and rating agencies required borrower or issuer counsel to deliver “non consolidation” legal opinions, premised on the lender’s reliance on its borrower’s separateness and the adherence to the bankruptcy-remote requirements by all parties involved with the borrower.<sup>8</sup> Consequently, the structural isolation of the SPE’s assets and cash flow, along with its separateness and corporate integrity, lay at the foundation of these financing transactions. As seen below, the separateness of the SPE and its assets were at the heart of the *General Growth* motions to dismiss.

## THE *GENERAL GROWTH* CHAPTER 11 CASES

At the time of the Chapter 11 filings, GGP and its affiliates were obligated on approximately \$18.27 billion of debt secured at the project level. After the implosion of the national and global real estate financing markets since the fall of 2008, many of the GGP group properties faced covenant defaults. Some lenders began exercising cash control and other remedies over properties that generated sufficient cash flow to cover their own operating expenses. Certain other properties faced loan maturity or “hyper-amortization”<sup>9</sup> in time-frames ranging from the next few months to years. In addition, GGP and certain of its affiliates had approximately \$6.58 billion of unsecured debt. Ultimately, GGP believed that the Chapter 11 filings for it and almost half of its affiliates were necessary to address an overall capital structure GGP believed had become unmanageable and unfinancable due to the collapse of the credit markets.

To put the motions to dismiss in context, on April 16, 2009, at the first day hearing for the Debtors’ cases, the Court granted the Debtors’ cash collateral motion and permitted the Debtors to have immediate access to the cash collateral generated by the SPEs, wherever located, in order to continue all the Debtors’ operations and to preserve the value of the group’s assets for a successful reorganization. Virtually all of project-level lenders objected to the use of cash collateral and proposed debtor in possession (“DIP”) financing on numerous grounds, including that the Debtors’ requested relief would vitiate the various SPEs’ integrity and bankruptcy-remote protections embedded in the mortgage and CMBS financings. At the first day hearing, the Court authorized the use of cash collateral on an interim basis while granting the lenders various forms of adequate protection pending the final hearing.

As a result of the implications of the issues considered by the Bankruptcy Court regarding the SPEs’ intended “bankruptcy-remote” structure, the *General Growth* cases have been monitored closely by industry groups and investors concerned with the systemic impact the cases could have on the structured finance market. In advance of the May 13 final DIP financing and cash collateral hearing, the Commercial Mortgage Securities Association (“CMSA”) and the Mortgage Bankers Association (“MBA”)

filed an *amici curiae* brief in which they stated:

CMSA and MBA and their members are gravely concerned with the filings by the individual Property Owners as part of the GGP Chapter 11 filing and the catastrophic impact such a precedent, if it stands, could have on the CMBS market, as well as on structured finance and the broader capital markets that rely on the same underlying principles of asset isolation in the architecture of securitization.<sup>10</sup>

This concern was echoed in a number of objections filed by secured creditors who argued that they were being forced to take on the Debtors' enterprise risk — a risk that they had not bargained for when investing in specific SPEs.<sup>11</sup>

In response to the secured creditors' objections, the Debtors pointed out that their proposed collection, upstreaming and use of cash collateral was merely a continuation of the prepetition *status quo*. Thus, despite the SPEs' theoretical separateness from the parent, the evidence showed that outside of bankruptcy the Debtors had operated as an integrated enterprise, with centralized cash management, and shared overhead expenses for such things as operation and maintenance of each property. Docket No. 397. In addition, while the secured creditors argued that "upstreaming" cash to a centralized bank account and "commingling" cash from multiple debtor entities would violate the SPEs' loan and organizational documents, the Debtors pointed out that this was an overstatement. For example, absent defaults, none of the SPEs' organizational documents or loan documents had cash traps or barred the project subsidiaries from transferring cash to a parent entity.<sup>12</sup> Rather, the "Cash Management Agreements generally required the project subsidiary to cause all rents to be deposited in a lock box....Absent a default or other Triggering Event, the cash was transferred daily out of the lock box as directed by the property-level borrower."<sup>13</sup> Most important to their argument, the Debtors also cited a number of cases for the propositions that, regardless of restrictions in the SPEs' prepetition loan and organizational documents, such restrictions could not trump the provisions of the Bankruptcy Code relating to the use of cash collateral in exchange for adequate protection.<sup>14</sup>

