



August 2009

DISTRESSED REAL ESTATE RESPONSE TEAM UPDATE

Court Permits GGP SPEs to Remain in Chapter 11

On August 11, 2009, in a highly anticipated ruling in the *General Growth Properties* case, the United States Bankruptcy Court for the Southern District of New York denied the separate motions of secured lenders to dismiss the bankruptcy cases of certain so-called bankruptcy-remote, special purpose entities (SPEs). General Growth Properties (GGP) had included the SPEs among its many affiliates that filed for bankruptcy protection earlier this year. The court rejected the contentions of the lenders that the management of GGP and its affiliates acted in bad faith by commencing bankruptcy proceedings on behalf of the SPEs.

PREMATURE FILING

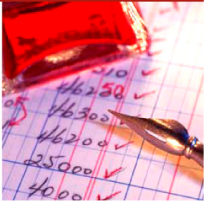
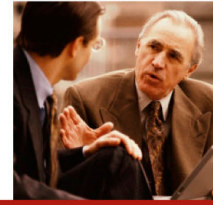
The secured lenders had advanced a number of arguments in support of their contention that GGP had acted in bad faith, including that the filings were premature and that the SPEs could not confirm a plan of reorganization. The court disposed of these arguments by stating “the Bankruptcy Code does not require that a debtor be insolvent prior to filing,” or require a debtor to prove that a plan is likely to be confirmed in order to file a petition. The court emphasized that the goal of the Bankruptcy Code is “to incentivize a debtor to file earlier rather than later, so as to preserve the value of the estate.”

FIDUCIARY DUTY OF INDEPENDENT MANAGERS

The court also considered the financial distress experienced by the GGP parent company and upper-tier subsidiaries, and the need to maintain cash flow to the upstream companies to support a reorganization of the entire enterprise. The court rejected the notion that each SPE should have focused on its own economic interests and disregarded the financial predicament of the larger GGP group of companies. Relying on both bankruptcy case law and Delaware corporate law, the court concluded that “the interests of the parent companies *must* be taken into account” and that management should not act for the sole interest of the SPEs’ secured creditors; rather, “directors and managers owe their duties to the corporation and, ordinarily, to the shareholders.” The court further noted that, despite their professed reliance on the integrity of the SPE structure, the secured lenders readily accepted the benefits from the support provided by the overall GGP enterprise to project-level SPEs, including guarantees from upstream GGP entities.

FAILURE TO NEGOTIATE WITH LENDERS

The court also held that GGP did not act in bad faith by failing to negotiate with the mortgage lenders prior to the filings or by abruptly replacing the independent managers of the SPEs just prior to the filings. As to the failure to negotiate, the court referred to unsuccessful attempts made by GGP to



initiate discussions with the servicers for the CMBS loans made to SPEs. According to the record, the servicers deferred discussions of an extension or refinancing until their CMBS loans were in default or much closer to maturity. The court concluded that GGP acted reasonably and in good faith by not delaying the bankruptcy filing until the loans matured or otherwise were in default.

REPLACEMENT OF INDEPENDENT MANAGERS

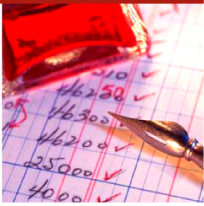
As to the replacement of the independent managers, in accordance with the organizational documents of the SPEs, at least two independent managers served on the boards of more than 150 GGP-related entities. Prior to the bankruptcy filings, the independent managers were terminated by GGP without notice to the secured lenders or even to the independent managers themselves. Successor managers then were named by GGP based, according to GGP management, on the new managers' "known experience in restructuring environments and complex business decisions." Despite the "admittedly surreptitious" nature of these actions, the court agreed with GGP that the management changes did not violate the organizational documents of the SPEs, that the new managers were qualified to serve and that they did not have a duty to prevent the SPEs from filing bankruptcy petitions. In the context of its analysis of whether the votes by all of the managers (including those independent managers who had not been replaced) in favor of the filings were in bad faith, the court found that, under Delaware law, the independent managers had a duty to act in the interests of the entities and their shareholders, and characterized as "mistaken" any belief that the independent managers should prevent a bankruptcy filing or otherwise act only in the interests of creditors.

ADEQUATE PROTECTION

The court concluded by noting that while the secured lenders clearly have been "inconvenienced," "the fundamental protections that the [secured lenders] negotiated and that the SPE structure represents are still in place and will remain in place during the chapter 11 cases. This includes protection against the substantive consolidation of the project-level Debtors with any other entities," which the court distinguished from the issue of whether the needs of the enterprise properly can be considered in deciding whether to continue to maintain GGP's centralized cash management system, thereby preserving the flow of cash upstream from the SPEs, or to seek bankruptcy protection. Despite these assurances, lenders are likely to view the effects of the *GGP* decision as more than merely inconvenient, in that one of the principal purposes of the SPE structure is to avoid interruption in the receipt and application of cash flow from the properties to service the lenders' debt—something that a bankruptcy case almost always entails. The court further reminded the lenders of their rights to seek additional adequate protection and of their continuing rights to recover in full upon confirmation of a plan of reorganization.

BANKRUPTCY-REMOTE SPEs

The court's ruling reminds lenders that despite their efforts to insulate the SPEs from a bankruptcy filing, the SPE structure is at best "bankruptcy remote" and not "bankruptcy proof." It remains good news to lenders, however, that the court confirmed that this decision does not imply that the



SPEs “could properly be substantively consolidated” with the other GGP entities. This position on substantive consolidation is consistent with the court’s cash collateral orders issued in May, which to some extent also respect the SPE structure.

FOR MORE INFORMATION

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