

In re General Growth Properties, Inc. et al. --
The Intersection of SPEs and Bankruptcy
by Gregory A. Cross

Background

General Growth Properties, Inc. ("GGP") is a publicly traded real estate investment trust that is primarily engaged in the business of owning and managing shopping centers. On April 16, 2009, GGP and 387 related entities filed Chapter 11 in the United States Bankruptcy Court for the Southern District of New York. An additional 27 GGP entities filed Chapter 11 on April 22, 2009. Together the GGP bankruptcy filings constitute the largest real estate bankruptcy in United States history.

The Single-Purpose Entity

Approximately one hundred sixty six of the GGP entities are single-purpose, bankruptcy-remote entities ("SPEs") owning regional mall properties. At the time of the filing only five of the SPEs had experienced any kind of default and the vast majority of the SPEs were performing strongly. The structure of the SPE is a material component of every commercial mortgage backed securities ("CMBS") loan transaction and many other commercial lending relationships.

As part of its preparation for filing, GGP fired the independent directors that each SPE was required to maintain and replaced them with two new "independent directors" of GGP's choosing. GGP justified the filing because among other things (i) its SPE subsidiaries were facing loan maturities (as long as 4 years out) that could not be refinanced, and (ii) the GGP corporate parents needed to file their own Chapter 11 petition.

The Motion for Authorization to Obtain DIP Financing and Use Cash Collateral

At the outset of the bankruptcy cases, the Debtors filed a motion for authorization (i) to obtain post-petition secured financing, and (ii) to use cash collateral. The proposed cash collateral order permitted all SPE cash to be commingled and paid upstream to a centralized account at the parent level. The proposed Debtor-in-Possession financing agreement secured a DIP loan made to the SPE's corporate parent with (i) a first priority lien in the commingled assets and (ii) a junior lien against each SPE Property. GGP argued that the SPE lenders were adequately protected by (i) the value of the SPE properties, and (ii) a new second lien against the intercompany receivables.

Thirty four secured lenders filed objections to the proposed use of cash collateral and the DIP Financing Order. The objection of the MBA and CMBS trade associations contended that "[i]f a lender cannot rely on the basic corporate formality of entity separateness, especially when added to it are the express provisions of the

Separateness Covenants, the structural underpinning for non-recourse asset specific financing is destroyed."

The Court never had to reach a decision on the DIP/Cash Collateral Motion because the secured lenders negotiated an order that was significantly more favorable than the Debtors' original proposed order and respected the integrity of the SPE, including (i) removal of all liens proposed against SPE properties, (ii) protection against diminution in the amount of intercompany receivables with a first priority SPE lender lien in all commingled cash, and (iii) a new second lien against previously unencumbered real property . The Bankruptcy Judge expressed the view that many of the issues before him were "Bankruptcy 101" and focused on the assumed existence of "adequate protection" to satisfy sections 363 and 364 of the Bankruptcy Code. The Bankruptcy Judge made passing reference to the requirements of Section 552(b) which permits lien stripping "only based upon the equities of the case."

The Motions to Dismiss

Numerous property level lenders also filed motions to dismiss certain of the Chapter 11 cases on the grounds of bad faith. All parties ultimately agreed that there was no subjective bad faith. At issue was whether the SPEs were permitted to consider the financial distress of the GGP corporate group when deciding whether to file a petition in bankruptcy.

In an August 11, 2009 Memorandum Opinion,¹ the Court denied the three motions to dismiss finding: (i) it was reasonable to consider the financial problems of the GGP Corporate Group; and (ii) under Delaware law, the SPE directors were required to consider the interests of their stockholder parents. See Heisley v. U.I.P. Engineered Prods. Corp. (In re U.I.P. Engineered Prods. Corp.), 831 Fed. 54 (4th Cir. 1987); In re Mirant Corp., 2005 WL 2148362 (Bankr. N.D. 2005); and North American Catholic Educational Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).

The Plan

The Debtors and the secured lenders reached a deal whereby the Debtors were able emerge from bankruptcy. The secured lenders agreed to extension of maturity dates in exchange for increased amortization payments and additional protections in the loan documents, including automatic relief from the automatic stay in the event of a subsequent bankruptcy.

¹ The Court's decision is reported as In re General Growth Properties, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).