The Debtors' centralized operations had not been hidden from creditors prepetition. "After all," the Debtors argued, "the entire premise of the REIT structure is that cash will be upstreamed to the parent for distribution as dividends to investors." Docket No. 397 at ¶ 85. The Debtors argued that to allow each secured lender to control its particular cash and to dole it out only to pay the expenses directly benefiting its property would actually be inconsistent with the manner in which the Debtors operated prepetition and would leave the Debtors with insufficient liquidity to run the nationwide enterprise that operates for the benefit of all of the properties.<sup>15</sup>

Based on these facts, the Court observed at the Debtors' first day hearing "[i]t is an obvious fact that the Lenders to the individual properties here did not do business with a single borrower; they did business with one of the largest similarly situated companies in the country and they get protections from that."<sup>16</sup> The Court predicted that many of the other structural issues raised in the objections would come into better focus once the Debtors finalized their DIP financing negotiations.

In the following weeks, the Debtors engaged in an auction process among three prospective DIP lenders, in which project-lender representatives provided input, while certain lenders filed motions to dismiss the Chapter 11 cases of their specific borrowers. On May 14, 2009, the Court entered a final DIP financing order approving a \$400 million DIP financing embodying negotiated terms, including adequate protection, which, from the perspective of the property lenders, substantially improved on the terms initially proposed by the Debtors.<sup>17</sup> The Final DIP Financing Order was viewed generally by commentators and the real estate financing community as maintaining the integrity of the prepetition SPE structures, while addressing in a satisfactory manner the practical considerations resulting from the Debtors' immediate financing needs.<sup>18</sup> However, several commentators noted that the SPE structures would be tested next through the Court's consideration and ruling on the pending motions to dismiss.

## **THE GENERAL GROWTH AUGUST 11, 2009 DECISION**

The motions to dismiss filed by two holders of CMBS debt argued that their SPE borrowers' Chapter 11 cases should be dismissed as bad faith

filings. They argued that dismissal was warranted because no imminent threat existed to the financial viability of these Debtors at the time of their filing. A holder of conventional mortgage debt argued for dismissal on the ground that its Subject Debtors were not in financial distress, that the Chapter 11 cases had been filed prematurely, and that these Subject Debtors had no chance to reorganize because they could not confirm a Chapter 11 plan over the mortgagee's objection and the mortgagee would object to any plan proposed by the Debtors.<sup>19</sup> The movants argued that they were now being forced to assume the credit risk of the entire GGP group — a risk that they had not bargained for when investing in specific SPEs — and that their specific borrowers had no present or impending need for Chapter 11 protection, since they still produced sufficient cash flow to service their individual debts.

The Court began its analysis with the controlling Second Circuit law regarding the dismissal of Chapter 11 cases alleged to be filed in bad faith: bankruptcy petitions should be dismissed if, on the filing date, no reasonable likelihood existed that the debtor intended to reorganize and no responsible probability existed that it would eventually emerge from bankruptcy.<sup>20</sup> The bankruptcy court in *In re Kingston Square Assocs.*<sup>21</sup> subsequently restated the Second Circuit standard for dismissal into a two-part test: “[A] bankruptcy petition will be dismissed if *both* objective futility of the reorganization process *and* subjective bad faith in filing the petition are found.”<sup>22</sup> The *Kingston Square* court further explained that “[i]t is the totality of circumstances, rather than any single factor, that will determine whether good faith exists.”<sup>23</sup> Accordingly, the Court conducted its analysis in terms of both the objective and subjective bad faith tests.

### **Objective Bad Faith Analysis**

The movants' objective good faith argument contended that the Chapter 11 filings of the Subject Debtors were premature, based on cases where petitions were dismissed because the debtors were not in actual financial distress at the time of their filing, the prospect of the debtor's liability was speculative, and where evidence existed that the filings were designed to obtain litigation advantage.<sup>24</sup> Contrary to the arguments presented in the

motions to dismiss, the Court found that the record demonstrated that each Subject Debtor was in a degree of financial distress at the time of its filing: four Subject Debtors had cross-defaulted to the defaults of affiliates or would have been in default as a result of the bankruptcy filings by affiliates; one Subject Debtor's loan had gone into hyper-amortization; five Subject Debtors had mortgage debt maturing or hyper-amortizing in 2010, two in 2011 and one in 2012; and the remaining seven Subject Debtors were either guarantors on maturing loans of other entities, their property was collateral for a maturing loan or the loans were otherwise in distress in the Debtors' view (as evidenced by, for example, a high loan-to-value ratio).<sup>25</sup>

The Court found that "[t]he Debtors' determination that the Subject Debtors were in financial distress was made after factual and legal analysis was conducted by the respective Debtors with their financial and restructuring advisors and legal counsel. The decisions were vetted in a series of Board meetings following substantial financial analysis."<sup>26</sup> The GGP board reviewed each Subject Debtor individually.<sup>27</sup> Accordingly, the Court determined that the Subject Debtors were justified in filing their Chapter 11 petitions when they did.<sup>28</sup> The Court explained that the Bankruptcy Code seeks to incentivize a debtor to file earlier rather than later, so as to preserve the value of the estate.<sup>29</sup> The Court declined the movants' suggestion to establish an arbitrary rule that a debtor is not in financial distress and cannot file a Chapter 11 petition if its principal debt is not due within a certain period of time of the filing. Rather, the Court found that the procedures used by the Debtors to determine which GGP group entities would file bankruptcy petitions were reasonable.

Similarly, the Court found to be reasonable the Debtors' conclusion that the financial market's disarray created uncertainty as to whether the Subject Debtors would be able to refinance their debt "years in the future."<sup>30</sup> As the Court continued "[t]here was no evidence to counter the Debtors' demonstration that the CMBS market, in which they historically had financed and refinanced most of their properties was 'dead' as of the Petition Date, and that no one knew when or if that market will revive. Indeed, at the time of the hearings on these Motions, it was anticipated that the market would worsen, and there was no evidence presented showing the means of refinancing billions of dollars of real estate debt coming

due in the next several years.”<sup>31</sup> The Court also noted that the Bankruptcy Code contains no filing requirement that a debtor be insolvent.<sup>32</sup>

Significantly, the Court concluded that Second Circuit law did not require the issue of each Subject Debtors’ good faith to be examined as if it were wholly independent of the GGP group. The Court understood that this “group” analysis was contrary to the lenders’ intentions and expectations in using a bankruptcy-remote SPE structure:

Movants argue that the SPE or bankruptcy-remote structure of the project-level Debtors requires that each Debtor’s financial distress be analyzed exclusively from its perspective, that the Court should consider only the financial circumstances of the individual Debtors, and that consideration of the financial problems of the Group in judging the good faith of an individual filing would violate the purpose of the SPE structure. There is no question that the SPE structure was intended to insulate the financial position of each of the Subject Debtors from the problems of its affiliates, and to make the prospect of a default less likely. There is also no question that this structure was designed to make each Subject Debtor ‘bankruptcy remote.’ Nevertheless, the record also establishes that the Movants each extended a loan to the respective subject debtor with a balloon payment that would require refinancing in a period of years and that would default if financing could not be obtained by the SPE or by the SPE’s parent coming to its rescue. Movants do not contend that they were unaware that they were extending credit to a company that was part of a much larger group, and that there were benefits as well as possible detriments from this structure. If the ability of the Group to obtain refinancing became impaired, the financial situation of the subsidiary would inevitably be impaired.<sup>33</sup>

The Court explained that the circumstances in question compelled the subsidiary SPEs to take into account the interests of the larger group, including the parent companies. The Subject Debtors’ organizational documents — their limited liability company operating agreements — required each Subject Debtor to appoint two “independent managers,” who essentially were to be persons having no affiliation with the GGP corporate

family.<sup>34</sup> The operating agreements required the independent managers to consider the interests of the entity and the respective creditors in acting or otherwise voting on matters such as the filing or consent to the filing of any bankruptcy proceeding, *to the extent permitted by law*.<sup>35</sup> However, the independent managers were charged with “a fiduciary duty of loyalty and care similar to that of a director of a business corporation organized under the General Corporation Law of the State of Delaware.”<sup>36</sup>

The Court’s analysis of the fiduciary duties owed by the independent directors, officers and managers of solvent SPEs to the SPE lenders, special servicers and equity holders is significant. The Court noted that, in 2007, the Delaware Supreme Court rejected the notion that directors of a nearly insolvent company, operating in the “zone of insolvency,” owed fiduciary duties to creditors,<sup>37</sup> and mandated that directors of a solvent corporation consider only the interests of the entity and its shareholders in exercising their fiduciary duties.<sup>38</sup> Since the movants did not argue that the SPE debtors in question were insolvent at any time, the Court determined that the fiduciaries of the SPE borrowers properly exercised their duties in considering the interests of the SPEs’ equity holders over the property-level creditors.

This result flew in the face of lender expectations that the “independent” fiduciaries of the SPE would, in fact, focus on the lenders’ interests in determining whether to approve the SPE’s bankruptcy filing. Citing to applicable Delaware law on director fiduciary duties, the Court was blunt in its regard for the lenders’ expectations: “[i]f Movants believed that an ‘independent manager’ can serve on a board solely for the purpose of voting ‘no’ to a bankruptcy filing because of the desires of a secured creditor, they were mistaken.”<sup>39</sup> As a result, the consideration of the interests of the GGP group entities as a whole by the SPE fiduciaries was deemed proper. The Subject Debtors’ bankruptcy filings were found to be not premature even where their loan maturities were years away.

### ***Subjective Bad Faith Analysis***

The movants’ subjective bad faith argument asserted that the Subject Debtors acted in bad faith because they failed to negotiate prior to filing

and because the initial independent managers of several of the SPEs were replaced shortly before the Chapter 11 filings. The Court explained that, in contrast to the Chapter 13 requirement that a consumer debtor obtain credit counseling before filing for bankruptcy, the Bankruptcy Code does not require a borrower to negotiate with its lender before filing a Chapter 11 petition.<sup>40</sup> The Court further noted that the Debtors were unable to find any lender or servicer having final decision-making authority with whom to negotiate, in part because of the master servicer / special servicer mechanism used in the CMBS financings. Master servicers would not negotiate loan modifications until the loans approached maturity, and they would not transfer the loans to the special servicers until the loans were actually in default.<sup>41</sup>

The Court then turned to its attention to the alleged improper replacement of independent managers on the eve of certain Subject Debtors' Chapter 11 filings. The Court found that the operating agreements permitted but did not require that the independent managers be supplied by a nationally recognized company which provides professional independent directors, managers and trustees. The operating documents did not require that the managers being replaced, or the lenders, be given notice of the terminations. The Court noted that "[i]t does not appear that these managers had any expertise in the real estate business and as mentioned above, some of the lenders thought the independent managers were obligated to protect their interests alone."<sup>42</sup> In contrast, the Debtors replaced the initial independent managers with persons who had capital markets and restructuring experience and understanding. While characterizing the secretive manner in which the original independent managers were filed as surreptitious, the Court nevertheless determined that the Debtors acted within their rights under the operating agreements.<sup>43</sup> Moreover, the Court found that the Debtors established that the filings were designed to preserve value of their estates and creditors, including the movants.<sup>44</sup>

## **IMPLICATIONS OF THE *GENERAL GROWTH CASES* AND DECISION**

The Decision did not reach surprising conclusions, especially in the context of the Court's initial orders on DIP financing, use of cash collateral

and consolidated cash management. Indeed, the Decision reinforces the established notion that “bankruptcy remote” does not equate to “bankruptcy proof.” This is not a new concept. While SPEs were used in the General Growth and other CMBS financings to *minimize* the risk that a bankruptcy filing at the parent level would impact the SPE, cases such as *Kingston Square*<sup>45</sup> already had demonstrated that the SPE structure could not make the bankruptcy risk completely disappear.

Rather, the lessons of such cases are that lenders seeking to rely on the “bankruptcy remote” structure of SPEs must take measures to ensure not only the theoretical separateness of their borrowers, but also the *actual* separateness. For example, in *General Growth*, the company functioned as an integrated single national owner and operator of shopping malls. Cash was upstreamed from the SPEs for use on a consolidated basis for the operation of the national business. The Court agreed with the Debtors that the SPE documentation did not prevent any of this from happening. Moreover, while the Court was cognizant of the rationale underlying GGP’s corporate and capital structure, and that the lenders’ and servicers’ arguments resulted from industry-held transactional expectations, it cautioned that certain of those expectations may have been unreasonable or just not feasible, especially in light of the particular facts of GGP’s business.

The Court stressed that its decision focused narrowly on whether or not to dismiss the Chapter 11 cases of the GGP SPEs in question as bad faith filings, and did not foreshadow how the Court would rule on other important issues that might yet be raised in the Debtors’ cases, including substantive consolidation and the classification and treatment of the secured, mezzanine and unsecured debt asserted against GGP Debtors. Still, lenders to companies structured similarly to the GGP group — holding companies with intermediate holding companies and property-level SPE subsidiaries — must now consider whether or not the *General Growth* Decision and orders represent a developing body of law which may be used as precedent in other cases. As the real estate financing markets bottom out and lenders consider re-introducing liquidity, prospective lenders, borrowers and rating agencies will have to consider whether the results of the *General Growth* cases raise implications for the future of securitizations premised on the bankruptcy-remote SPE structure.

The Court also highlighted a significant fly in the ointment of the securitization master servicer / special servicer structure, which militated against a finding that the SPEs' Chapter 11 filings had been made in bad faith. Master servicers of real estate mortgage conduits ("REMICs") manage the day-to-day loan administration functions and serviced the loans when not in default, while a special servicer would assume management authority for a loan in default. Only special servicers have the ability to agree to modify a loan (in some cases, with the consent of the holders of the CMBS securities issued by the REMIC), but loans would not be transferred to special servicers until the loan was in default or loan maturity was impending.

As a result, before the Debtors' bankruptcy filings, GGP sought permission to communicate with special servicers, but was told by master servicers that the loans had to be much closer to maturity before they would be transferred to special servicers. Only one servicer was willing to meet with GGP, bolstering GGP's contention that it had no ability to pursue a restructuring of the property-level debt outside of a bankruptcy. In future restructurings, master servicers would appear to benefit from being approachable in order to engage in pre-bankruptcy restructuring negotiations. It is likely that the tax regulations governing these structures will have to be reviewed to determine the full range of issues arising from a servicer taking a more pro-active role in pre-default restructuring negotiations. Alternatively, loan and servicing document provisions permitting borrowers to have more expeditious and direct access to special servicers, who already have the ability to engage in pre-bankruptcy negotiations, may ameliorate this problem without requiring a change in the tax laws or tax counsel analysis. Taking a page from the script typically used by indenture trustees and their noteholders, master and special servicers may want to consider whether to seek the guidance of at least a significant group, if not majority, of noteholders, the parties having the primary economic interest in the financing, before responding to negotiation requests in the negative.

The parties to CMBS transactions may consider whether modifications to existing documents are warranted, desirable and possible. Lenders and noteholders may seek to have their SPE borrowers amend organizational documents to address apparent deficiencies highlighted by the Deci-

sion. While corporate directors and officers do not have fiduciary duties to creditors until the corporations are insolvent, limited liability company managers and officers derive their fiduciary duties from the entity's organizational documents. Section 18-1101 of the Delaware Limited Liability Company Act allows a limited liability company to restrict or even eliminate a manager or officer's fiduciary duties to the entity's member. Some commentators have even gone so far as to suggest that Section 18-1101 may permit the limited liability company operating agreement to impose fiduciary duties on managers and officers in favor of creditors regardless of whether the entity is insolvent or whether the fiduciary duties to equity have been eliminated. No court has addressed this issue.

Lenders will need to assess the importance of pressing these points against the practical realities of whether any persons would agree to serve as a manager if their fiduciary obligations were prescribed in such a manner, especially in light of developing Delaware law on director, officer and member fiduciary duties. Lenders also may request that notice provisions respecting an independent manager's termination be added to operating agreements as well as loan documents, and that a member's ability to appoint and remove an independent manager be limited or further proscribed. However, lenders who consider such alternatives will have to walk the ever-fine line between imposing reasonable secured creditor rights of due notice and assuming the increased risks of liability to third parties by taking such an active role in their borrower's affairs through the inclusion of such provisions as part of their loan and collateral documentation.

In addition, lenders must now consider whether the Decision, taken in conjunction with the Bankruptcy Court's other rulings in the *General Growth* cases, is evidence of a broader predilection by bankruptcy courts against dismissing as bad faith filings the Chapter 11 case of an SPE in circumstances similar to the *General Growth* cases. The perception that bankruptcy courts will be loathe to dismiss SPE bankruptcy cases filed for the benefit of an entire corporate group may invite companies structured similarly to GGP to pursue their financial restructuring in Chapter 11, regardless of whether their SPE subsidiaries are insolvent. The lenders' analysis of how future bankruptcy courts may decide these issues could, in turn, have a significant impact on underwriting requirements, as well

as the pricing, recourse and cash management provisions relating to both property-level and CMBS financings.

## CONCLUSION

Property-level and CMBS lenders, REMIC securities holders and their master and special servicers must now be alert to the prospects that their borrowers and collateral can be the subject of bankruptcy cases regardless of the individual borrower's financial condition. Moreover, the historic and accepted use of SPEs and securitizations for property-specific and CMBS financing has not always succeeded in isolating and protecting the collateral, cash and debt of property-level lenders from the claims of creditors of affiliated entities controlled under a larger corporate umbrella. Lenders should expect that their financing structures will be viewed by courts in the context of a dormant 2009 financing market, rather than the lenders' expectations borne out of the boom years for real estate financing.

## NOTES

<sup>1</sup> GGP, together with approximately 750 subsidiaries, affiliates and joint ventures, is a publicly-traded real estate investment trust operating a nationwide network of approximately 200 shopping malls in 44 states.

<sup>2</sup> The Debtors filed their voluntary Chapter 11 petitions on April 16 and 23, 2009. Their Chapter 11 cases are jointly administered for procedural purposes in the Court, under the caption *In re General Growth Properties, Inc., et al.*, Case No. 09-11977 (ALG) (jointly administered).

<sup>3</sup> *In re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

<sup>4</sup> Subsequently, on August 28, 2009 the Court entered its order denying each of the motions to dismiss, based on the Decision. No appeals were taken.

<sup>5</sup> The Court also ruled that a SPE Debtor organized as a trust under Illinois law was a business trust eligible to be a debtor under Chapter 11. *General Growth* at 70-72.

<sup>6</sup> *General Growth* at 69-70.

<sup>7</sup> While the SPE structure is intended to insulate the SPE from the economic risks of the parent and affiliates, the possibility of a bankruptcy filing remains

in the event the SPE has a legitimate business reason to file for Chapter 11 protection, including the need to invoke the automatic stay of Bankruptcy Code Section 362(a) to protect its assets from foreclosure. *See, e.g., Ad Hoc Group of Timber Noteholders v. The Pacific Lumber Co. (In re Scotia Pacific Company, LLC)*, 508 F.3d 214 (5th Cir. 2007) (filing of Chapter 11 petition by special purpose entity to avoid foreclosure of entity's timber lands by noteholders).

<sup>8</sup> Non-consolidations opinions are intended to be reasoned opinions, based on the particular facts and circumstances of the financing in question, that the SPE borrower was organized validly in a manner that would not likely result in the substantive consolidation of the borrower with the bankruptcy cases of its parent and affiliated entities. Under the doctrine of substantive consolidation, a bankruptcy court may, if appropriate circumstances are determined to exist, consolidate the assets and liabilities of different affiliated entities by merging their assets and liabilities and treating the related entities as a consolidated entity for purposes of the bankruptcy. Through substantive consolidation, the intercompany claims of the consolidated companies are eliminated, the assets of all of the entities are treated as common assets, and claims of creditors against any of the debtors are treated as against the common fund. Among other things, substantive consolidation has been used with similar effect by courts to extend a debtor's bankruptcy case to include in its bankruptcy estate the assets of a related entity which is not a debtor in a bankruptcy case. For examples of cases dealing with the standards courts will look to in ruling on substantive consolidation, see *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005); *Eastgroup Properties v. Southern Motel Assoc. Ltd.*, 935 F.2d 245 (11th Cir. 1991); *Union Savings Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co.)*, 860 F.2d 515 (2d Cir. 1988); *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270 (D.C. Cir. 1987); *FDIC v. Hogan (Matter of Gulfco Inv. Corp.)*, 593 F.2d 921 (10th Cir. 1979); *In re Vecco Const. Indus., Inc.*, 4 B.R. 407 (Bankr. E.D.Va. 1980).

<sup>9</sup> Hyper-amortization refers to the situation where the borrower's failure to repay or refinance the loan at a negotiated anticipated repayment date would result in a dramatic increase in interest rates and in the restrictions on GGP's access to the property owners' cash.

<sup>10</sup> Docket No. 289 at p.3.

<sup>11</sup> *See, e.g.,* Docket Nos. 232-237, 241-248, 252, 255-257, 266, 289, 295-296, 398, 427, 445 and 495.

<sup>12</sup> See Docket No. 397 at ¶¶ 89, 90.

<sup>13</sup> *Id.* at ¶ 90.

<sup>14</sup> See, e.g., *In re R.H. Macy & Co.*, 170 B.R. 69, 77 (Bankr. S.D.N.Y. 1994); *In re Federated Dep't Stores, Inc.*, 1990 WL 120751, at \*5-6 (S.D. Ohio July 26, 1990).

<sup>15</sup> See *Id.* at ¶ 6.

<sup>16</sup> See *Transcript of 4/16/09 Hearing* at 88.

<sup>17</sup> See Final Order Authorizing Debtors To (A) Obtain Postpetition Secured Financing Pursuant To Bankruptcy Code Sections 105(A), 362, And 364, (B) Use Cash Collateral And Grant Adequate Protection Pursuant To Bankruptcy Code Sections 361 And 363 And (C) Repay In Full Amounts Owed Under Certain Prepetition Secured Loan Agreement (Docket No. 527) (the "Final DIP Financing Order") at pp. 21 — 24. The Court held, among other things, that:

...the terms of the DIP loan were designed not to impinge on the rights of the secured creditors or to preclude the secured creditors from preserving their positions in these cases and their fundamental interests. Indeed, the parties, in negotiating the DIP loan, were so successful that the real objections that are outstanding are objections as to the provisions for adequate protection rather than the provisions of the DIP loan *per se*.

Hrg. Tr. at 148-49.

Thus, while ordering the secured parties to relinquish control over the cash collateral and to redirect it to GGP's main operating account, the Court granted each of the secured parties the following adequate protections, among others, pursuant to Sections 361 and 363(e) of the Bankruptcy Code:

- a postpetition first-priority security interest in, and lien on (A) the intercompany claims that its respective Debtor receives on account of the net cash that flows into GGP's centralized cash management system and (B) the main operating account, in each case in an amount equal to the lesser of (x) the aggregate diminution in value of the applicable secured party's interest in the cash collateral (after taking into account the value of the prepetition collateral) and (y) the postpetition net positive balance of the intercompany claim of the Debtor whose property constitutes prepetition collateral of such secured party;
- a second-priority lien on certain properties securing a prepetition loan facility (referenced in the Final Order as the Prepetition Goldman Facility) to be paid off with the DIP proceeds;
- allowed superpriority claims under sections 503(b) and 507(b) of the

Bankruptcy Code, senior to the claims under section 364(c)(1) of the Bankruptcy Code held by the DIP lenders; and

- current payment of interest at the non-default contract rate set forth in the parties' respective credit documentation.

Final Order at ¶ 8.

<sup>18</sup> Based on the Final Order, Fitch Ratings stated its view that while “positions by GGP to date lead Fitch to believe that certain CMBS bondholder protections may be in jeopardy in the future,” the Bankruptcy Court’s ruling upheld the integrity of the SPEs. *See* Fitch: SPE Structure Holds up in GGP Ch. 11 but Adds Costs to U.S. CMBS Trusts, dated May 21, 2009 ([http://money.aol.com/article/fitch-spe-structure-holds-up-in-ggp-ch/493992?icid=sphere\\_searchsphere\\_news](http://money.aol.com/article/fitch-spe-structure-holds-up-in-ggp-ch/493992?icid=sphere_searchsphere_news)).

<sup>19</sup> *General Growth* at 55. The Court overruled the argument that a debtor’s supposed inability to confirm a plan at the time of its Chapter 11 filing evidenced the bad faith of the filing. The Court noted that the Bankruptcy Code contains no filing requirement that a debtor prove a plan is confirmable when it files. The Court chided the mortgagee that its argument “reflects its view of the leverage it has in the subject cases. Its invocation of its asserted leverage is ironic, in view of the fact that MetLife also asserts that the Subject Debtors’ filings were taken in subjective bad faith.” *General Growth* at 65.

<sup>20</sup> *Id.*, citing *C-TC 9th Ave. P’ship v. Norton co. (In re C-TC 9th Ave. P’ship)*, 113 F.3d 1304, 1309-10 (2d Cir. 1997), quoting *Baker v. Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.)*, 931 F. 2d 111 (2d Cir. 1991).

<sup>21</sup> 214 B.R. 713 (Bankr. S.D.N.Y. 1997).

<sup>22</sup> *Id.* at 725 (emphasis in original).

<sup>23</sup> *Id.*; *General Growth* at 56. *Kingston Square Associates* also was significant with respect to the Decision because the court in that case determined, in assessing the totality of circumstances, that it was not required to determine the validity of the SPEs’ “bankruptcy proof” provisions, since the SPEs in that case had not observed the corporate formalities required under their documents. The *Kingston Square Associates* case involved a challenge to the bankruptcy filings of certain SPEs that were the product of mortgage backed securitizations. Each SPE owned an apartment complex and possessed “bankruptcy remote” corporate governance provisions designed to make bankruptcy unavailable to a defaulting borrower absent the affirmative consent of the mortgagee’s designee on the borrower’s board of directors. Given that the board of each SPE believed that it would be unable to obtain the consent

of the mortgagee's designee to file for bankruptcy to thwart the mortgagee's efforts to foreclose, the debtors' principal paid a law firm to solicit creditors to file involuntary Chapter 11 petitions against the debtors. The court held the collusive filings did not constitute "cause" to dismiss the filings or convert them to Chapter 7 under Section 1112(b) of the Bankruptcy Code. *Id.* at 737. Indeed, the court recognized that the existence of a director's fiduciary duties might include supporting a bankruptcy filing where necessary to thwart a foreclosure action. 214 B.R. at 735-36.

<sup>24</sup> *Id.* at 57.

<sup>25</sup> *Id.* at 57-58.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 58-59. The Debtors used at least ten factors in considering whether to file a Chapter 11 for a particular GGP group entity, in conjunction with other considerations relating to the specific entity:

- (1) The company is a borrower or guarantor under a credit facility that is currently in default and for which no forbearance has been obtained.
- (2) The company is a borrower or guarantor under a credit facility that is currently in a forbearance period that can be terminated at the Lenders' discretion.
- (3) The default of GGP or another entity within the GGP group structure and/or a bankruptcy filing by an entity guaranteeing the company's debt triggers an event of default under the company's existing loan.
- (4) The company owns a property which is subject to an existing cash trap that has been implemented.
- (5) The company is a borrower or guarantor under a loan that matures within the next three to four years.
- (6) The company is part of a project in which one or more subsidiaries or affiliates are under consideration for filing to facilitate a restructuring.
- (7) The company is the general partner of a partnership that is under consideration for filing.
- (8) The company is subject to multiple other filing considerations, including a loan which has a loan-to-value ratio in excess of 70%.
- (9) The company holds unencumbered assets and is filing to facilitate the inclusion of such assets as part of an overall corporate restructuring.
- (10) The company may be part of a non-core asset disposition process that could be facilitated by a Section 363 sale in bankruptcy.

*General Growth* at 59, fn26.

<sup>28</sup> *Id.* at 59.

<sup>29</sup> *Id.* at 60.

<sup>30</sup> *Id.* at 60-61.

<sup>31</sup> *Id.* (footnote deleted).

<sup>32</sup> *Id.* at 61.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 63-64.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).

<sup>38</sup> *Id.* at 64.

<sup>39</sup> *Id.* at 64.

<sup>40</sup> *Id.* at 66.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 67.

<sup>43</sup> *Id.* at 68.

<sup>44</sup> *Id.* at 69.

<sup>45</sup> *See also In re LTV Steel Company, Inc.*, 274 B.R. 278 (Bankr. N.D. Ohio 2001). In that case, the debtor was a steel company which had created two wholly-owned subsidiary SPEs for the purposes of doing an asset-backed securitization and transferred to these entities various receivables and inventory of the parent. After the parent filed for bankruptcy, it sought an interim order allowing it to use cash collateral which included the transferred inventory and receivables ostensibly owned by the SPEs. The debtor and the agent for various prepetition creditors secured by the cash collateral negotiated an agreement on the interim order which recognized that a dispute existed as to whether the transactions between the SPEs and the debtor were true sales, but allowed for the use of the cash collateral pending a final hearing. Following entry of the interim order, one of the prepetition secured creditors filed an emergency motion seeking to modify the interim order. That prepetition lender argued, among other things, that the receivables which constituted its collateral were not property of the estate. The court rejected the lender's argument, and held that the issue of whether a "true sale" had taken place was fact-intensive and required an evidentiary hearing, and so relief from the interim order was improper. The court further held that the debtor had at least some equitable interest in the inventory and receivables, and that such interest

was the property of the estate. This equitable interest was sufficient in the court's eyes to allow the interim order to stand. The court stated: "[t]o suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept." *LTV Steel*, 274 B.R. at 285. Finally, the court noted that to grant the lender its desired relief would deny the debtor the cash collateral which it needed to survive, putting thousands of employees out of work and depriving 100,000 retirees of needed medical benefits. Following the court's ruling, the moving lender and the other banks agreed to provide DIP financing that took out the securitized debt, contingent on the Debtor agreeing that the disputed transfers had been true sales. This strategy avoided the need for the court to decide the merits of the debtor's claim that the transfers had been "disguised financings."